Internal Revenue
bulletin

Bulletin No. 2007-38
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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2007–54, page 604.

Life insurance reserves. This ruling provides guidance regarding (1) the amount of life insurance reserves taken into account for a variable contract where some or all of the reserves are accounted for as part of a life insurance company's separate account reserves and (2) what interest rate is used to calculate required interest under section 812(b)(2)(A) of the Code on life insurance reserves in situations where the amount of those reserves is the tax reserve determined under section 807(d)(2).

Rev. Rul. 2007–55, page 604.

Fringe benefits aircraft valuation formula. The Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charge in effect for the second half of 2007 are set forth for purposes of determining the value of noncommercial flights on employer-provided aircraft under section 1.61–21(g) of the regulations.

Rev. Rul. 2007–60, page 606.

Revenue rulings obsolete. This ruling obsoletes Rev. Rul. 75–425, 1975–2 C.B. 291, which provides guidance related to the effect of signing a waiver (USCIS Form I–508) under section 247(b) of the Immigration and Nationality Act (8 U.S.C. section 1257(b)) by alien individuals employed in the United States by a foreign government or international organization. Rev. Rul. 75–425 obsoleted.

T.D. 9347, page 624.

Final regulations under section 6655 of the Code provide guidance with respect to estimated tax payments by corporations. Rev. Ruls. 67–93, 76–450, and 78–257 obsoleted.

T.D. 9350, page 607.

Final regulations under section 6011 of the Code modify and clarify the rules relating to the disclosure of reportable transactions under regulations section 1.6011–4. The regulations also make conforming changes to the disclosure rules under regulations sections 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, and 56.6011–4. These regulations affect taxpayers who must disclose transactions under section 6011 and material advisors under sections 6111 and 6112.

EXEMPT ORGANIZATIONS

T.D. 9350, page 607.

Final regulations under section 6011 of the Code modify and clarify the rules relating to the disclosure of reportable transactions under regulations section 1.6011–4. The regulations also make conforming changes to the disclosure rules under regulations sections 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, and 56.6011–4. These regulations affect taxpayers who must disclose transactions under section 6011 and material advisors under sections 6111 and 6112.

REG–116215–07, page 659.

Proposed regulations provide rules relating to information made available by the IRS for public inspection under section 6104(a) of the Code and materials that are made publicly available under section 6110.

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Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ESTATE TAX

T.D. 9350, page 607.

Final regulations under section 6011 of the Code modify and clarify the rules relating to the disclosure of reportable transactions under regulations section 1.6011–4. The regulations also make conforming changes to the disclosure rules under regulations sections 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, and 56.6011–4. These regulations affect taxpayers who must disclose transactions under section 6011 and material advisors under sections 6111 and 6112.

GIFT TAX

T.D. 9350, page 607.

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EMPLOYMENT TAX

T.D. 9350, page 607.

Final regulations under section 6011 of the Code modify and clarify the rules relating to the disclosure of reportable transactions under regulations section 1.6011–4. The regulations also make conforming changes to the disclosure rules under regulations sections 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, and 56.6011–4. These regulations affect taxpayers who must disclose transactions under section 6011 and material advisors under sections 6111 and 6112.

EXCISE TAX

T.D. 9350, page 607.

Final regulations under section 6011 of the Code modify and clarify the rules relating to the disclosure of reportable transactions under regulations section 1.6011–4. The regulations also make conforming changes to the disclosure rules under regulations sections 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, and 56.6011–4. These regulations affect taxpayers who must disclose transactions under section 6011 and material advisors under sections 6111 and 6112.

ADMINISTRATIVE

T.D. 9351, page 616.

Final regulations under section 6111 of the Code provide rules relating to the disclosure of reportable transactions by material advisors who must disclose transactions under section 6111 and material advisors who maintain lists under section 6112.

T.D. 9352, page 621.

Final regulations under section 6112 of the Code provide rules relating to the list maintenance obligation of material advisors who must maintain lists under section 6112.

Announcement 2007–77, page 662.

This document contains corrections to proposed regulations (REG–103842–07, 2007–28 I.R.B. 79) that involve the deduction for income attributable to domestic production activities under section 199 of the Code and that affect taxpayers who produce qualified films under sections 199(c)(4)(A)(i)(II) and (c)(6) and taxpayers who are members of an expanded affiliated group under section 199(d)(4).

Announcement 2007–78, page 663.

This document contains corrections to final regulations (T.D. 9321, 2007–19 I.R.B. 1123) which set forth guidance on the application of secton 409A of the Code to nonqualified deferred compensation plans.

Announcement 2007–80, page 667.

This document contains corrections to temporary regulations (T.D. 9330, 2007–31 I.R.B. 239) that apply to corporations that have undergone ownership changes within the meaning of section 382 of the Code. The regulations also provide guidance regarding the treatment of prepaid income under the built-in gain provisions of section 382(h).

Announcement 2007–81, page 667.

This document provides a change of location for a public hearing on proposed regulations (REG–119097–05, 2007–28 I.R.B. 74) providing guidance on the portion of a trust properly includible in a grantor's gross estate under sections 2036 and 2039 of the Code if the grantor has retained the use of property in a trust or the right to annuity, unitrust, or other income payment from such trust for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not in fact end before the grantor's death.

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 61.—Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

Fringe benefits aircraft valuation formula. The Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charge in effect for the second half of 2007 are set forth for purposes of determining the value of noncommercial flights on employer-provided aircraft under section 1.61–21(g) of the regulations.

Rev. Rul. 2007–55

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charge and SIFL mileage rates:

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
7/1/07 - 12/31/07	$37.91	Up to 500 miles = $.2074 per mile
		501–1500 miles = $.1581 per mile
		Over 1500 miles = $.1520 per mile

DRAFTING INFORMATION

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

Section 807.—Rules for Certain Reserves

(Also § 812.)

Life insurance reserves. This ruling provides guidance regarding (1) the amount of life insurance reserves taken into account for a variable contract where some or all of the reserves are accounted for as part of a life insurance company's separate account reserves and (2) what interest rate is used to calculate required interest under section 812(b)(2)(A) of the Code on life insurance reserves in situations where the amount of those reserves is the tax reserve determined under section 807(d)(2).

Rev. Rul. 2007–54

ISSUE(S)

1. What is the amount of the life insurance reserves taken into account under section 807 of the Internal Revenue Code for a variable contract where some or all of the reserves are accounted for as part of a life insurance company's separate account reserves?

2. If the amount of the life insurance reserves for a variable contract is the tax reserve determined under section 807(d)(2), what interest rate is used to calculate required interest on those reserves?

FACTS

Situation 1. IC is a life insurance company as defined in section 816(a) and is the issuer of Contract A. Contract A provides for the payment of variable annuity benefits computed on the basis of a recognized mortality table and the investment experience of *IC*'s segregated asset account (separate account). *IC* bears the mortality risks with regard to the contingencies involved in the variable annuity benefits. Contract A neither provides any "supplemental benefits" (as defined in section 807(e)(3)(D)) nor involves any "qualified substandard risks" (as defined in section 807(e)(5)(B)).

Contract A is a "variable contract" as defined in section 817(d) and an "annuity contract" under section 817(g). *IC*'s reserves for Contract A are "life insurance reserves" as defined in section 816(b).

For taxable years 2006 and 2007, the amounts of end-of-year tax reserves determined under section 807(d)(2) for Contract A are $8,000 and $10,000, respectively. The applicable Federal interest rate for Contract A is 4.82 percent, and the applicable Federal interest rate exceeds the prevailing State assumed rate for the Contract.

The 2006 and 2007 end-of-year net surrender values determined under section 807(e)(1) for Contract A are $7,840 and $9,830, respectively. The amounts taken into account by *IC* with regard to Contract A in determining its 2006 and 2007 end-of-year statutory reserves within the meaning of section 807(d)(6) are $8,050 and $10,045, respectively. None of *IC*'s statutory reserves is attributable to any deferred or uncollected premium.

Situation 2. The facts are the same as Situation 1, except that Contract A provides a minimum guaranteed death benefit in addition to variable annuity benefits. *IC* bears the mortality risks and investment risks with regard to the contingencies involved in the provision of the death benefit.

For taxable years 2006 and 2007, the end-of-year tax reserves determined under section 807(d)(2) for Contract A are $8,155 and $10,165, respectively. The 2006 and 2007 end-of-year net surrender values determined under section 807(e)(1) for Contract A are $8,000 and $10,000, respectively. The amount taken into account by *IC* with regard to Contract A in determining its 2006 and 2007 end-of-year statutory reserves within the meaning of section 807(d)(6) are $8,210 and $10,215, respectively.

If Contract A had not provided the minimum guaranteed death benefit, the 2006 and 2007 end-of-year tax reserves determined under section 807(d)(2) would have been $8,000 and $10,000, respectively.

LAW AND ANALYSIS

Issue 1. Section 803(a) provides that life insurance company gross income is the sum of (i) premiums, (ii) net decreases in certain reserves under section 807(a), and (iii) other amounts generally included by a taxpayer in gross income. Section 805(a)(2) authorizes a deduction for the net increase in certain reserves under section 807(b). In calculating the change in reserves for a variable contract, the increase or decrease in the reserves due to appreciation and depreciation of separate account assets is removed. *See* section 817(a).

Section 807(c) sets forth the items taken into account in determining the net decrease or net increase in reserves under section 807(a) and (b). Among the items taken into account are "life insurance reserves" (as defined in section 816(b)).

For purposes of determining a life insurance company's income or deduction from a change in reserves, section 807(d)(1) provides that the amount of the life insurance reserves for any contract is the greater of— (i) the contract's net surrender value, or (ii) the contract's tax reserve determined under section 807(d)(2). However, the life insurance reserves for a contract cannot exceed the "statutory reserves" (as defined in section 807(d)(6)).

Section 807(d)(2) provides that the amount of the tax reserve for any contract is determined using— (i) the tax reserve method applicable to the contract, (ii) the greater of the applicable Federal interest rate or the prevailing State assumed interest rate, and (iii) the prevailing commissioners' standard tables for mortality and morbidity adjusted as appropriate to reflect the risks (such as substandard risks) incurred under the contract which are not otherwise taken into account. The tax reserves determined under section 807(d)(2) reflect all of the benefits (including the net surrender value) payable under the contract.

Section 807(e)(1) provides generally that the net surrender value of "any contract" is determined with regard to any penalty or charge which would be imposed on surrender, but without regard to any market value adjustment on surrender. The net surrender value represents the current contractual cash benefit payable under a contract.

Except as otherwise provided in special rules under section 807(e)(3) and (5) (relating to qualified supplemental benefits and qualified substandard risks), the comparison of the tax reserve and the net surrender value is made on an aggregate benefit basis. *See* H. Rep. No. 432, Pt. 2, 98th Cong., 2d Sess. 1414 (1984); S. Prt. 169, Vol. I, 98th Cong. 2d Sess. 540 (1984).

Section 807 makes no distinction between a fixed (non-variable) contract and a variable contract. For both fixed and variable contracts, a life insurance company determines its income or deduction from a change in reserves using the amounts of its life insurance reserves determined under section 807. *See also* section 817(a) (referring to "the sum of the items described in section 807(c)").

Section 817(c) requires a life insurance company to account separately for the income, exclusion, deduction, asset, reserve, and other liability items attributable to variable contracts. If a variable contract contains a guarantee (for example, a minimum death benefit), section 817(d) (flush language) requires an insurance company to account for the excess of obligations under the guarantee over the obligations under the contract without regard to the guarantee as part of the company's general account, and not as part of the company's separate account.

In both Situation 1 and Situation 2, the end-of-year tax reserves determined under section 807(d)(2) for Contract A— (i) exceed the end-of-year net surrender value of the Contract, but (ii) are less than the end-of-year statutory reserves for the Contract. Accordingly, under section 807(d)(1), the amount of the end-of-year life insurance reserves taken into account under section 807 for Contract A in both Situations is the amount of the end-of-year tax reserves determined under section 807(d)(2). In Situation 1, the amounts of the 2006 and 2007 end-of-year life insurance reserves for Contract A are $8,000 and $10,000, respectively. In Situation 2, the amounts of the 2006 and 2007 end-of-year life insurance reserves for Contract A are $8,155 and $10,165, respectively.

In Situation 2, *IC* is required under section 817(d) to account for the excess of its obligations under Contract A with the minimum death benefit over its obligations under the Contract without the death benefit as part of the company's general account reserves. Pursuant to section 817(c), *IC* accounts for its remaining obligations under the Contract A as part of the company's separate account reserves. Accordingly, for end-of-year 2006, *IC* accounts for the $155 excess of its obligations under Contract A with the minimum death benefit ($8,155) over its obligations under the Contract without the death benefit ($8,000) as part of the company's general account reserves. *IC* accounts for the remaining $8,000 as part of its separate account reserves. For end-of-year 2007, *IC* accounts for the $165 excess of its obligations under Contract A with the minimum death benefit ($10,165) over its obligations under Contract A without the death benefit ($10,000) as part of the company's general account reserves. *IC* accounts for the remaining $10,000 as part of its separate account reserves.

The allocation of obligations between general account reserves and separate account reserves has no effect on the determination of the amount of *IC*'s life insurance reserves for Contract A under section 807(d).

Issue 2. To prevent a life insurance company from realizing a double benefit for tax-preferred investment income (tax-exempt interest and dividends qualifying for the dividends received deduction) used to fund the company's obligations to policyholders, sections 807 and 805 require the company to adjust certain income and deduction items for the policyholders' share of such tax preferred income. *See* section 807(a) and (b), section 805(a)(4).

Section 812 provides the mechanism to calculate the life insurance company's and policyholders' respective shares of net investment income. Under section 812(b)(1), a life insurance company's share of net investment income is the excess (if any) of "net investment income" (determined under section 812(c)) for the taxable year over the sum of (i) "policy interest" (determined under section 812(b)(2)) for the taxable year, and (ii) the "gross investment income's proportionate share of policyholder dividends" (determined under section 812(b)(3)) for the taxable year.

Policy interest includes "required interest" on reserves. Section 812(b)(2)(A). Required interest on a contract's reserves is calculated using the mean of the contract's beginning-of-year and end-of-year reserves and the interest rate used in determining the contract's reserves. For example, if the life insurance reserves for a contract are determined using the greater of the applicable Federal interest rate or the prevailing State assumed interest rate for the contract, then required interest on those reserves is calculated by multiplying (i) the mean of the reserves by (ii) the interest rate used in calculating the reserves (*i.e.*, the greater of the applicable Federal interest rate or the prevailing State assumed interest rate for the contract). If neither the prevailing State assumed interest rate nor the applicable Federal interest rate is used in determining a contract's life insurance reserves, then required interest is calculated using another appropriate rate. Section 812(b)(2); Rev. Rul. 2003–120, 2003–2 C.B. 1154.

In both Situation 1 and Situation 2, the amount of the life insurance reserves taken into account under section 807 for Contract A is the amount of tax reserve determined under section 807(d)(2), which is determined using the applicable Federal interest rate for the Contract. As the applicable Federal interest rate is used to determine the amount of the life insurance reserves for Contract A, the required interest on the Contract's life insurance reserves is calculated by multiplying the mean of those reserves by the applicable Federal interest rate for the Contract. Rev. Rul. 2003–120.

In Situation 1, the mean of the 2007 beginning-of-year and end-of-year life insurance reserves for Contract A is $9,000 ([$8,000 + $10,000] ÷ 2 = $9,000) and the applicable Federal interest rate for Contract A is 4.82 percent. For taxable year 2007, the required interest on Contract A's life insurance reserves is $433.80 ($9,000 × 4.82% = $433.80).

In Situation 2, the mean of the 2007 beginning-of-year and end-of-year life insurance reserves for Contract A is $9,160 ([$8,155 + $10,165] ÷ 2 = $9,160). The applicable Federal interest rate for Contract A is 4.82 percent. For taxable year 2007, the required interest on Contract A's life insurance reserves is $441.51 ($9,160 × 4.82% = $441.51). Consistent with the allocation of Contract A's life insurance reserves between *IC*'s general account reserves and separate account reserves, $7.71 of the required interest ($441.51 × $160 / $9,160 = $7.71) is taken into account under section 812 as required interest on *IC*'s general account reserves. The remaining $433.80 ($441.51 × $9,000 / $9,160 = $433.80) of the required interest is taken into account under section 812 as required interest on *IC*'s separate account reserves.

HOLDING(S)

1. Under section 807(d)(1), the amounts of the end-of-year life insurance reserves for Contract A in both Situation 1 and Situation 2 are the amounts of the tax reserve determined under section 807(d)(2). Thus, in Situation 1, the amounts of the 2006 and 2007 end-of-year life insurance reserves for Contract A are $8,000 and $10,000, respectively. In Situation 2, the amounts of the 2006 and 2007 end-of-year life insurance reserves for Contract A are $8,155 and $10,165, respectively.

2. In both Situation 1 and Situation 2, the required interest on Contract A's life insurance reserves is calculated by multiplying the mean of the Contract's beginning-of-year and end-of-year reserves by the applicable Federal interest rate for the Contract. In Situation 1, the 2007 required interest on Contract A's life insurance reserves is $433.80. In Situation 2, the 2007 required interest on Contract A's life insurance reserves is $441.51. Of this amount, $7.71 is required interest on *IC*'s general account reserves for Contract A, and the remaining $433.80 is required interest on *IC*'s separate account reserves for Contract A.

DRAFTING INFORMATION

The principal author of this revenue ruling is Stephen D. Hooe of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact Stephen D. Hooe at (202) 622–3900 (not a toll-free call).

Section 812.—Definition of Company's Share and Policyholders' Share

A revenue ruling that provides guidance regarding (1) the amount of life insurance reserves taken into account for a variable contract where some or all of the reserves are accounted for as part of a life insurance company's separate account reserves and (2) what interest rate is used to calculate required interest under section 812(b)(2)(A) on life insurance reserves in situations where the amount of those reserves is the tax reserve determined under section 807(d)(2). See Rev. Rul. 2007-54, page 604.

Section 893.—Compensation of Employees of Foreign Governments or International Organizations

26 CFR 1.893–1: Compensation of employees of foreign governments or international organizations.

Revenue rulings obsolete. This ruling obsoletes Rev. Rul. 75–425, 1975–2 C.B. 291, which provides guidance related to the effect of signing a waiver (USCIS Form I–508) under section 247(b) of the Immigration and Nationality Act (8 U.S.C. section 1257(b)) by alien individuals employed in the United States by a foreign government or international organization. Rev. Rul. 75–425 obsoleted.

Rev. Rul. 2007–60

The Internal Revenue Service is continuing its program of reviewing guidance (including revenue rulings, revenue procedures, and notices) published in the Internal Revenue Bulletin to identify those rulings that are obsolete because (1) the applicable statutory provisions or regulations have been changed or repealed; (2) the ruling position is specifically covered by statute, regulations, or subsequent published position; or (3) the facts on which the ruling position is based no longer exist or are not sufficiently described to permit clear application of the current statute and regulations.

Rev. Rul. 75–425, 1975–2 C.B. 291, concerns the effect of an alien individual employed by a foreign government or international organization in the United States signing a waiver (United States Citizenship and Immigration Services (USCIS) Form I–508) under section 247(b) of the Immigration and Nationality Act (8 U.S.C. § 1257(b)). Generally, an alien individual employed by a foreign government or international organization who files the waiver provided by section 247(b) of the Immigration and Nationality Act is, from the date of filing the waiver, no longer entitled to exemption from income tax under section 893 of the Internal Revenue Code with respect to his or her compensation received from such foreign government or international organization. *See* Treas. Reg. § 1.893–1(a)(5) and (b)(4). However, the filing of the waiver will have no effect on any income tax exemption derived by an alien individual from the provisions of an income tax treaty, consular agreement, or other international agreement to the extent the application of the exemption is not dependent upon the internal revenue laws of the United States. *See* Treas. Reg. § 1.893–1(c)(2).

Rev. Rul. 75–425 sets forth the application of the above rules with respect to a list of foreign countries with which the United States had an income tax treaty or consular agreement and a list of international organizations with respect to which the United States was a signatory to the international agreement creating the international organization(s) at the time of publication of the revenue ruling. Because many of those income tax treaties, consular agreements, and international agreements have been modified, superseded, or are no longer in force, and because the facts on which the ruling position was based no longer exist or are not sufficiently described to permit clear application of the currently applicable legal provisions and agreements, the Internal Revenue Service has concluded that Rev. Rul. 75–425 is no longer determinative with respect to foreign government and international organization employees of any foreign country. Accordingly, Rev. Rul. 75–425 is hereby declared obsolete.

Alien individuals employed by a foreign government or international organization in the United States, who file the waiver provided by section 247(b) of the Immigration and Nationality Act (USCIS Form I–508), will be entitled to any tax exemption conferred under the provisions of an applicable income tax treaty, consular agreement, or international agreement, that is still in force, to the extent the application of the exemption is not dependent upon the internal revenue laws of the United States. For guidance with respect to a specific foreign country or international organization, send an e-mail to *embassy@irs.gov*.

DRAFTING INFORMATION

Various personnel from the Office of Associate Chief Counsel (International) participated in the drafting of this revenue ruling. For further information regarding this revenue ruling, contact Richard A. Ward at (202) 874–1621 (not a toll-free call) or e-mail *embassy@irs.gov*.

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 1.6011–4: Requirement of statement disclosing participation in certain transactions by taxpayers.

T.D. 9350

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 20, 25, 31, 53, 54, and 56

AJCA Modifications to the Section 6011 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 6011 of the Internal Revenue Code that modify the rules relating to the disclosure of reportable transactions under section 6011. These regulations affect taxpayers participating in reportable transactions under section 6011, material advisors responsible for disclosing reportable transactions under section 6111, and material advisors responsible for keeping lists under section 6112.

DATES: *Effective Date:* These regulations are effective August 3, 2007.

FOR FURTHER INFORMATION CONTACT: Charles D. Wien, Michael H. Beker, or Tolsun N. Waddle, 202–622–3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations that amend 26 CFR part 1 by modifying and clarifying the rules relating to the disclosure of reportable transactions under section 6011. This document also contains final regulations that amend 26 CFR parts 20, 25, 31, 53, 54, and 56 by modifying the rules for purposes of estate, gift, employment, and pension and exempt organizations excise taxes that require the disclosure of listed transactions by certain taxpayers on their Federal tax returns under section 6011.

The American Jobs Creation Act of 2004, Public Law 108–357, (118 Stat. 1418), (AJCA) was enacted on October 22, 2004. The AJCA revised sections 6111 and 6112, thereby necessitating changes to the rules under section 6011. On November 1, 2006, the IRS and Treasury Department issued a notice of proposed rulemaking and temporary and final regulations under sections 6011, 6111, and 6112 (REG–103038–05, 2006–49 I.R.B. 1049, REG–103039–05, 2006–49 I.R.B. 1057, REG–103043–05, 2006–49 I.R.B. 1063, T.D. 9295, 2006–49 I.R.B. 1030) (the November 2006 regulations). The November 2006 regulations were published in the **Federal Register** (71 FR 64488, 71 FR 64496, 71 FR 64501, 71 FR 64458) on November 2, 2006.

The IRS and Treasury Department received written public comments responding to the proposed regulations and held a public hearing regarding the proposed rules on March 20, 2007. After consideration of the comments received and the comments made at the hearing, the proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations but include some modifications based on the recommendations made in the public comments.

Summary of Comments and Explanation of Provisions

Nine written comments were received in response to the NPRM. All comments were considered and are available for public inspection upon request.

Transactions of Interest

The proposed regulations identified transactions of interest as a new reportable transaction category. As stated in the preamble to the proposed regulations, a transaction of interest is a transaction that the IRS and Treasury Department believe has a potential for tax avoidance or evasion, but for which the IRS and Treasury Department lack enough information to determine whether the transaction should be identified specifically as a tax avoidance transaction. These final regulations adopt the language in the proposed regulations regarding transactions of interest without modification. This language provides that a transaction of interest is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest. These final regulations also retain the language in the proposed regulations that provide that a taxpayer's participation in a transaction of interest will be determined in the published guidance which identifies the transaction of interest.

Several commentators requested more specificity and guidance on the definition of what constitutes a transaction of interest. Specifically, the commentators recommended that the term "participation," for purposes of determining whether a taxpayer participated in a transaction of interest, be defined in the regulations rather than in the published guidance identifying the transaction of interest. The commentators also requested that the published guidance describing a transaction of interest be crafted in a clear and specific manner, thereby enabling taxpayers to determine whether they participated in a transaction of interest. One commentator also recommended providing a list of factors in the regulations that the IRS would consider when identifying a transaction of interest. Further, several commentators requested that the IRS and Treasury Department provide notice to taxpayers that the IRS and Treasury Department are considering designating a particular transaction as a transaction of interest and requesting comments prior to publishing guidance identifying a transaction as a transaction of interest.

The IRS and Treasury Department believe that providing a specific definition for the transactions of interest category in the regulations would unduly limit the IRS and Treasury Department's ability to identify transactions that have the potential for tax avoidance or evasion. In order to maintain flexibility in identifying a transaction of interest, the description of a transaction of interest will be provided in the published guidance that identifies the transaction of interest. The published guidance identifying a transaction of interest will provide taxpayers with the information necessary to determine whether a particular transaction is the same as or substantially similar to the transaction described in the published guidance and to determine who participated in the transaction.

The IRS and Treasury Department do not believe that the regulations should be amended to include language requiring the IRS and Treasury Department to provide advance notice for transactions of interest as suggested by the commentators. However, the IRS and Treasury Department may choose to publish advance notice and request comments in certain circumstances. The determination of whether to provide advance notice and a request for comments will be made on a transaction by transaction basis.

The proposed regulations also provide that upon publication of the final regulations, the transactions of interest category of reportable transaction will apply to transactions entered into on or after November 2, 2006. These final regulations adopt the effective date stated in the proposed regulations.

The preamble to the proposed regulations provides that when the IRS and Treasury Department have gathered enough information to make an informed decision as to whether a particular transaction of interest is a tax avoidance type of transaction, the IRS and Treasury Department may take one or more actions, including removing the transaction from the transaction of interest category in published guidance, designating the transaction as a listed transaction, or providing a new category of reportable transaction. Several commentators recommended that the period during which a transaction may be considered a transaction of interest be limited to twenty-four months, unless the IRS and Treasury Department affirmatively act to extend the designation for an additional twenty-four months with no limit on the number of permissible extensions. One commentator suggested that the length of the period be limited to twenty-four months, with no extensions.

The IRS and Treasury Department believe that limiting the length of time a transaction may be designated a transaction of interest would be contrary to the purpose of the transactions of interest category of reportable transaction and would hinder the ability of the IRS and Treasury Department to efficiently and effectively gather the necessary information to determine whether a particular transaction is a tax avoidance type of transaction. Accordingly, these final regulations do not adopt these suggestions.

Disclosure of Reportable Transactions by Owners of a Pass-through Entity

I. *Timing of disclosures*

The proposed regulations provide that if a taxpayer who is a partner in a partnership, a shareholder in an S corporation, or a beneficiary of a trust receives a timely Schedule K–1 less than 10 calendar days before the due date of the taxpayer's return (including extensions) and, based on receipt of the timely Schedule K–1, the taxpayer determines that the taxpayer participated in a reportable transaction, the disclosure statement will not be considered late if the taxpayer discloses the reportable transaction by filing a disclosure statement with the Office of Tax Shelter Analysis (OTSA) within 45 calendar days after the due date of the taxpayer's return (including extensions). Several commentators requested that the proposed regulations not limit relief to taxpayers who receive a timely Schedule K–1 before the due date of their return. Others believed the 45 day disclosure period was too short. One commentator recommended that the provision apply to late disclosures that were inadvertent or non-abusive. One commentator recommended that the 10 day period be extended to 30 days and the 45 day disclosure period be extended to 90 days. With respect to the date the disclosure period begins, two commentators commented that the disclosure period should begin on the date the taxpayer receives the timely Schedule K–1.

The IRS and Treasury Department agree that the 45 day disclosure period should be extended. These final regulations extend the disclosure period to 60 calendar days. The IRS and Treasury Department believe that this additional period will provide taxpayers with ample time to review the entity's return and comply with any administrative and regulatory requirements before filing their disclosure statement. It should be noted that if a taxpayer receives a timely Schedule K–1 after the due date of the taxpayer's return (including extensions), the taxpayer will have received the timely Schedule K–1 less than 10 calendar days before the due date of the return and will have 60 calendar days after the due date of the taxpayer's return (including extensions) to file the disclosure statement.

II. *Pass-through owners*

Several commentators have suggested that the disclosure obligations of owners of a pass-through entity that participates in a reportable transaction be amended to provide that only certain owners of the pass-through entity are required to disclose their participation in the reportable transaction. One commentator suggested that an owner of a pass-through entity should be removed from this disclosure obligation when (1) the owner did not know and should not have known that the pass-through entity engaged in the reportable transaction; and (2) the pass-through entity failed to disclose timely its participation in the reportable transaction on its return to OTSA. The commentator also recommends that if the owner knew or reasonably should have known of the pass-through entity's participation in the reportable transaction, the owner should be required to file a disclosure statement even if the pass-through entity did not disclose the transaction to the owner. A different commentator suggested that an owner of a pass-through entity not be required to disclose the owner's participation in a reportable transaction, even if the owner knew or should have known of the pass-through entity's participation in the reportable transaction.

Several commentators also suggested adopting a *de minimis* ownership rule exempting taxpayers owning less than a certain percentage of the pass-through entity from the disclosure requirements. One commentator suggested exempting owners of 5 percent or less of the outstanding interests in the pass-through entity that participates in a reportable transaction.

The IRS and Treasury Department are aware that certain partners, shareholders, and beneficiaries may file income tax returns that reflect the tax consequences, tax benefits, or tax strategy of a reportable transaction even though the taxpayer is unaware that the pass-through entity engaged in the reportable transaction. The IRS and Treasury Department recognize the concerns of the commentators. In light of the potential monetary penalties for failing to disclose participation in a reportable transaction and in order to maintain flexibility in determining who should be subject to the disclosure requirements for a particular transaction, these final regulations amend the proposed regulations to add language providing flexibility to the IRS and Treasury Department to issue other provisions for disclosure under §1.6011–4 in published guidance.

Time Period for Disclosing Participation in a Listed Transaction and Transaction of Interest

Under the proposed regulations if a transaction becomes a listed transaction or a transaction of interest after the filing of a taxpayer's tax return (including an amended return) reflecting the taxpayer's participation in the listed transaction or transaction of interest and before the end of the period of limitations for assessment of tax for any taxable year in which the taxpayer participated in the listed transaction or transaction of interest, then a disclosure statement must be filed, regardless of whether the taxpayer participated in the listed transaction or transaction of interest in the year the transaction became a listed transaction or a transaction of interest, with OTSA within 60 calendar days after the date on which the transaction became a listed transaction or a transaction of interest. The proposed regulations also provide that the Commissioner may determine the time for disclosure of listed transactions and transactions of interest in the published guidance identifying the transaction.

Many commentators suggested that the current rule, which requires the disclosure of subsequently identified listed transactions on the taxpayer's next filed tax return be retained in light of the potential monetary penalties and potential administrative burden due to the shortened disclosure period. One commentator recommended that the taxpayer be required to file the disclosure statement by the later of the taxpayer's next filed tax return or within 60 calendar days after the date on which the transaction becomes a listed transaction or transaction of interest.

A critical factor in the ability to analyze a particular transaction is the ability to have the necessary information available in a timely manner. Thus, requiring taxpayers to file a disclosure statement with OTSA in a timely manner is essential. Because the IRS and Treasury Department recognize that compliance within 60 calendar days may be burdensome in certain circumstances, the proposed regulations are amended to provide that taxpayers have 90 calendar days to disclose their participation in a subsequently identified listed transaction or transaction of interest.

Brief Asset Holding Period Reportable Transaction Category

Due to changes in section 901 and based on comments received, the IRS and Treasury Department have determined that the brief asset holding period reportable transaction category is no longer necessary. These final regulations therefore remove this category as a reportable transaction category.

Form 8271

Before the enactment of the AJCA, section 6111 provided that tax shelter organizers were required to provide investors in tax shelters the registration number for the tax shelter. Section 301.6111–1T, Q&A 55, requires investors to report the registration number of the tax shelter to the IRS on Form 8271, "*Investor Reporting of Tax Shelter Registration Number*", and attach the Form 8271 to any return on which any deduction, loss, credit, or other tax benefit attributable to the tax shelter is claimed. Because only a few investors must still file Form 8271 for pre-AJCA section 6111 tax shelters and because the IRS already is aware of these transactions, the IRS and Treasury Department have decided that investors are no longer required to file Forms 8271 otherwise due on or after August 3, 2007. The Form 8271 will be obsoleted. Taxpayers required to file Form 8886, "*Reportable Transaction Disclosure Statement*", pursuant to §1.6011–4(d), and Form 8271 with respect to the same transaction only need to report the registration number on Form 8886.

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 a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 35) do not apply. The disclosure statement referenced in these regulations has been made available for public comment and any update to the disclosure statement will be made available for public comment in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. chapter 35). Pursuant to section 7805(f) of the Internal Revenue 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 authors of these regulations are Charles D. Wien, Michael H. Beker, and Tolsun N. Waddle, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20, 25, 31, 53, 54, and 56 are amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.6011–4 is revised to read as follows:

§1.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* Every taxpayer that has participated, as described in paragraph (c)(3) of this section, in a reportable transaction within the meaning of paragraph (b) of this section and who is required to file a tax return must file within the time prescribed in paragraph (e) of this section a disclosure statement in the form prescribed by paragraph (d) of this section. The fact that a transaction is a reportable transaction shall not affect the legal determination of whether the taxpayer's treatment of the transaction is proper.

(b) *Reportable transactions*—(1) *In general.* A reportable transaction is a transaction described in any of the paragraphs (b)(2) through (7) of this section. The term transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan.

(2) *Listed transactions.* A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service (IRS) has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.

(3) *Confidential transactions*—(i) *In general.* A confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee.

(ii) *Conditions of confidentiality.* A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid the minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the advisor confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction.

(iii) *Minimum fee.* For purposes of this paragraph (b)(3), the minimum fee is—

(A) $250,000 for a transaction if the taxpayer is a corporation;

(B) $50,000 for all other transactions unless the taxpayer is a partnership or trust, all of the owners or beneficiaries of which are corporations (looking through any partners or beneficiaries that are themselves partnerships or trusts), in which case the minimum fee is $250,000.

(iv) *Determination of minimum fee.* For purposes of this paragraph (b)(3), in determining the minimum fee, all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction are taken into account. Fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent return preparation fees are unreasonable in light of the facts and circumstances. For purposes of this paragraph (b)(3), a taxpayer also is treated as paying fees to an advisor if the taxpayer knows or should know that the amount it pays will be paid indirectly to the advisor, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property. The IRS will scrutinize carefully all of the facts and circumstances in determining whether consideration received in connection with a confidential transaction constitutes fees.

(v) *Related parties.* For purposes of this paragraph (b)(3), persons who bear a relationship to each other as described in section 267(b) or 707(b) will be treated as the same person.

(4) *Transactions with contractual protection*—(i) *In general.* A transaction with contractual protection is a transaction for which the taxpayer or a related party (as described in section 267(b) or 707(b)) has the right to a full or partial refund of fees (as described in paragraph (b)(4)(ii) of this section) if all or part of the intended tax consequences from the transaction are not sustained. A transaction with contractual protection also is a transaction for which fees (as described in paragraph (b)(4)(ii) of this section) are contingent on the taxpayer's realization of tax benefits from the transaction. All the facts and circumstances relating to the transaction will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to the transaction have not designated as fees or any agreement to provide services without reasonable compensation.

(ii) *Fees.* Paragraph (b)(4)(i) of this section only applies with respect to fees paid by or on behalf of the taxpayer or a related party to any person who makes or provides a statement, oral or written, to the taxpayer or related party (or for whose benefit a statement is made or provided to the taxpayer or related party) as to the potential tax consequences that may result from the transaction.

(iii) *Exceptions*—(A) *Termination of transaction.* A transaction is not considered to have contractual protection solely because a party to the transaction has the right to terminate the transaction upon the happening of an event affecting the taxation of one or more parties to the transaction.

(B) *Previously reported transaction.* If a person makes or provides a statement to a taxpayer as to the potential tax consequences that may result from a transaction only after the taxpayer has entered into the transaction and reported the consequences of the transaction on a filed tax return, and the person has not previously received fees from the taxpayer relating to the transaction, then any refundable or contingent fees are not taken into account in determining whether the transaction has contractual protection. This paragraph (b)(4) does not provide any substantive rules regarding when a person may charge refundable or contingent fees with respect to a transaction. See Circular 230, 31 CFR Part 10, for the regulations governing practice before the IRS.

(5) *Loss transactions*—(i) *In general.* A loss transaction is any transaction resulting in the taxpayer claiming a loss under section 165 of at least—

(A) $10 million in any single taxable year or $20 million in any combination of taxable years for corporations;

(B) $10 million in any single taxable year or $20 million in any combination of taxable years for partnerships that have only corporations as partners (looking through any partners that are themselves partnerships), whether or not any losses flow through to one or more partners; or

(C) $2 million in any single taxable year or $4 million in any combination of taxable years for all other partnerships, whether or not any losses flow through to one or more partners;

(D) $2 million in any single taxable year or $4 million in any combination of taxable years for individuals, S corporations, or trusts, whether or not any losses flow through to one or more shareholders or beneficiaries; or

(E) $50,000 in any single taxable year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership, if the loss arises with respect to a section 988 transaction (as defined in section 988(c)(1) relating to foreign currency transactions).

(ii) *Cumulative losses.* In determining whether a transaction results in a taxpayer claiming a loss that meets the threshold amounts over a combination of taxable years as described in paragraph (b)(5)(i) of this section, only losses claimed in the taxable year that the transaction is entered into and the five succeeding taxable years are combined.

(iii) *Section 165 loss*—(A) For purposes of this section, in determining the thresholds in paragraph (b)(5)(i) of this section, the amount of a section 165 loss is adjusted for any salvage value and for any insurance or other compensation received. See §1.165–1(c)(4). However, a section 165 loss does not take into account offsetting gains, or other income or limitations. For example, a section 165 loss does not take into account the limitation in section 165(d) (relating to wagering losses) or the limitations in sections 165(f), 1211, and 1212 (relating to capital losses). The full amount of a section 165 loss is taken into account for the year in which the loss is sustained, regardless of whether all or part of the loss enters into the computation of a net operating loss under section 172 or a net capital loss under section 1212 that is a carryback or carryover to another year. A section 165 loss does not include any portion of a loss, attributable to a capital loss carryback or carryover from another year, that is treated as a deemed capital loss under section 1212.

(B) For purposes of this section, a section 165 loss includes an amount deductible pursuant to a provision that treats a transaction as a sale or other disposition, or otherwise results in a deduction under section 165. A section 165 loss includes, for example, a loss resulting from a sale or exchange of a partnership interest under section 741 and a loss resulting from a section 988 transaction.

(6) *Transactions of interest.* A transaction of interest is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest.

(7) [*Reserved*].

(8) *Exceptions*—(i) *In general.* A transaction will not be considered a reportable transaction, or will be excluded from any individual category of reportable transaction under paragraphs (b)(3) through (7) of this section, if the Commissioner makes a determination by published guidance that the transaction is not subject to the reporting requirements of this section. The Commissioner may make a determination by individual letter ruling under paragraph (f) of this section that an individual letter rul-

ing request on a specific transaction satisfies the reporting requirements of this section with regard to that transaction for the taxpayer who requests the individual letter ruling.

(ii) *Special rule for RICs*. For purposes of this section, a regulated investment company (RIC) as defined in section 851 or an investment vehicle that is owned 95 percent or more by one or more RICs at all times during the course of the transaction is not required to disclose a transaction that is described in any of paragraphs (b)(3) through (5) and (b)(7) of this section unless the transaction is also a listed transaction or a transaction of interest.

(c) *Definitions*. For purposes of this section, the following definitions apply:

(1) *Taxpayer*. The term *taxpayer* means any person described in section 7701(a)(1), including S corporations. Except as otherwise specifically provided in this section, the term *taxpayer* also includes an affiliated group of corporations that joins in the filing of a consolidated return under section 1501.

(2) *Corporation*. When used specifically in this section, the term *corporation* means an entity that is required to file a return for a taxable year on any 1120 series form, or successor form, excluding S corporations.

(3) *Participation*—(i) *In general*—(A) *Listed transactions*. A taxpayer has participated in a listed transaction if the taxpayer's tax return reflects tax consequences or a tax strategy described in the published guidance that lists the transaction under paragraph (b)(2) of this section. A taxpayer also has participated in a listed transaction if the taxpayer knows or has reason to know that the taxpayer's tax benefits are derived directly or indirectly from tax consequences or a tax strategy described in published guidance that lists a transaction under paragraph (b)(2) of this section. Published guidance may identify other types or classes of persons that will be treated as participants in a listed transaction. Published guidance also may identify types or classes of persons that will not be treated as participants in a listed transaction.

(B) *Confidential transactions*. A taxpayer has participated in a confidential transaction if the taxpayer's tax return reflects a tax benefit from the transaction and the taxpayer's disclosure of the tax treatment or tax structure of the transaction is limited in the manner described in paragraph (b)(3) of this section. If a partnership's, S corporation's or trust's disclosure is limited, and the partner's, shareholder's, or beneficiary's disclosure is not limited, then the partnership, S corporation, or trust, and not the partner, shareholder, or beneficiary, has participated in the confidential transaction.

(C) *Transactions with contractual protection*. A taxpayer has participated in a transaction with contractual protection if the taxpayer's tax return reflects a tax benefit from the transaction and, as described in paragraph (b)(4) of this section, the taxpayer has the right to the full or partial refund of fees or the fees are contingent. If a partnership, S corporation, or trust has the right to a full or partial refund of fees or has a contingent fee arrangement, and the partner, shareholder, or beneficiary does not individually have the right to the refund of fees or a contingent fee arrangement, then the partnership, S corporation, or trust, and not the partner, shareholder, or beneficiary, has participated in the transaction with contractual protection.

(D) *Loss transactions*. A taxpayer has participated in a loss transaction if the taxpayer's tax return reflects a section 165 loss and the amount of the section 165 loss equals or exceeds the threshold amount applicable to the taxpayer as described in paragraph (b)(5)(i) of this section. If a taxpayer is a partner in a partnership, shareholder in an S corporation, or beneficiary of a trust and a section 165 loss as described in paragraph (b)(5) of this section flows through the entity to the taxpayer (disregarding netting at the entity level), the taxpayer has participated in a loss transaction if the taxpayer's tax return reflects a section 165 loss and the amount of the section 165 loss that flows through to the taxpayer equals or exceeds the threshold amounts applicable to the taxpayer as described in paragraph (b)(5)(i) of this section. For this purpose, a tax return is deemed to reflect the full amount of a section 165 loss described in paragraph (b)(5) of this section allocable to the taxpayer under this paragraph (c)(3)(i)(D), regardless of whether all or part of the loss enters into the computation of a net operating loss under section 172 or net capital loss under section 1212 that the taxpayer may carry back or carry over to another year.

(E) *Transactions of interest*. A taxpayer has participated in a transaction of interest if the taxpayer is one of the types or classes of persons identified as participants in the transaction in the published guidance describing the transaction of interest.

(F) [*Reserved*].

(G) *Shareholders of foreign corporations*—(*1*) *In general*. A reporting shareholder of a foreign corporation participates in a transaction described in paragraphs (b)(2) through (5) and (b)(7) of this section if the foreign corporation would be considered to participate in the transaction under the rules of this paragraph (c)(3) if it were a domestic corporation filing a tax return that reflects the items from the transaction. A reporting shareholder of a foreign corporation participates in a transaction described in paragraph (b)(6) of this section only if the published guidance identifying the transaction includes the reporting shareholder among the types or classes of persons identified as participants. A reporting shareholder (and any successor in interest) is considered to participate in a transaction under this paragraph (c)(3)(i)(G) only for its first taxable year with or within which ends the first taxable year of the foreign corporation in which the foreign corporation participates in the transaction, and for the reporting shareholder's five succeeding taxable years.

(*2*) *Reporting shareholder*. The term *reporting shareholder* means a United States shareholder (as defined in section 951(b)) in a controlled foreign corporation (as defined in section 957) or a 10 percent shareholder (by vote or value) of a qualified electing fund (as defined in section 1295).

(ii) *Examples*. The following examples illustrate the provisions of paragraph (c)(3)(i) of this section:

Example 1. Notice 2003–55, 2003–2 C.B. 395, which modified and superseded Notice 95–53, 1995–2 C.B. 334 (see §601.601(d)(2) of this chapter), describes a lease stripping transaction in which one party (the transferor) assigns the right to receive future payments under a lease of tangible property and treats the amount realized from the assignment as its current income. The transferor later transfers the property subject to the lease in a transaction intended to qualify as a transferred basis transaction, for example, a transaction described in section 351. The transferee corporation claims the deductions associated with the high basis property subject to the lease. The transferor's and transferee corporation's tax returns reflect tax positions described in Notice 2003–55. Therefore, the transferor and transferee corporation have participated in the listed transaction. In the section 351 transaction, the transferor will have received stock with low value and high basis from the transferee corporation. If the transferor subsequently transfers the high basis/low value stock to a taxpayer in another transaction intended to qualify as a transferred basis transaction and the taxpayer uses the stock to generate a loss, and if the taxpayer knows or has reason to know that the tax loss claimed was derived indirectly from the lease stripping transaction, then the taxpayer has participated in the listed transaction. Accordingly, the taxpayer must disclose the transaction and the manner of the taxpayer's participation in the transaction under the rules of this section. For purposes of this example, if a bank lends money to the transferor, transferee corporation, or taxpayer for use in their transactions, the bank has not participated in the listed transaction because the bank's tax return does not reflect tax consequences or a tax strategy described in the listing notice (nor does the bank's tax return reflect a tax benefit derived from tax consequences or a tax strategy described in the listing notice) nor is the bank described as a participant in the listing notice.

Example 2. XYZ is a limited liability company treated as a partnership for tax purposes. X, Y, and Z are members of XYZ. X is an individual, Y is an S corporation, and Z is a partnership. XYZ enters into a confidential transaction under paragraph (b)(3) of this section. XYZ and X are bound by the confidentiality agreement, but Y and Z are not bound by the agreement. As a result of the transaction, XYZ, X, Y, and Z all reflect a tax benefit on their tax returns. Because XYZ's and X's disclosure of the tax treatment and tax structure are limited in the manner described in paragraph (b)(3) of this section and their tax returns reflect a tax benefit from the transaction, both XYZ and X have participated in the confidential transaction. Neither Y nor Z has participated in the confidential transaction because they are not subject to the confidentiality agreement.

Example 3. P, a corporation, has an 80% partnership interest in PS, and S, an individual, has a 20% partnership interest in PS. P, S, and PS are calendar year taxpayers. In 2006, PS enters into a transaction and incurs a section 165 loss (that does not meet any of the exceptions to a section 165 loss identified in published guidance) of $12 million and offsetting gain of $3 million. On PS' 2006 tax return, PS includes the section 165 loss and the corresponding gain. PS must disclose the transaction under this section because PS' section 165 loss of $12 million is equal to or greater than $2 million. P is allocated $9.6 million of the section 165 loss and $2.4 million of the offsetting gain. P does not have to disclose the transaction under this section because P's section 165 loss of $9.6 million is not equal to or greater than $10 million. S is allocated $2.4 million of the section 165 loss and $600,000 of the offsetting gain. S must disclose the transaction under this section because S's section 165 loss of $2.4 million is equal to or greater than $2 million.

(4) *Substantially similar*. The term *substantially similar* includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term *substantially similar* must be broadly construed in favor of disclosure. For example, a transaction may be substantially similar to a listed transaction even though it involves different entities or uses different Internal Revenue Code provisions. (See for example, Notice 2003–54, 2003–2 C.B. 363, describing a transaction substantially similar to the transactions in Notice 2002–50, 2002–2 C.B. 98, and Notice 2002–65, 2002–2 C.B. 690.) The following examples illustrate situations where a transaction is the same as or substantially similar to a listed transaction under paragraph (b)(2) of this section. (Such transactions may also be reportable transactions under paragraphs (b)(3) through (7) of this section.) See §601.601(d)(2)(ii)(*b*) of this chapter. The following examples illustrate the provisions of this paragraph (c)(4):

Example 1. Notice 2000–44, 2000–2 C.B. 255 (see §601.601(d)(2)(ii)(*b*) of this chapter), sets forth a listed transaction involving offsetting options transferred to a partnership where the taxpayer claims basis in the partnership for the cost of the purchased options but does not adjust basis under section 752 as a result of the partnership's assumption of the taxpayer's obligation with respect to the options. Transactions using short sales, futures, derivatives or any other type of offsetting obligations to inflate basis in a partnership interest would be the same as or substantially similar to the transaction described in Notice 2000–44. Moreover, use of the inflated basis in the partnership interest to diminish gain that would otherwise be recognized on the transfer of a partnership asset would also be the same as or substantially similar to the transaction described in Notice 2000–44. See §601.601(d)(2)(ii)(b).

Example 2. Notice 2001–16, 2001–1 C.B. 730 (see §601.601(d)(2)(ii)(*b*) of this chapter), sets forth a listed transaction involving a seller (X) who desires to sell stock of a corporation (T), an intermediary corporation (M), and a buyer (Y) who desires to purchase the assets (and not the stock) of T. M agrees to facilitate the sale to prevent the recognition of the gain that T would otherwise report. Notice 2001–16 describes M as a member of a consolidated group that has a loss within the group or as a party not subject to tax. Transactions utilizing different intermediaries to prevent the recognition of gain would be the same as or substantially similar to the transaction described in Notice 2001–16. An example is a transaction in which M is a corporation that does not file a consolidated return but which buys T stock, liquidates T, sells assets of T to Y, and offsets the gain on the sale of those assets with currently generated losses. See §601.601(d)(2)(ii)(*b*).

(5) *Tax*. The term *tax* means Federal income tax.

(6) *Tax benefit*. A tax benefit includes deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, status as an entity exempt from Federal income taxation, and any other tax consequences that may reduce a taxpayer's Federal income tax liability by affecting the amount, timing, character, or source of any item of income, gain, expense, loss, or credit.

(7) *Tax return*. The term *tax return* means a Federal income tax return and a Federal information return.

(8) *Tax treatment*. The tax treatment of a transaction is the purported or claimed Federal income tax treatment of the transaction.

(9) *Tax structure*. The tax structure of a transaction is any fact that may be relevant to understanding the purported or claimed Federal income tax treatment of the transaction.

(d) *Form and content of disclosure statement*. A taxpayer required to file a disclosure statement under this section must file a completed Form 8886, "*Reportable Transaction Disclosure Statement*" (or a successor form), in accordance with this paragraph (d) and the instructions to the form. The Form 8886 (or a successor form) is the disclosure statement required under this section. The form must be attached to the appropriate tax return(s) as provided in paragraph (e) of this section. If a copy of a disclosure statement is required to be sent to the Office of Tax Shelter Analysis (OTSA) under paragraph (e) of this section, it must be sent in accordance with the instructions to the form. To be considered complete, the information provided on the form must describe the expected tax treatment and all potential tax benefits expected to result from the transaction, describe any tax result protection (as defined in §301.6111–3(c)(12) of this chapter) with respect to the transaction, and identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and the identity of all parties involved in the transaction. An incomplete Form 8886 (or a successor form) containing a statement that information will be provided upon request is not considered a complete disclosure statement. If the form is not completed in accordance with the provisions in this paragraph (d) and the instructions to the form, the taxpayer will not be considered to have complied with the disclosure requirements of this section. If a taxpayer receives one or more reportable transaction numbers for a reportable transaction, the taxpayer must include the reportable transaction number(s) on the Form 8886 (or a successor form). See §301.6111–3(d)(2) of this chapter.

(e) *Time of providing disclosure*—(1) *In general.* The disclosure statement for a reportable transaction must be attached to the taxpayer's tax return for each taxable year for which a taxpayer participates in a reportable transaction. In addition, a disclosure statement for a reportable transaction must be attached to each amended return that reflects a taxpayer's participation in a reportable transaction. A copy of the disclosure statement must be sent to OTSA at the same time that any disclosure statement is first filed by the taxpayer pertaining to a particular reportable transaction. If a reportable transaction results in a loss which is carried back to a prior year, the disclosure statement for the reportable transaction must be attached to the taxpayer's application for tentative refund or amended tax return for that prior year. In the case of a taxpayer that is a partner in a partnership, a shareholder in an S corporation, or a beneficiary of a trust, the disclosure statement for a reportable transaction must be attached to the partnership, S corporation, or trust's tax return for each taxable year in which the partnership, S corporation, or trust participates in the transaction under the rules of paragraph (c)(3)(i) of this section. If a taxpayer who is a partner in a partnership, a shareholder in an S corporation, or a beneficiary of a trust receives a timely Schedule K–1 less than 10 calendar days before the due date of the taxpayer's return (including extensions) and, based on receipt of the timely Schedule K–1, the taxpayer determines that the taxpayer participated in a reportable transaction within the meaning of paragraph (c)(3) of this section, the disclosure statement will not be considered late if the taxpayer discloses the reportable transaction by filing a disclosure statement with OTSA within 60 calendar days after the due date of the taxpayer's return (including extensions). The Commissioner in his discretion may issue in published guidance other provisions for disclosure under §1.6011–4.

(2) *Special rules*—(i) *Listed transactions and transactions of interest.* In general, if a transaction becomes a listed transaction or a transaction of interest after the filing of a taxpayer's tax return (including an amended return) reflecting the taxpayer's participation in the listed transaction or transaction of interest and before the end of the period of limitations for assessment of tax for any taxable year in which the taxpayer participated in the listed transaction or transaction of interest, then a disclosure statement must be filed, regardless of whether the taxpayer participated in the transaction in the year the transaction became a listed transaction or a transaction of interest, with OTSA within 90 calendar days after the date on which the transaction became a listed transaction or a transaction of interest. The Commissioner also may determine the time for disclosure of listed transactions and transactions of interest in the published guidance identifying the transaction.

(ii) *Loss transactions.* If a transaction becomes a loss transaction because the losses equal or exceed the threshold amounts as described in paragraph (b)(5)(i) of this section, a disclosure statement must be filed as an attachment to the taxpayer's tax return for the first taxable year in which the threshold amount is reached and to any subsequent tax return that reflects any amount of section 165 loss from the transaction.

(3) *Multiple disclosures.* The taxpayer must disclose the transaction in the time and manner provided for under the provisions of this section regardless of whether the taxpayer also plans to disclose the transaction under other published guidance, for example, §1.6662–3(c)(2).

(4) *Example.* The following example illustrates the application of this paragraph (e):

Example. In January of 2008, F, a calendar year taxpayer, enters into a transaction that at the time is not a listed transaction and is not a transaction described in any of the paragraphs (b)(3) through (7) of this section. All the tax benefits from the transaction are reported on F's 2008 tax return filed timely in April 2009. On May 2, 2011, the IRS publishes a notice identifying the transaction as a listed transaction described in paragraph (b)(2) of this section. Upon issuance of the May 2, 2011 notice, the transaction becomes a reportable transaction described in paragraph (b) of this section. The period of limitations on assessment for F's 2008 taxable year is still open. F is required to file Form 8886 for the transaction with OTSA within 90 calendar days after May 2, 2011.

(f) *Rulings and protective disclosures*—(1) *Rulings.* If a taxpayer requests a ruling on the merits of a specific transaction on or before the date that disclosure would otherwise be required under this section, and receives a favorable ruling as to the transaction, the disclosure rules under this section will be deemed to have been satisfied by that taxpayer with regard to that transaction, so long as the request fully discloses all relevant facts relating to the transaction which would otherwise be required to be disclosed under this section. If a taxpayer requests a ruling as to whether a specific transaction is a reportable transaction on or before the date that disclosure would otherwise be required under this section, the Commissioner in his discretion may determine that the submission satisfies the disclosure rules under this section for the taxpayer requesting the ruling for that transaction if the request fully discloses all relevant facts relating to the transaction which would otherwise be required to be disclosed under this section. The potential obligation of the taxpayer to disclose the transaction under this section will not be suspended during the period that the ruling request is pending.

(2) *Protective disclosures.* If a taxpayer is uncertain whether a transaction must be disclosed under this section, the taxpayer may disclose the transaction in accordance with the requirements of this section and comply with all the provisions of this section, and indicate on the disclosure statement that the disclosure statement is being filed on a protective basis. The IRS will not treat disclosure statements filed on a protective basis any differently than other disclosure statements filed under this section. For a protective disclosure to be effective, the taxpayer must comply with these disclosure regulations by providing to the IRS all information requested by the IRS under this section.

(g) *Retention of documents.* (1) In accordance with the instructions to Form 8886 (or a successor form), the taxpayer must retain a copy of all documents and other records related to a transaction subject to disclosure under this section that are material to an understanding of the tax treatment or tax structure of the transaction. The documents must be retained until the expiration of the statute of limitations applicable to the final taxable year for which disclosure of the transaction was required under this section. (This document retention requirement is in addition to any document retention requirements that section 6001 generally imposes on the taxpayer.) The documents may include the following:

(i) Marketing materials related to the transaction;

(ii) Written analyses used in decision-making related to the transaction;

(iii) Correspondence and agreements between the taxpayer and any advisor, lender, or other party to the reportable transaction that relate to the transaction;

(iv) Documents discussing, referring to, or demonstrating the purported or claimed tax benefits arising from the reportable transaction; and documents, if any, referring to the business purposes for the reportable transaction.

(2) A taxpayer is not required to retain earlier drafts of a document if the taxpayer retains a copy of the final document (or, if there is no final document, the most recent draft of the document) and the final document (or most recent draft) contains all the information in the earlier drafts of the document that is material to an understanding of the purported tax treatment or tax structure of the transaction.

(h) *Effective/applicability date*—(1) *In general*. This section applies to transactions entered into on or after August 3, 2007. However, this section applies to transactions of interest entered into on or after November 2, 2006. Paragraph (f)(1) of this section applies to ruling requests received on or after November 1, 2006. Otherwise, the rules that apply with respect to transactions entered into before August 3, 2007, are contained in §1.6011–4 in effect prior to August 3, 2007. (See 26 CFR part 1 revised as of April 1, 2007).

(2) [*Reserved*].

§1.6011–4T [Removed]

Par. 3. Section 1.6011–4T is removed.

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 4. The authority citation for part 20 continues to read, in part, as follows:

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

Par. 5. Section 20.6011–4 is revised to read as follows:

§20.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general*. If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves an estate tax under chapter 11 of subtitle B of the Internal Revenue Code, the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date*. This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 6. The authority citation for part 25 continues to read, in part, as follows:

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

Par. 7. Section 25.6011–4 is revised to read as follows:

§25.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general*. If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves a gift tax under chapter 12 of subtitle B of the Internal Revenue Code, the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date*. This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

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

Par. 8. The authority citation for part 31 continues to read, in part, as follows:

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

Par. 9. Section 31.6011–4 is revised to read as follows:

§31.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general*. If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves an employment tax under chapters 21 through 25 of subtitle C of the Internal Revenue Code, the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date*. This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Par. 10. The authority citation for part 53 continues to read, in part, as follows:

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

Par. 11. Section 53.6011–4 is revised to read as follows:

§53.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general*. If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves an excise tax under chapter 42 of subtitle D of the Internal Revenue Code (relating to private foundations and certain other tax-exempt organizations), the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date*. This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

PART 54—PENSION EXCISE TAXES

Par. 12. The authority citation for part 54 continues to read, in part, as follows:

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

Par. 13. Section 54.6011–4 is revised to read as follows:

§54.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general*. If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves an excise tax under chapter 43 of subtitle D of the Internal Revenue Code (relating to qualified pension, etc., plans) the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date*. This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

PART 56—PUBLIC CHARITY EXCISE TAXES

Par. 14. The authority citation for part 56 continues to read, in part, as follows:

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

Par. 15. Section 56.6011–4 is revised to read as follows:

§56.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2) of this chapter), and the listed transaction or transaction of interest involves an excise tax under chapter 41 of subtitle D of the Internal Revenue Code (relating to public charities), the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date*. This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

Kevin M. Brown,
Deputy Commissioner for
Services and Enforcement.

Approved July 25, 2007.

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

(Filed by the Office of the Federal Register on July 31, 2007, 11:22 a.m., and published in the issue of the Federal Register for August 3, 2007, 72 F.R. 43146)

Section 6104.—Publicity of Information Required From Certain Exempt Organizations and Certain Trusts

Proposed regulations provide rules relating to information made available by the IRS for public inspection under section 6104(a). See REG-116215-07, page 659.

Section 6110.—Public Inspection of Written Determinations

Proposed regulations provide rules relating to materials that are made publicly available under section 6110. See REG-116215-07, page 659.

Section 6111.—Disclosure of Reportable Transactions

26 CFR 301.6111–3: Disclosure of reportable transactions.

T.D. 9351

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

AJCA Modifications to the Section 6111 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 6111 of the Internal Revenue Code that provide the rules relating to the disclosure of reportable transactions by material advisors. These regulations affect material advisors responsible for disclosing reportable transactions under section 6111 and material advisors responsible for keeping lists under section 6112.

DATES: *Effective Date:* These regulations are effective August 3, 2007.

FOR FURTHER INFORMATION CONTACT: Charles D. Wien, Michael H. Beker, or Tolsun N. Waddle, 202–622–3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations that amend 26 CFR part 301 by providing rules relating to the disclosure of reportable transactions by material advisors under section 6111.

The American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418), (AJCA) was enacted on October 22, 2004. Section 815 of the AJCA amended section 6111 to require each material advisor with respect to any reportable transaction to make a return (in such form as the Secretary may prescribe) setting forth: (1) information identifying and describing the transaction; (2) information describing any potential tax benefits expected to result from the transaction; and (3) such other information as the Secretary may prescribe. Section 6111(a), as amended, also provides that the return must be filed not later than the date specified by the Secretary. Section 6111(b)(1), as amended, provides a definition for the term material advisor and includes as part of that definition a requirement that the material advisor derive certain threshold amounts of gross income that the Secretary may prescribe. The AJCA amendments to section 6111 also authorize the Secretary to prescribe regulations that provide: (1) that only one person shall be required to meet the requirements of section 6111(a) in cases in which two or more persons would otherwise be required to meet such requirements; (2) exemptions from the requirements of section 6111; and (3) rules as may be necessary or appropriate to carry out the purposes of section 6111. Section 815 of the AJCA is effective for transactions with respect to which material aid, assistance, or advice is provided after October 22, 2004.

In response to the AJCA, the IRS and Treasury Department issued interim guidance on section 6111 in Notice 2004–80, 2004–2 C.B. 963; Notice 2005–17, 2005–1 C.B. 606; Notice 2005–22, 2005–1 C.B. 756; and Notice 2006–6, 2006–1 C.B. 385 (see §601.601(d)(2)). On November 1, 2006, the IRS and Treasury Department issued a notice of proposed rulemaking and temporary and final regulations under sections 6011, 6111, and 6112 (REG–103038–05, 2006–49 I.R.B. 1049, REG–103039–05, 2006–49 I.R.B. 1057, REG–103043–05, 2006–49 I.R.B. 1063, T.D. 9295, 2006–49 I.R.B. 1030) (the November 2006 regulations). The November 2006 regulations were published in the **Federal Register** (71 FR 64488, 71 FR 64496, 71 FR 64501, 71 FR 64458) on November 2, 2006.

The IRS and Treasury Department received written public comments responding to the proposed regulations and held a public hearing regarding the proposed rules on March 20, 2007. After consideration of the comments received and comments made at the hearing, the proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations but include some modifications based on recommendations in the public comments.

Summary of Comments and Explanation of Provisions

Nine written comments were received in response to the NPRM. All comments were considered and are available for public inspection upon request.

Reportable Transaction Number

The proposed regulations provide that a material advisor must provide a reportable transaction number to all taxpayers and material advisors to whom the material advisor makes or provides tax statements. Many commentators commented that the requirement to provide the reportable transaction number to all taxpayers and material advisors to whom the material advisor makes or provides tax statements is overly broad and suggested, instead, that the reportable transaction number only be required to be furnished to those for whom the taxpayer acted as a material advisor. One commentator recommended that the regulation be amended to remove the obligation to provide a reportable transaction number. Another commentator recommended that a material advisor should be required to provide the reportable transaction number to taxpayers only in the case of marketed transactions. The commentator also commented that in a purely one-on-one, non-abusive transaction, the use of the reportable transaction number may infringe upon the attorney-client relationship.

The IRS and Treasury Department attempted to balance the need for disclosure of reportable transactions with the resulting burden imposed upon taxpayers. The IRS and Treasury Department do not believe that requiring a material advisor to provide a reportable transaction number to certain taxpayers and material advisors imposes an undue burden upon taxpayers in light of the benefit to tax administration. However, the IRS and Treasury Department recognize that requiring the reportable transaction number to be provided to all persons for whom the material advisor made a tax statement may be unnecessary. Therefore, these final regulations state that a material advisor is required to provide a reportable transaction number to all taxpayers and material advisors for whom the material advisor acts as a material advisor.

Material Advisor Fee Threshold Language

The proposed regulations provide, in general, that a lower threshold amount of gross income applies in the case of a reportable transaction when substantially all of the tax benefits are provided to natural persons (looking through any partnerships, S corporations, or trusts). The IRS and Treasury Department received comments asking for clarification of the term "substantially all of the tax benefits."

The final regulations provide that the determination of whether the lower threshold amount applies is based on the facts and circumstances. Generally, unless the facts and circumstances prove otherwise, if 70 percent or more of the tax benefits from a reportable transaction are provided to natural persons (looking through any partnerships, S corporations, or trusts) then substantially all of the tax benefits will be considered to be provided to natural persons.

Material Advisor Disclosure of the Identity of Other Material Advisors

The proposed regulations provide that a material advisor who is required to file a disclosure statement must also disclose the identity of other material advisors. Two commentators recommended that these final regulations be amended to provide that a material advisor must provide the identity of other material advisors only if the material advisor has actual knowledge of such other material advisors.

After carefully considering the recommendation by the commentators, these final regulations provide that a material advisor must provide the identities of any material advisor(s) who the material advisor knows or has reason to know acted as a material advisor with respect to the transaction.

Designation Agreements

The proposed regulations provide that if more than one material advisor is required to disclose a reportable transaction under section 6111, the material advisors may designate by written agreement a single material advisor to disclose the transaction. The designation of one material advisor to disclose the transaction does not relieve the other material advisors of their obligation to disclose the transaction to the IRS in accordance with section 6111, if the designated material advisor fails to disclose the transaction to the IRS in a timely manner. One commentator recommended that a good faith participation in a designation agreement be treated as if the non-designated material advisor has satisfied the advisor's obligations under section 6111 and/or section 6112. The commentator also suggested that if the previous recommendation is not adopted, that these final regulations prohibit designation agreements entirely.

These final regulations do not adopt the recommendation of the commentator. The purpose of the designation agreement language is to reduce the burden on material advisors in complying with the disclosure and list maintenance regulations while balancing the need of the IRS and Treasury Department to receive the necessary information described in sections 6111 and 6112. The designation agreement allows material advisors, if they choose, to have one material advisor comply with the disclosure and list maintenance obligations rather than multiple advisors maintaining duplicative lists. Inherent in the language is the assumption that the designated material advisor will comply with the requirements. Absolving the non-designated material advisors from the obligations listed in sections 6111 and 6112 for good faith designation agreements would require the IRS to determine whether the designation agreement was entered into in good faith and would increase the burdens on tax administration.

Form 8271

Before the enactment of the AJCA, section 6111 provided that tax shelter organizers were required to provide investors in tax shelters the registration number for the tax shelter. Section 301.6111–1T, Q&A 55, requires investors to report the registration number of the tax shelter to the IRS on Form 8271, *"Investor Reporting of Tax Shelter Registration Number"*, and attach the Form 8271 to any return on which any deduction, loss, credit, or other tax benefit attributable to the tax shelter is claimed. Because only a few investors must still file Form 8271 for pre-AJCA section 6111 tax shelters and because the IRS already is aware of these transactions, the IRS and Treasury Department have decided that investors are no longer required to file Forms 8271 otherwise due on or after August 3, 2007. The Form 8271 will be obsoleted. However, these final regulations continue to require that material advisors must provide the reportable transaction number to all taxpayers and material advisors for whom the material advisor acts as a material advisor.

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 a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 35) do not apply. The return referenced in these regulations will be made available for public comment in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. chapter 35). Pursuant to section 7805(f) of the Internal Revenue 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 authors of these regulations are Charles D. Wien, Michael H. Beker, and Tolsun N. Waddle, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding entries in numerical order to read, in part, as follows:

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

Section 301.6111–3 also issued under 26 U.S.C. 6111.

Par. 2. Section 301.6111–3 is added to read as follows:

§301.6111–3 Disclosure of reportable transactions.

(a) *In general.* Each material advisor, as defined in paragraph (b) of this section, with respect to any reportable transaction, as defined in §1.6011–4(b) of this chapter, must file a return as described in paragraph (d) of this section by the date described in paragraph (e) of this section.

(b) *Material advisor*—(1) *In general.* A person is a material advisor with respect to a transaction if the person provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and directly or indirectly derives gross income in excess of the threshold amount as defined in paragraph (b)(3) of this section for the material aid, assistance, or advice. The term transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan or arrangement, and includes any series of steps carried out as part of a plan.

(2) *Material aid, assistance, or advice*—(i) *In general.* Except as provided in paragraph (b)(5) of this section, a person provides material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any transaction if the person makes or provides a tax statement to or for the benefit of—

(A) A taxpayer who either is required to disclose the transaction under §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter because the transaction is a listed transaction or a transaction of interest, or would have been required to disclose the transaction under §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter if the transaction had become a listed transaction or a transaction of interest within the period of limitations in §1.6011–4(e) of this chapter;

(B) A taxpayer who the potential material advisor knows is or reasonably expects to be required to disclose the transaction under §1.6011–4 of this chapter because the transaction is or is reasonably expected to become a transaction described in §1.6011–4(b)(3) through (5) or (7) of this chapter;

(C) A material advisor who is required to disclose the transaction under this section because it is a listed transaction or a transaction of interest; or

(D) A material advisor who the potential material advisor knows is or reasonably expects to be required to disclose the transaction under this section because the transaction is or is reasonably expected to become a transaction described in §1.6011–4(b)(3) through (5) or (7) of this chapter.

(ii) *Tax statement*—(A) *In general*. A tax statement is any statement (including another person's statement), oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a reportable transaction as defined in §1.6011–4(b)(2) through (7) of this chapter. A tax statement under this section includes tax result protection that insures some or all of the tax benefits of a reportable transaction.

(B) *Confidential transactions*. A statement relates to a tax aspect of a transaction that causes it to be a confidential transaction if the statement concerns a tax benefit related to the transaction and either the taxpayer's disclosure of the tax treatment or tax structure of the transaction is limited in the manner described in §1.6011–4(b)(3) of this chapter by or for the benefit of the person making the statement, or the person making the statement knows the taxpayer's disclosure of the tax structure or tax aspects of the transaction is limited in the manner described in §1.6011–4(b)(3) of this chapter.

(C) *Transactions with contractual protection*. A statement relates to a tax aspect of a transaction that causes it to be a transaction with contractual protection if the statement concerns a tax benefit related to the transaction and either—

(*1*) The taxpayer has the right to a full or partial refund of fees paid to the person making the statement or the fees are contingent in the manner described in §1.6011–4(b)(4) of this chapter; or

(*2*) The person making the statement knows or has reason to know that the taxpayer has the right to a full or partial refund of fees (described in §1.6011–4(b)(4)(ii) of this chapter) paid to another if all or part of the intended tax consequences from the transaction are not sustained or that fees (as described in §1.6011–4(b)(4)(ii) of this chapter) paid by the taxpayer to another are contingent on the taxpayer's realization of tax benefits from the transaction in the manner described in §1.6011–4(b)(4) of this chapter.

(D) *Loss transactions*. A statement relates to a tax aspect of a transaction that causes it to be a loss transaction if the statement concerns an item that gives rise to a loss described in §1.6011–4(b)(5) of this chapter.

(E) [*Reserved*].

(iii) *Special rules*—(A) *Capacity as an employee*. A material advisor generally does not include a person who makes a tax statement solely in the person's capacity as an employee, shareholder, partner or agent of another person. Any tax statement made by that person will be attributed to that person's employer, corporation, partnership or principal. However, a person shall be treated as a material advisor if that person forms or avails of an entity with the purpose of avoiding the rules of section 6111 or 6112 or the penalties under section 6707 or 6708.

(B) *Post-filing advice*. A person will not be considered to be a material advisor with respect to a transaction if that person does not make or provide a tax statement regarding the transaction until after the first tax return reflecting tax benefit(s) of the transaction is filed with the IRS. However, this exception does not apply to a person who makes a tax statement with respect to the transaction if it is expected that the taxpayer will file a supplemental or amended return reflecting additional tax benefits from the transaction.

(C) *Publicly filed statements*. A tax statement with respect to a transaction that includes only information about the transaction contained in publicly available documents filed with the Securities and Exchange Commission no later than the close of the transaction will not be considered a tax statement to or for the benefit of a person described in paragraph (b)(2) of this section.

(3) *Gross income derived for material aid, assistance, or advice*—(i) *Threshold amount*—(A) *In general*. The threshold amount of gross income is $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons (looking through any partnerships, S corporations, or trusts). For all other transactions, the threshold amount is $250,000.

(B) *Listed transactions and transactions of interest*. For listed transactions described in §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter, the threshold amounts in paragraph (b)(3)(i)(A) of this section are reduced from $50,000 to $10,000 and from $250,000 to $25,000. For transactions of interest described in §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter, the threshold amounts in paragraph (b)(3)(i)(A) of this section may be reduced as identified in the published guidance describing the transaction.

(C) [*Reserved*].

(D) *Substantially all of the tax benefits*. For purposes of this section, the determination of whether substantially all of the tax benefits from a reportable transaction are provided to natural persons is made based on all the facts and circumstances. Generally, unless the facts and circumstances prove otherwise, if 70 percent or more of the tax benefits from a reportable transaction are provided to natural persons (looking through any partnerships, S corporations, or trusts) then substantially all of the tax benefits will be considered to be provided to natural persons.

(ii) *Gross income derived directly or indirectly for the material aid, assistance, or advice*. In determining the amount of gross income a person derives directly or indirectly for material aid, assistance, or advice, all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a reportable transaction are taken into account. Fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent return preparation fees are unreasonable in light of all of the facts and circumstances. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property. The IRS will scrutinize carefully all of the facts and circumstances in determining whether consideration received in connection with a reportable transaction constitutes gross income derived directly or indirectly for aid, assistance, or advice. For purposes of this section, the threshold amount must be met independently for each transaction that is a reportable transaction and aggregation of fees among transactions is not required.

(4) *Date a person becomes a material advisor*—(i) *In general*. A person will be treated as becoming a material advisor when all of the following events have occurred (in no particular order)—

(A) The person provides material aid, assistance or advice as described in paragraph (b)(2) of this section;

(B) The person directly or indirectly derives gross income in excess of the threshold amount as described in paragraph (b)(3) of this section; and

(C) The transaction is entered into by the taxpayer to whom or for whose benefit the person provided the tax statement, or in the case of a tax statement provided to another material advisor, when the transaction is entered into by a taxpayer to whom or for whose benefit that material advisor provided a tax statement.

(ii) *Determining if the taxpayer entered into the transaction*. Material advisors, including those who cease providing services before the time the transaction is entered into, must make reasonable and good faith efforts to determine whether the event described in paragraph (b)(4)(i)(C) of this section has occurred.

(iii) *Listed transactions and transactions of interest*. If a transaction that was not a reportable transaction is identified as a listed transaction or a transaction of interest in published guidance after the occurrence of the events described in paragraph (b)(4)(i) of this section, the person will be treated as becoming a material advisor on the date the transaction is identified as a listed transaction or a transaction of interest.

(5) *Other persons designated as material advisors*. Published guidance may identify other types or classes of persons as material advisors.

(c) *Definitions*. For purposes of this section, the following definitions apply:

(1) *Reportable transaction*. The term *reportable transaction* is defined in §1.6011–4(b)(1) of this chapter.

(2) *Listed transaction*. The term *listed transaction* is defined in §1.6011–4(b)(2) of this chapter. See also §§20.6011–4(a), 25.6011–4(a), 31.6011–4(a), 53.6011–4(a), 54.6011–4(a), or 56.6011–4(a) of this chapter.

(3) *Derive*. The term *derive* means receive or expect to receive.

(4) *Person*. The term *person* means any person described in section 7701(a)(1), including an affiliated group of corporations that join in the filing of a consolidated return under section 1501.

(5) *Substantially similar*. The term *substantially similar* is defined in §1.6011–4(c)(4) of this chapter.

(6) *Tax*. The term *tax* means Federal tax.

(7) *Tax benefit*. A tax benefit includes deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, status as an entity exempt from Federal income taxation, and any other tax consequences that may reduce a taxpayer's Federal tax liability by affecting the amount, timing, character, or source of any item of income, gain, expense, loss, or credit.

(8) *Tax return*. The term *tax return* means a Federal tax return and a Federal information return.

(9) *Tax structure*. The tax structure of a transaction is any fact that may be relevant to understanding the purported or claimed Federal tax treatment of the transaction.

(10) *Tax treatment*. The tax treatment of a transaction is the purported or claimed Federal tax treatment of the transaction.

(11) *Taxpayer*. The term *taxpayer* is defined in §1.6011–4(c)(1) of this chapter.

(12) *Tax result protection*. The term *tax result protection* includes insurance company and other third party products commonly described as tax result insurance.

(13) *Transaction of interest*. The term *transaction of interest* is defined in §1.6011–4(b)(6) of this chapter. See also §§20.6011–4(a), 25.6011–4(a), 31.6011–4(a), 53.6011–4(a), 54.6011–4(a), or 56.6011–4(a) of this chapter.

(d) *Form and content of material advisor's disclosure statement*—(1) *In general*. A material advisor required to file a disclosure statement under this section must file a completed Form 8918, *"Material Advisor Disclosure Statement"* (or successor form) in accordance with this paragraph (d) and the instructions to the form. To be considered complete, the information provided on the form must describe the expected tax treatment and all potential tax benefits expected to result from the transaction, describe any tax result protection with respect to the transaction, and identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and the identity of any material advisor(s) whom the material advisor knows or has reason to know acted as a material advisor as defined in paragraph (b) of this section with respect to the transaction. An incomplete form containing a statement that information will be provided upon request is not considered a complete disclosure statement. A material advisor may file a single form for substantially similar transactions. An amended form must be filed if information previously provided is no longer accurate, if additional information that was not disclosed becomes available, or if there are material changes to the transaction. A material advisor is not required to file an additional form for each additional taxpayer that enters into the same or substantially similar transaction. If the form is not completed in accordance with the provisions in this paragraph (d) and the instructions to the form, the material advisor will not be considered to have complied with the disclosure requirements of this section.

(2) *Reportable transaction number*. The IRS will issue to a material advisor a reportable transaction number with respect to the disclosed reportable transaction. Receipt of a reportable transaction number does not indicate that the disclosure statement is complete, nor does it indicate that the transaction has been reviewed, examined, or approved by the IRS. Material advisors must provide the reportable transaction number to all taxpayers and material advisors for whom the

material advisor acts as a material advisor as defined in paragraph (b) of this section. The reportable transaction number must be provided at the time the transaction is entered into, or, if the transaction is entered into prior to the material advisor receiving the reportable transaction number, within 60 calendar days from the date the reportable transaction number is mailed to the material advisor.

(e) *Time of providing disclosure*. The material advisor's disclosure statement for a reportable transaction must be filed with the Office of Tax Shelter Analysis (OTSA) by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor with respect to the reportable transaction or in which the circumstances necessitating an amended disclosure statement occur. The disclosure statement must be sent to OTSA at the address provided in the instructions for Form 8918 (or a successor form).

(f) *Designation agreements*. If more than one material advisor is required to disclose a reportable transaction under this section, the material advisors may designate by written agreement a single material advisor to disclose the transaction. The transaction must be disclosed by the last day of the month following the end of the calendar quarter that includes the earliest date on which a material advisor who is a party to the agreement became a material advisor with respect to the transaction as described in paragraph (b)(4) of this section. The designation of one material advisor to disclose the transaction does not relieve the other material advisors of their obligation to disclose the transaction to the IRS in accordance with this section, if the designated material advisor fails to disclose the transaction to the IRS in a timely manner.

(g) *Protective disclosures*. If a potential material advisor is uncertain whether a transaction must be disclosed under this section, the advisor may disclose the transaction in accordance with the requirements of this section and comply with all the provisions of this section, and indicate on the disclosure statement that the disclosure statement is being filed on a protective basis. The IRS will not treat disclosure statements filed on a protective basis any differently than other disclosure statements filed under this section. For a protective disclosure to be effective, the advisor must comply with the regulations under this section and §301.6112–1 by providing to the IRS all information requested by the IRS under these sections.

(h) *Rulings*. If a potential material advisor requests a ruling as to whether a specific transaction is a reportable transaction on or before the date that disclosure would otherwise be required under this section, the Commissioner in his discretion may determine that the submission satisfies the disclosure rules under this section for that transaction if the request fully discloses all relevant facts relating to the transaction which would otherwise be required to be disclosed under this section. The potential obligation of the person to disclose the transaction under this section (or to maintain or furnish the list under §301.6112–1) will not be suspended during the period that the ruling request is pending.

(i) *Effective/applicability date*—(1) *In general*. This section applies to transactions with respect to which a material advisor makes a tax statement on or after August 3, 2007. However, this section applies to transactions of interest entered into on or after November 2, 2006 with respect to which a material advisor makes a tax statement under §301.6111–3 on or after November 2, 2006. Paragraph (h) of this section applies to ruling requests received on or after November 1, 2006. Otherwise, the rules that apply with respect to transactions entered into before August 3, 2007 are contained in Notice 2004–80, 2004–2 C.B. 963; Notice 2005–17, 2005–1 C.B. 606; and Notice 2005–22, 2005–1 C.B. 756 (see §601.601(d)(2)(ii)(*b*) in effect prior to August 3, 2007.

(2) [*Reserved*].

§301.6111–3T [Removed]

Par. 3. Section 301.6111–3T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 25, 2007.

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

(Filed by the Office of the Federal Register on July 31, 2007, 11:22 a.m., and published in the issue of the Federal Register for August 3, 2007, F.R. 43157)

Section 6112.—Material Advisors of Reportable Transactions Must Keep Lists of Advisees, etc.

26 CFR 301.6112–1: Material advisors of reportable transactions must keep lists of advisees, etc.

T.D. 9352

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

AJCA Modifications to the Section 6112 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 6112 of the Internal Revenue Code that provide the rules relating to the obligation of material advisors to prepare and maintain lists with respect to reportable transactions. These regulations affect material advisors responsible for keeping lists under section 6112.

DATES: *Effective Date:* These regulations are effective August 3, 2007.

FOR FURTHER INFORMATION CONTACT: Charles D. Wien, Michael H. Beker, or Tolsun N. Waddle, 202–622–3070; (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this final regulation have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1686. Responses to these collections of information are mandatory. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number assigned by the Office of Management and Budget.

The estimated annual burden per recordkeeper for the collection of information in §301.6112–1 is 100 hours and the estimated number of recordkeepers is 500.

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

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

Background

This document contains final regulations that amend 26 CFR part 301 by amending the rules relating to the list maintenance requirements of material advisors with respect to reportable transactions under section 6112.

The American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418), (AJCA) was enacted on October 22, 2004. Section 815 of the AJCA amended section 6112 to provide that each material advisor (as defined in section 6111, as amended by the AJCA) with respect to any reportable transaction is required to maintain a list (in such manner as the Secretary may by regulations prescribe) identifying each person with respect to whom the advisor acted as a material advisor with respect to the transaction, and containing other information as the Secretary may by regulations require. Section 815 of the AJCA is effective for transactions with respect to which material aid, assistance, or advice is provided after October 22, 2004. Prior to the amendments to section 6111 made by the AJCA, the definition of material advisor was in §301.6112–1 of the Procedure and Administration Regulations.

On November 1, 2006, the IRS and Treasury Department issued a notice of proposed rulemaking and temporary and final regulations under sections 6011, 6111, and 6112 (REG–103038–05, 2006–49 I.R.B. 1049, REG–103039–05, 2006–49 I.R.B. 1057, REG–103043–05, 2006–49 I.R.B 1063, T.D. 9295, 2006–49 I.R.B. 1030) (the November 2006 regulations). The November 2006 regulations were published in the **Federal Register** (71 FR 64488, 71 FR 64496, 71 FR 64501, 71 FR 64458) on November 2, 2006.

The IRS and Treasury Department received written public comments responding to the proposed regulations and held a public hearing regarding the proposed rules on March 20, 2007. After consideration of the comments received and comments made at the hearing, the proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations but include some modifications based on recommendations in the public comments.

Summary of Comments and Explanation of Provisions

Furnishing of Lists

The proposed regulations provided that each material advisor must prepare and maintain a list for each reportable transaction. The proposed regulations also provided that each list must include three components: an itemized statement, a description of the transaction, and documents. Further, the proposed regulations provided that each material advisor responsible for maintaining a list must, upon written request by the IRS, make each component of the list available to the IRS by furnishing each component of the list to the IRS within 20 business days from the day on which the request is provided. The proposed regulations stated that each component of the list must be furnished to the IRS in a form that enables the IRS to determine without undue delay or difficulty the information required to be on the list. If any component of the list is not in such form, the material advisor will not be considered to have complied with the list maintenance provisions of section 6112 and the regulations thereunder.

Several commentators recommended that the proposed regulations should provide the IRS with flexibility to determine, based on the amount of information required, a production schedule that will be sufficient to avoid the imposition of penalties. Two commentators suggested providing a phased disclosure procedure. One commentator recommended that the 20 business days begin after the advisor had an adequate opportunity to gather the required information. Another commentator recommended amending the proposed regulations to provide a substantial compliance standard.

The IRS and Treasury Department believe that providing the IRS the ability to determine an alternative production schedule will benefit both taxpayers and the IRS. These final regulations remove the language regarding the period for furnishing a list or the components of the list to the IRS because that period will be addressed in forthcoming published guidance under section 6708. In addition, an alternative schedule for furnishing the list or the components of the list will be addressed in published guidance under section 6708.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that most of the information is already required to be reported under the current regulations; the clarifications and new information required by the final regulations add little or no new burden to the existing requirements. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, 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 authors of these regulations are Charles D. Wien, Michael H. Beker, and Tolsun N. Waddle, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6112–1 is revised to read as follows:

§301.6112–1 Material advisors of reportable transactions must keep lists of advisees, etc.

(a) *In general.* Each material advisor, as defined in §301.6111–3(b), with respect to any reportable transaction, as defined in §1.6011–4(b) of this chapter, shall prepare and maintain a list in accordance with paragraph (b) of this section and shall furnish such list to the Internal Revenue Service (IRS) in accordance with paragraph (e) of this section.

(b) *Preparation and maintenance of lists*—(1) *In general.* A separate list must be prepared and maintained for each reportable transaction. However, one list must be maintained for substantially similar transactions. A list must be maintained in a form that enables the IRS to determine without undue delay or difficulty the information required in paragraph (b)(3) of this section. The Commissioner in his discretion may provide in published guidance a form or method for maintaining and/or furnishing the list.

(2) *Persons required to be included on lists.* A material advisor is required to maintain a list identifying each person with respect to whom the advisor acted as a material advisor with respect to the reportable transaction. However, a material advisor is not required to identify a person on the list if the person entered into a listed transaction or a transaction of interest more than 6 years before the transaction was identified in published guidance as a listed transaction or a transaction of interest.

(3) *Contents.* Each list must include the three components described in paragraph (b)(3)(i), (ii), and (iii) of this section.

(i) *Statement.* An itemized statement containing the following information—

(A) The name of each reportable transaction, the citation to the published guidance number identifying the transaction if the transaction is a listed transaction or a transaction of interest, and the reportable transaction number obtained under section 6111;

(B) The name, address, and TIN of each person required to be included on the list;

(C) The date on which each person required to be included on the list entered into each reportable transaction, if known by the material advisor;

(D) The amount invested in each reportable transaction by each person required to be included on the list, if known by the material advisor;

(E) A summary or schedule of the tax treatment that each person is intended or expected to derive from participation in each reportable transaction; and

(F) The name of each other material advisor to the transaction, if known by the material advisor.

(ii) *Description of the transaction.* A detailed description of each reportable transaction that describes both the tax structure of the transaction and the purported tax treatment of the transaction.

(iii) *Documents.* The following documents—

(A) A copy of any designation agreement (as described in paragraph (f) of this section) to which the material advisor is a party; and

(B) Copies of any additional written materials, including tax analyses or opinions, relating to each reportable transaction that are material to an understanding of the purported tax treatment or tax structure of the transaction that have been shown or provided to any person who acquired or may acquire an interest in the transactions, or to their representatives, tax advisors, or agents, by the material advisor or any related party or agent of the material advisor. However, a material advisor is not required to retain earlier drafts of a document provided the material advisor retains a copy of the final document (or, if there is no final document, the most recent draft of the document) and the final document (or most recent draft) contains all the information in the earlier drafts of such document that is material to an understanding of the purported tax treatment or the tax structure of the transaction.

(c) *Definitions.* For purposes of this section, the following terms are defined as:

(1) *Material advisor.* The term *material advisor* is defined in §301.6111–3(b).

(2) *Reportable transaction.* The term *reportable transaction* is defined in §1.6011–4(b)(1) of this chapter.

(3) *Listed transaction.* The term *listed transaction* is defined in §1.6011–4(b)(2) of this chapter. See also §§20.6011–4(a), 25.6011–4(a), 31.6011–4(a), 53.6011–4(a), 54.6011–4(a), or 56.6011–4(a) of this chapter.

(4) *Substantially similar.* The term *substantially similar* is defined in §1.6011–4(c)(4) of this chapter.

(5) *Person.* The term *person* is defined in §301.6111–3(c)(4).

(6) *Related party.* A person is a related party with respect to another person if such person bears a relationship to such other person described in section 267(b) or 707(b).

(7) *Tax.* The term *tax* is defined in §301.6111–3(c)(6).

(8) *Tax benefit.* The term *tax benefit* is defined in §301.6111–3(c)(7).

(9) *Tax return.* The term *tax return* is defined in §301.6111–3(c)(8).

(10) *Tax structure.* The term *tax structure* is defined in §301.6111–3(c)(9).

(11) *Tax treatment.* The term *tax treatment* is defined in §301.6111–3(c)(10).

(12) *Transaction of interest.* The term *transaction of interest* is defined in §1.6011–4(b)(6) of this chapter. See also §§20.6011–4(a), 25.6011–4(a), 31.6011–4(a), 53.6011–4(a), 54.6011–4(a), or 56.6011–4(a) of this chapter.

(d) *Retention of lists.* Each material advisor must maintain each component of the list described in paragraph (b)(3) of this section in a readily accessible form for seven years following the earlier of the date on which the material advisor last made a tax statement relating to the transaction, or the date the transaction was last entered into, if known. If the material advisor required to prepare, maintain, and furnish the list is a corporation, partnership, or other entity (entity) that has dissolved or liquidated before completion of the seven-year period, the person responsible under state law for winding up the affairs of the entity must prepare, maintain and furnish each component of the list on behalf of the entity, unless the entity submits the list to the Office of Tax Shelter Analysis (OTSA) within 60 days after the dissolution or liquidation. If state law does not specify any person as responsible for winding up the affairs, then each of the directors of the corporation, the general partners of the partnership, or the trustees, owners, or members of the entity are responsible for preparing, maintaining and furnishing each component of the list on behalf of the entity, unless the entity submits the list to the OTSA within 60 days after the dissolution or liquidation. The responsible person must also provide notice to OTSA of such dissolution or liquidation within 60 days after the dissolution or liquidation. The list and the notice provided to OTSA must be sent to: Internal Revenue Service, OTSA Mail Stop 4915, 1973 North Rulon White Blvd., Ogden, Utah 84404, or to such other address as provided by the Commissioner.

(e) *Furnishing of lists*—(1) *In general*. Each material advisor responsible for maintaining a list must, upon written request by the IRS, make each component of the list described in paragraph (b)(3) of this section available to the IRS. Each component of the list must be furnished to the IRS in a form that enables the IRS to determine without undue delay or difficulty the information required in paragraph (b)(3) of this section. If any component of the list is not in a form that enables the IRS to determine without undue delay or difficulty the information required in paragraph (b)(3) of this section, the material advisor will not be considered to have complied with the list maintenance provisions in section 6112 and this section. A material advisor must make the list or each component of the list available to the IRS within the period prescribed in section 6708 or published guidance relating to section 6708.

(2) *Claims of privilege*. Each material advisor who is required to maintain a list with respect to a reportable transaction, must still maintain the list pursuant to the requirements of this section even if a person asserts a claim of privilege with respect to the information specified in paragraph (b)(3)(iii)(B) of this section.

(f) *Designation agreements*. If more than one material advisor is required to maintain a list of persons for a reportable transaction, in accordance with paragraph (b) of this section, the material advisors may designate by written agreement a single material advisor to maintain the list or a portion of the list. The designation of one material advisor to maintain the list does not relieve the other material advisors from their obligation to furnish the list to the IRS in accordance with paragraph (e)(1) of this section, if the designated material advisor fails to furnish the list to the IRS in a timely manner. A material advisor is not relieved from the requirement of this section because a material advisor is unable to obtain the list from any designated material advisor, any designated material advisor did not maintain a list, or the list maintained by any designated material advisor is not complete.

(g) *Effective/applicability date*. In general, this section applies to transactions with respect to which a material advisor makes a tax statement under §301.6111–3 on or after August 3, 2007. However, this section applies to transactions of interest entered into on or after November 2, 2006, with respect to which a material advisor makes a tax statement under §301.6111–3 on or after November 2, 2006. Otherwise, the rules that apply before August 3, 2007 are contained in §301.6112–1 in effect prior to August 3, 2007 (see 26 CFR part 301 revised as of April 1, 2007, and see also Notice 2004–80, 2004–2 C.B. 963; Notice 2005–17, 2005–1 C.B. 606; and Notice 2005–22, 2005–1 C.B. 756 (see §601.601(d)(2)(ii)(*b*) of this chapter).

Kevin M. Brown,
Deputy Commissioner for
Services and Enforcement.

Approved July 25, 2007.

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

(Filed by the Office of the Federal Register on July 31, 2007, 11:22 a.m., and published in the issue of the Federal Register for August 3, 2007, 72 F.R. 43154)

Section 6655.—Failure by Corporation to Pay Estimated Income Tax

26 CFR 1.6655–1: Addition to the tax in the case of a corporation.

T.D. 9347

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 301, and 602

Corporate Estimated Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance to corporations with respect to estimated tax requirements. These final regulations generally affect corporate taxpayers who are required to make estimated tax payments. These final regulations reflect changes to the law since 1984. This document also removes the section 6154 regulations.

DATES: *Effective date:* These regulations are effective on August 7, 2007.

Applicability date: These regulations apply to tax years beginning after September 6, 2007.

FOR FURTHER INFORMATION CONTACT: Timothy Sheppard, at (202) 622–4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1), the Procedure and Administration Regulations (26 CFR Part 301), and the OMB Control Numbers under the Paperwork Reduction Act Regulations (26 CFR Part 602) relating to corporate estimated taxes under section 6425 and section 6655 of the Internal Revenue Code (Code). This document also removes §§1.6154–1, 1.6154–2, 1.6154–3, 1.6154–4, 1.6154–5, and 301.6154–1. The IRS is removing the section 6154 regulations because Congress repealed section 6154 in 1987.

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

These regulations do not reflect changes made by the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222 (120 Stat. 345) (TIPRA), as amended by the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Act of 2007, Public Law 110–28 (121 Stat. 112), because TIPRA made temporary, targeted changes to the time and amount of any required installment otherwise due in September 2010 and September 2011. TIPRA also changed the amount of required installments in 2006, 2012, and 2013 for corporations with assets of not less than $1 billion. Although these changes are not reflected in these regulations, these and any further changes made in the Code supersede the rules in these regulations.

A notice of proposed rulemaking under section 6655 (REG–107722–00, 2006–1 C.B. 354) was published in the **Federal Register** (70 FR 73393) on December 12, 2005. The proposed regulations provide guidance on how to determine the amount of a corporation's estimated tax due with each quarterly installment. No requests for a public hearing were received, so the public hearing on the proposed regulations, scheduled for March 15, 2006, was cancelled. The IRS received written and electronic comments responding to the notice of proposed rulemaking. After consideration of all comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions and Summary of Comments

Section 6655 generally requires corporations to make quarterly estimated tax payments or be assessed an addition to tax for any underpayment. As a general rule, payments are due on the fifteenth day of the fourth, sixth, ninth, and twelfth months. Each quarterly payment must be at least twenty-five percent of the required annual payment in order to avoid an underpayment penalty. Generally, the required annual payment equals one hundred percent of the tax shown on the return for the current year tax, or for certain small taxpayers, the lesser of one hundred percent of the tax shown on the return for the current year tax or one hundred percent of the tax shown on the return for the preceding taxable year. Alternatively, corporations may elect to use an annualized income installment or an adjusted seasonal installment if less than the amount computed under the general rules.

1. *Comments Concerning §1.6655–1 (Addition to Tax in the Case of a Corporation) of the Proposed Regulations*

A. *Recapture of a tax credit not included in the definition of "tax"*

One commentator requested that the final regulations clarify that the recapture of a tax credit under Chapter 1 is not a section 11 tax and not included within the definition of tax for purposes of section 6655 unless there is authority that provides that the recaptured credit is treated as a tax imposed by section 11.

Revenue Ruling 78–257, 1978–1 C.B. 440, provides that the term *tax*, as defined in section 6655, includes the amount of tax resulting from the recomputation of a prior year's investment credit at the applicable rate for the current year. However, *Berkshire Hathaway, Inc. v. United States*, 802 F.2d 429 (Fed. Cir. 1986), held that, for purposes of the definition of tax under section 6655, the recapture tax under former section 47 was not a tax imposed by section 11. The Court concluded that because the taxpayer paid no tax imposed by section 11 in the preceding taxable year, that taxpayer was not subject to an addition to tax for failing to pay estimated tax in the current year under the former provision in section 6655(d)(2) that allowed a taxpayer to pay estimated tax in the current year based on the law applicable to (other than the rates), and the known facts of, the prior year's return. Based on the holding in *Berkshire Hathaway*, §1.6655–1(g)(1)(iii) of the final regulations provides that, unless otherwise provided in the Internal Revenue Code, for purposes of the definition of tax as used in section 6655, a recapture of tax, such as a recapture provided by section 50(a)(1)(A) and any other similar provision, is not considered to be a tax imposed by section 11. Therefore, Rev. Rul. 78–257 is removed. See §601.601(d)(2)(ii)(*b*).

B. *Tax rate changes for preceding year safe harbor*

Section 6655(d)(1)(B)(ii) allows taxpayers to determine their required annual payment based on 100 percent of the tax shown on the preceding year's return. Commentators suggested that the rule provided in §1.6655–1(g)(3) of the proposed regulations, which requires taxpayers to recompute the tax determined for the preceding taxable year based on the current year tax rates if the tax rates for the current year and the preceding year differ, is not authorized by section 6655. The commentators suggested that, prior to the effective date of its amendment in 1987, section 6655 allowed estimated tax payments to be based on the facts shown on the return for the preceding taxable year and the law applicable to that year but using the tax rates for the current taxable year. The commentators requested that the final regulations not adopt the rule provided in §1.6655–1(g)(3) of the proposed regulations.

Section 6655 no longer provides specific statutory authority to recompute tax determined for the preceding taxable year using the rates applicable to the current taxable year. Therefore, the final regulations do not adopt the rule provided in §1.6655–1(g)(3) of the proposed regulations.

C. *Return for the preceding taxable year*

One commentator requested that the final regulations clarify that the regulations adopt the holding in *Mendes v. Commissioner*, 121 T.C. 308 (2003). In *Mendes*, the Tax Court held that a tax return that is filed after the IRS issues a notice of deficiency is not a return for purposes of section 6654(d)(1)(B)(i). *Id.* at 324–325. *Mendes* cited *Evans Cooperage Co., Inc. v. United States*, 712 F.2d 199 (5th Cir. 1983), for the proposition that the purpose of the preceding year safe harbor is "to provide a predictable escape from any possible penalty liability [and this purpose] would be defeated if penalties for underpayment of estimated taxes during the year were based, not on the easily determinable amount reflected on the preceding year's return, but instead upon the ultimate tax liability, possibly determined by adverse tax audit, a year or so after the tax year for...which the estimated tax installments were paid." *Mendes*, 121 T.C. at 326 (quoting *Evans Cooperage*, 712 F.2d at 204). *Evans Cooperage* held that the statutory reference to "tax shown on the return of the corporation for the preceding taxable year" refers to the timely filed return for the preceding year, not to any later-filed amended return. *Evans Cooperage*, 712 F.2d at 204.

Section 1.6655–1(g)(2) of the proposed regulations provides that the reference in section 6655(d)(1)(B)(ii) to "return of the corporation of the preceding taxable year" includes the Federal income tax return as amended, only if an amended Federal income tax return has been filed before the due date for an installment. As long as a taxpayer has remaining estimated tax installment payments to make during the tax year and is basing the payments on the preceding year return, the remaining payments should be made based on the most recent information the IRS has on the preceding year return. This includes the information on an amended return for the preceding year filed before an installment due date. Section 1.6655–1(g)(2) of the final regulations retains this rule but clarifies that the term "return for the preceding taxable year" includes the Federal income tax return as amended only if filed before the applicable installment due date if an amended Federal income tax return is filed for the preceding taxable year. If an amended Federal income tax return is filed on or after an installment due date, then the term "return for the preceding taxable year" does not include that amended Federal income tax return with respect to the installments due prior to the time the amended Federal income tax return is filed. This rule applies regardless of whether the IRS issues a notice of deficiency prior to the filing of the amended Federal income tax return.

2. *Comments Concerning §1.6655–2 (Annualized Income Installment Method) of the Proposed Regulations*

As a general comment to the proposed regulations, one commentator noted that the estimated tax payment rules should strive to provide the most accurate picture of annualized taxable income based on facts known as of the end of an annualization period. The IRS and Treasury Department agree with this comment and recognize that treating an annualization period as a short taxable year does not necessarily result in an accurate estimate of annualized taxable income. The final regulations make it clear that taxpayers may not determine taxable income for an annualization period or an adjusted seasonal installment period as though the period is a short taxable year.

Consistent with the general rejection of a short taxable year approach, the final regulations recognize that certain types of items that are generally incurred once (or otherwise infrequently) during the taxable year or that are subject to special exceptions, should not be annualized because doing so would create a distortion in the estimate of annualized taxable income. This approach also recognizes that although distortions may occur in the annualization process due to general fluctuations in the timing of items of income and deductions incurred throughout the year, taxpayers should generally be permitted to rely on such annualized estimates to the extent the estimate is based upon information available to the taxpayer as of the end of the annualization period.

A commentator expressed concern that the rules provided in the proposed regulations were too mechanical and created traps for the unwary. In response to this comment, the final regulations provide rules which are intended to produce a reasonably accurate estimate of annualized taxable income for estimated tax purposes without imposing an undue compliance burden on taxpayers. Specifically, the final regulations address this general concern by allowing taxpayers to make a reasonably accurate allocation of certain items of income or expense. However, a taxpayer's annualized taxable income for estimated tax purposes is primarily based on items of income and expense recognized during the annualization period. Therefore, the annualization method is as inherently complex as computing taxable income.

A. *Reasonably accurate allocation*

Commentators noted that many of the rules provided in the proposed regulations with respect to economic performance and recurring expenses would create significant administrative burdens, result in similarly situated taxpayers being treated differently, and did not further the underlying goal of providing an accurate picture of annualized taxable income.

The final regulations do not retain the recurring expense rules provided in the proposed regulations. The final regulations provide special rules for specific items of deduction that are routinely incurred on an annual basis or for which a special exception to the general accounting rules exists. Given the nature of these items, applying the general annualization rules to these items could result in a significant distortion in the estimate of annualized taxable income. These items include real property tax deductions; employee and independent contractor bonus compensation deductions (including the employer's share of employment taxes related to such compensation); deductions under sections 404 (deferred compensation) and 419 (welfare benefit funds); items allowed as a deduction for the taxable year by reason of section 170(a)(2) and §1.170A–11(b) (certain charitable contributions by accrual method corporations), §1.461–5 (recurring item exception) or §1.263(a)–4(f) (12-month rule); and items of deduction designated by the Secretary by publication in the Internal Revenue Bulletin (IRB) (see §601.601(d)(2)(ii)(*b*)).

The final regulations require that these specified items of deduction be allocated in a reasonably accurate manner. The item of deduction that must be allocated in a reasonably accurate manner includes the total amount of the item of deduction recognized by the taxpayer during the taxable year regardless of whether the item is deemed to be paid or incurred during the taxable year as a result of events that occurred during the taxable year, after the taxable year, or both. While a reasonably accurate allocation may permit certain items to be recognized in an annualization period prior to being paid or incurred, an amount may only be taken into account to the extent the item of deduction is properly recognized by the taxpayer during the taxable year. Therefore, taxpayers will be subject to a section 6655 addition to tax for an underpayment of estimated tax if an underpayment results from a deduction the taxpayer expected to be incurred but was not ultimately recognized as a deduction by the taxpayer in the computation of taxable income for that year.

The final regulations provide that an allocation will be considered to be made in a reasonably accurate manner if the item is allocated ratably throughout the tax year. In addition, an allocation will be considered to be made in a reasonably accurate manner to the extent it provides a reasonable estimate of taxable income for the taxable year based upon the facts known as of the end of the annualization period. The final regulations provide a list of some relevant factors to be taken into consideration in determining whether an allocation provides a reasonable estimate of taxable income based upon facts known as of the end of the annualization period. The IRS and Treasury Department recognize that various allocations may be considered to be done in a reasonably accurate manner and intend for taxpayers to have flexibility in determining which allocation to use, particularly when use of a specific allocation reduces administrative burdens on the taxpayer. In general, allocations that are made with the intent to distort will not be considered to have been made in a reasonably accurate manner.

Many of the items of deduction which are required to be allocated in a reasonably accurate manner include items that may not have otherwise been allowed to be taken into account by taxpayers (for example, year-end bonus liabilities, items paid after year end) under the general annualization rules to the extent they were deemed to be incurred in the last quarter of the year. In this regard, the final regulations provide a measure of relief to taxpayers with respect to such items. The final regulations provide that the Secretary may designate in future IRB guidance additional items of deduction that are required to be allocated in a reasonably accurate manner. Taxpayers are encouraged to bring items to the attention of the IRS and Treasury Department that they believe should be allocated in a reasonably accurate manner rather than applying the general annualization rules.

Commentators requested that taxpayers be permitted to take the exceptions provided in section 170(a)(2) and §1.170A–11(b) (certain charitable contributions by accrual method corporations), §1.461–5 (recurring item exception) or §1.263(a)–4(f) (12-month rule) into account for purposes of determining items of expense incurred during an annualization period. As noted above, these exceptions frequently apply either to expenses paid annually or to expenses paid after the end of the taxable year. The specific rules and underlying intent of these exceptions do not easily translate to the concept of an annualization period. The final regulations provide that items of expense that utilize these exceptions will be considered to be properly taken into account if they are allocated among annualization periods in a reasonably accurate manner. Therefore, the final regulations permit taxpayers for estimated tax payment purposes to allocate throughout the tax year items of deduction recognized in the taxable year as a result of these exceptions to the extent the allocation is made in a reasonably accurate manner. The final regulations adopt this approach in order to reduce the complexity and burden associated with the computation of estimate taxes by allowing taxpayers to allocate these specific items of expense in a reasonably accurate manner while also preventing unintended distortions under the annualization method.

B. *Net operating loss deductions*

Several commentators addressed provisions in the proposed regulations requiring a net operating loss (NOL) deduction to be taken into account in computing an annualized installment after annualizing the taxable income for the annualization period. One commentator argued that economic performance with respect to an NOL carryover has already occurred and therefore, the NOL deduction should be taken into account in computing an annualized installment before annualizing the taxable income for the annualization period. Another commentator suggested that special rules be provided for extraordinary items such as NOL deductions noting the unique nature of such items. Comments were also received suggesting that NOL deductions should be treated the same as any other deduction.

NOL deductions are different from other items of deduction occurring throughout the year in that there is no anticipation that similar deductions will recur throughout the year or in future years. In this regard, NOL deductions are more like extraordinary items. Treating NOL deductions in the same manner as other recurring deductions would be inconsistent with attempting to provide a reasonably accurate picture of annualized taxable income and could result in a distorted estimate of annualized taxable income similar to the distortions created by the various techniques the regulations are intended to prevent. The final regulations treat a NOL deduction as an extraordinary item that is treated as occurring on the first day of the taxable year and is taken into account after annualization. As a result of the final regulations, Rev. Rul. 67–93, 1967–1 C.B. 366, is removed. See §601.601(d)(2)(ii)(*b*).

C. *Credit carryovers*

One commentator suggested that a credit carryover should be taken into account in computing an annualized installment before annualizing the taxable income for the annualization period because economic performance has occurred for the credit carryover. In general, taxpayers annualize components of a credit for the current taxable year to determine the amount of a credit because the credit is based on components for the current year. However, credit carryovers are generally based on the components for the entire year in which the credit arose. Therefore, the credit carryover already is computed based on annualized components for the year in which the credit arose. Because a credit carryover is based on annualized components, the final regulations provide that a credit carryover must be taken into account after determining the annualized tax and before taking into account the applicable percentage for the annualization period.

D. *Credits incurred in an annualization period and recaptured credits*

One commentator suggested that the final regulations provide that credits incurred in an annualization period are not annualized. The commentator suggested that annualization should be based on the underlying basis for the credit. The commentator also suggested that if a credit is based on an item that is annualized in computing the required installment for the annualization period, the amounts should be annualized in determining the amount of the credit. Finally, the commentator suggested that similar rules should apply to the recapture of credits that are included within the definition of tax.

Section 1.6655–2(f)(3)(iii) of the final regulations provides that the items upon which the credit is computed are annualized pursuant to the provisions of §1.6655–2(f)(1) and the amount of the credit is computed based on the annualized items. The amount of the credit is then deducted from the annualized tax. For example, for an annualization period consisting of three months in a full 12-month taxable year, the items upon which the credit is based that are taken into account for the three-month period are multiplied by four, the credit is determined, and the credit reduces the annualized tax. Reducing the annualized tax by a credit before taking into account the applicable percentage is consistent with the statutory definition of tax provided in section 6655(g)(1) and the annualized income installment method provided in section 6655(e). In order to clarify this rule, §1.6655–2(b)(1) of the final regulations provides that tax means tax after taking into account credits and before applying the applicable percentage. These rules generally do not apply to a credit recapture because, as discussed in heading 1A of the preamble, a credit recapture, such as a recapture provided by section 50(a)(1)(A), is not taken into account when determining the tax for an annualized income installment for purposes of section 6655.

E. *Depreciation and amortization expense*

One commentator requested clarification on the alternative method in §1.6655–2(f)(2)(v)(A) of the proposed regulations. The proposed regulations provide that a taxpayer may claim for an annualization period at least a proportionate amount of 50 percent of the taxpayer's estimated depreciation and amortization (depreciation) expense for the current taxable year attributable to assets that a taxpayer had in service on the last day of the preceding taxable year, that remain in service on the first day of the current taxable year, and that are subject to the half-year convention. Several commentators suggested that the regulations were not clear on how a taxpayer determines how much more than 50 percent may be used and requested that the final regulations provide criteria for making this determination.

Another commentator suggested that the general rule in §1.6655–2(f)(2)(v)(A) of the proposed regulations for taking into account depreciation was impractical for many taxpayers because of the administrative burdens associated with the computation of actual and expected depreciation expense. The commentator also suggested that the rule does not provide an alternative calculation methodology for assets subject to a convention other than the half-year convention or for intangible assets. The commentator requested that the final regulations provide alternative computation methodologies for all depreciable and amortizable assets and allow taxpayers to take into account section 179 deductions. The commentator also requested that the final regulations eliminate the alternative rule in §1.6655–2(f)(2)(v)(A) of the proposed regulations that allows taxpayers to take into account a proportionate amount of 50 percent of taxpayers' current year estimated depreciation expense. The commentator requested that instead the final regulations provide a safe harbor that allows taxpayers to claim a proportionate amount of 90 percent of the prior year depreciation expense for all assets placed in service in an earlier year.

By including the alternative rule in §1.6655–2(f)(2)(v)(A) of the proposed regulations, the IRS and Treasury Department intended to illustrate the minimum amount of depreciation a taxpayer is entitled to take for a taxable year. In response to the comments referenced above, the final regulations do not include the alternative method in §1.6655–2(f)(2)(v)(A) of the proposed regulations. The final regulations provide a general rule that permits taxpayers to estimate their annual depreciation expense and include a proportionate amount of such expense for annualization purposes. The final regulations also provide that, in determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, additional first-year depreciation deductions, and other similar events and provisions that, based on all the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current taxable year), are reasonably expected to occur or apply during the taxable year. The IRS and Treasury Department believe that prescribing special rules for depreciation is appropriate because unlike many other deductions, depreciation generally accrues ratably throughout the taxable year. Therefore, in contrast to the general annualization rules, the final regulations require depreciation expense to be taken into account ratably throughout the taxable year.

As an alternative to the general rule for depreciation expense, the final regulations provide two safe harbors. The first safe harbor requires taxpayers to take into account for an annualization period a proportionate amount of depreciation expense allowed for the taxable year from: (1) assets that were in service on the last day of the prior taxable year, are in service on the first day of the current taxable year, and have not been disposed of during the annualization period; (2) assets that were placed in service during the annualization period and have not been disposed of during that period; and (3) assets that were in service on the last day of the prior taxable year and that are disposed of during the annualization period. For purposes of additional first-year depreciation deductions, the final regulations provide that only a proportionate amount of the current year's additional first-year depreciation deduction to be taken into account in determining a taxpayer's taxable income for the taxable year is taken into account in computing taxable income for an annualization period. In addition, the final regulations provide that amounts that the taxpayer deducts under section 179 or any similar provision, are treated the same as additional first-year depreciation.

The second safe harbor included in the final regulations provides that a taxpayer may take into account a proportionate amount of 90 percent of its preceding year's depreciation that is taken on its Federal income tax return for the preceding taxable year. However, if the taxpayer's preceding taxable year is less than 12 months (a short taxable year), the amount of depreciation expense taken into account for the preceding taxable year must be put on an annualized basis. In addition, a taxpayer must use whatever depreciation safe harbor method it selects under §1.6655–2(f)(3)(iv)(B) of the final regulations for all depreciation deductions within the annualization period for the annualized income installment but may use a different depreciation method provided in §1.6655–2(f)(3)(iv) for each annualized income installment during the taxable year.

F. *Events arising after the installment due date*

One commentator requested that the final regulations include examples of events that would arise after the installment due date that would be considered reasonably unforeseeable to illustrate the rule provided in §1.6655–2(h) of the proposed regulations. In considering the request for more specific guidance as to what constitutes an unforeseeable event, the IRS and Treasury Department determined that providing relief for certain unforeseeable events would more appropriately be addressed through contemporaneous guidance. Furthermore, the unforeseeable event exception provided in the proposed regulations was inherently subjective and retaining such a rule would be difficult to administer. In addition, certain provisions in the final regulations allow events that occur after the end of an annualization period to be taken into account but only to the extent the anticipated events actually occur. Therefore, the final regulations do not retain the unforeseeable event exception as provided in §1.6655–2(h) of the proposed regulations.

The final regulations do permit taxpayers in specific circumstances to take into account transactions that are properly reflected in the taxpayer's return for a particular year to be taken into account for annualization purposes regardless of when the underlying event giving rise to the item occurs. For example, the final regulations permit taxpayers to defer income related to a transaction to which sections 1031 or 1033 may apply even if the replacement of property required under sections 1031 or 1033 has not occurred as of the end of an annualization period to the extent the taxpayer has a reasonable belief that qualifying replacement property will be acquired.

G. *Items that substantially affect taxable income but cannot be determined accurately by the installment due date*

Section 1.6655–2(g) of the proposed regulations provides that in determining the applicability of the annualized income installment method or the adjusted seasonal installment method, reasonable estimates may be made from existing data for items that substantially affect income if the amount of such items cannot be determined with reasonable accuracy by the installment due date. Examples of these items are the inflation index for taxpayers using the dollar-value LIFO (last-in, first-out) inventory method, intercompany adjustments for taxpayers that file consolidated returns, and the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year.

The IRS and Treasury Department believe that the language in §1.6655–2(g) of the proposed regulations could be misinterpreted and broadly applied to items to which the rule was not intended. The final regulations provide that §1.6655–2(g) applies only to the items specifically listed. These items include the inflation index for taxpayers using the dollar-value LIFO inventory method, adjustments required under section 263A, intercompany adjustments for taxpayers that file consolidated returns, the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year, section 199 computations, deferred gain under sections 1031 and 1033 that the taxpayer reasonably believes will be replaced with qualifying property, and to any other item specifically designated in guidance published in the Internal Revenue Bulletin.

H. *Taking into account a section 199 deduction*

Commentators requested clarification on how taxpayers using the annualized income installment method (or the adjusted seasonal installment method) should take into account a section 199 deduction. One commentator suggested that because the section 199 deduction is calculated based on income and expense items incurred during the taxable year and has some characteristics of a credit, the final regulations should treat a section 199 deduction as a credit. Commentators also suggested that the final regulations require taxpayers to annualize income and compute the section 199 deduction based on the annualized amount. Another commentator requested that the final regulations treat a section 199 deduction as an item that substantially affects taxable income but cannot be accurately determined by the installment due date. The commentator requested that the final regulations allow taxpayers to make a reasonable estimate of the section 199 deduction for purposes of determining the proportionate amount that should be taken into account in determining annualized taxable income.

Although the section 199 deduction is calculated based on income and expense items incurred during the taxable year, the section 199 deduction is a deduction and not a credit. Therefore, a section 199 deduction must be taken into account to reduce taxable income, not to reduce tax. Under the final regulations, a section 199 deduction is computed prior to annualizing the taxable income for the annualization period. However, in recognition that qualification for the section 199 deduction is restricted by various annual limitations that may not be known as of the end any specific annualization period, the final regulations provide that a section 199 deduction should be treated as an item that substantially affects taxable income but cannot be accurately determined by the installment due date. Therefore, the final regulations permit taxpayers to make a reasonable estimate of the section 199 deduction for purposes of determining the amount to be taken into account in determining annualized taxable income.

I. *Section 263A expenses*

One commentator suggested that the proposed regulations do not provide rules on how taxpayers should account for section 263A adjustments to compute annualized taxable income. The commentator requested that the final regulations not require taxpayers to compute an actual section 263A adjustment for an installment period because this computation would create a significant administrative burden for taxpayers. The commentator also requested that the final regulations provide simplifying rules that allow taxpayers to compute the section 263A adjustment for an installment period by multiplying the prior year's absorption ratio by the inventory on hand at the end of the annualization period or by estimating the annual adjustment and prorating it to each annualization period.

Section 263A expenses are added to the items covered by the rules provided in §1.6655–2(g) of the final regulations for items that substantially affect taxable income but cannot be accurately determined by the installment due date. Therefore, taxpayers may use reasonable estimates from existing data with respect to the amount of adjustments required under section 263A if that amount cannot be determined with reasonable accuracy by the installment due date.

J. *LIFO*

One commentator noted that although the proposed regulations provide simplifying rules to determine the internal inflation index for taxpayers using internal dollar-value LIFO inventory methods, the proposed regulations do not provide rules for taxpayers to determine an external inflation index under the inventory price index computation (IPIC) LIFO method. The commentator requested that the final regulations include a rule that allows taxpayers to determine an estimated external inflation index by multiplying the prior year inventory mix by the applicable inflation index for the annualization period. The commentator also requested that the final regulations include a rule that allows a taxpayer that elected to use final indices to use preliminary indices if the final indices for the appropriate month have not been published. The dollar-value LIFO inventory method includes the use of external indexes, such as the IPIC LIFO method, as well as internal indexes. Therefore, the IRS and Treasury Department do not believe that a separate rule is necessary for the use of external inflation indexes.

K. *Advance payment*

One commentator noted that the proposed regulations do not address how a taxpayer who defers revenue either under §1.451–5(c) or Rev. Proc. 2004–34, 2004–1 C.B. 991, should account for an advance payment to determine annualized taxable income. Section 1.451–5(c) and Rev. Proc. 2004–34 generally allow a taxpayer to defer recognition of a qualifying advance payment for a limited time but only to the extent that financial statements also defer recognition of the income. The commentator requested that the final regulations include a rule that allows a taxpayer using the deferral method under §1.451–5(c) or Rev. Proc. 2004–34 to not recognize an advance payment as income in the annualization period until the advance payment is recognized in the taxpayer's applicable financial statements for the annualization period. The commentator also requested that the final regulations allow a taxpayer using a deferral method to recognize any portion of an advance payment on the last day of the taxable year in which the advance payment is required to be recognized under §1.451–5(c) or Rev. Proc. 2004–34, if that portion of the advance payment is not recognized in the taxpayer's financial statements for any of the annualization periods arising within the limited time provided in §1.451–5(c) or Rev. Proc. 2004–34. See §601.601(d)(2)(ii)(*b*).

The IRS and Treasury Department agree with the commentator that the final regulations should specifically address advance payments and that the rule should be consistent with §1.451–5 and Rev. Proc. 2004–34. Pursuant to §1.6655–2(f)(3)(i)(A) of the final regulations, if the taxpayer uses the method of accounting provided in §1.451–5(b)(1)(ii) for an advance payment, the advance payment is includible in computing taxable income under that method of accounting except that, if §1.451–5(c) applies, any amount not included in computing taxable income by the end of the second taxable year following the year in which a substantial advance payment is received, and not previously included in accordance with the taxpayer's accrual method of accounting, is includible in computing taxable income on the last day of such second taxable year. In addition, §1.6655–2(f)(3)(i)(B) of the final regulations provides that if the taxpayer uses the deferral method provided in section 5.02 of Rev. Proc. 2004–34 for an advance payment, the advance payment is includible in computing taxable income under that method of accounting for annualization purposes. But any amount not included in computing taxable income by the end of the taxable year succeeding the taxable year of receipt is includible in computing taxable income on the last day of such succeeding taxable year. The final regulations provide an example involving an advance payment.

L. *Extraordinary items*

One commentator suggested that the final regulations provide special treatment for extraordinary items for purposes of computing annualized taxable income and suggested that the regulations consider the extraordinary items listed in §1.1502–76(b)(2)(ii)(C). The commentator requested that the final regulations not require taxpayers to take into account extraordinary items under the general rules of §1.6655–2(f) of the proposed regulations because doing so would result in a distortion of annualized taxable income. The commentator requested that extraordinary items be taken into account after annualizing taxable income. The commentator requested that the final regulations provide that taxpayers begin to account for extraordinary items in the annualization period in which the extraordinary event occurs or, alternatively, in the annualization period in which it becomes reasonably foreseeable that the extraordinary event will occur. The commentator also requested that the final regulations provide an exclusive list of extraordinary items by referring to the list of extraordinary items in §1.1502–76(b)(2)(ii)(C) with certain modifications.

The IRS and Treasury Department agree with the commentator that the annualization of extraordinary items could result in a distortion of annualized taxable income. The final regulations include a list of extraordinary items similar to the items in §1.1502–76(b)(2)(ii)(C). Included in the list of extraordinary items in the final regulations are NOL deductions and section 481(a) adjustments. In addition, the final regulations also provide a *de minimis* rule wherein only extraordinary items in excess of $1,000,0000 will be required to be accounted for after annualizing taxable income. However, this *de minimis* rule does not apply to NOL deductions and section 481(a) adjustments.

M. *Section 481(a) adjustments*

The rule in §1.6655–2(f)(2)(iv) of the proposed regulations provides that a taxpayer takes into account a section 481(a) adjustment related to an automatic accounting method change during an annualization period only if a copy of the Form 3115, *"Application for Change in Accounting Method"*, has been mailed to the IRS National Office on or before the last day of the annualization period. One commentator suggested that the rule provided by §1.6655–2(f)(2)(iv) of the proposed regulations creates administrative burdens for taxpayers, is inconsistent with the depreciation and amortization rules provided in §1.6655–2(f)(2)(v) of the proposed regulations, and could result in the filing of incomplete Forms 3115. The commentator suggested that the rule in §1.6655–2(f)(2)(iv)(B)(*1*) of the proposed regulations causes an administrative burden by requiring taxpayers to recompute taxable income using a different method of accounting than would be used to calculate taxpayers' tax provision for financial accounting purposes, which generally allows taxpayers to take into account section 481(a) adjustments for an automatic accounting method change if they anticipate that the change will be timely filed. The commentator also suggested that if the final regulations adopt the rule in §1.6655–2(f)(2)(v) of the proposed regulations that allows taxpayers to anticipate capital expenditures to estimate depreciation expense for an annualization period, the final regulations should provide a similar rule for automatic accounting method changes by allowing taxpayers to take into account section 481(a) adjustments resulting from anticipated filings for automatic accounting method changes.

The final regulations provide that, in general, any section 481(a) adjustment that results from a change in accounting method that is approved by the Commissioner and properly reflected in the taxpayer's return for the tax year is taken into account as an extraordinary item deemed to occur on the first day of the tax year for annualization purposes. The final regulations provide that a section 481(a) adjustment may be taken into account in this manner notwithstanding (i) the annualization period in which the Form 3115 is filed (including requests filed after year-end), (ii) whether the requested change in accounting method is considered an automatic or non-automatic accounting method change request, (iii) whether the section 481(a) adjustment is positive or negative, and (iv) the date on which the taxpayer receives the approval of the Commissioner. In allowing for a section 481(a) adjustment to be taken into account in this manner, taxpayers should be aware that they will be subject to a section 6655 addition to tax for an underpayment of estimated tax in an installment period caused from taking into account a section 481(a) adjustment the taxpayer expected to be incurred but for which the taxpayer does not receive the consent of the Commissioner to change its method of accounting for that particular tax year. The final regulations also provide an exception to the general rule. Under the exception a taxpayer may choose to treat the filing of a Form 3115 as the date on which the extraordinary item is deemed to occur rather than the first day of the tax year but only with respect to the section 481(a) adjustment (or a portion thereof) that is recognized in the year of change. Use of this exception will impact the period in which the taxpayer will be required to take into account the new method of accounting as provided in §1.6655–6.

N. *Simplify the 52/53 week taxable year rules*

One commentator suggested that the 52/53 week taxable year rules provided by §1.6655–2(e) of the proposed regulations are too complex and administratively burdensome. The commentator suggested that the final regulations not include the 52/53 week taxable year rules in §1.6655–2(e) of the proposed regulations and rely on the general concept of annualization. The commentator suggested that taxpayers with 52/53 week taxable years under section 441(f) know how to annualize their applicable annualization period without the rules provided by §1.6655–2(e) of the proposed regulations.

The purpose of the annualized income installment method is to give taxpayers a method of determining annualized income based on the actual facts that occur in the annualization period. Therefore, with limited exceptions, the IRS and Treasury Department drafted the proposed regulations and these final regulations to provide rules that only allow taxpayers to take into account items of income and expense that arise in the applicable annualization period. The IRS and Treasury Department recognize that the 52/53 week taxable year rules provided by §1.6655–2(e) of the proposed regulations are complex. Although the final regulations retain the 52/53 week taxable year rules provided by §1.6655–2(e) of the proposed regulations, the final regulations also provide a safe harbor that allows a taxpayer with a 52/53 week taxable year to determine its annualization period on the month that ends closest to the end of its applicable thirteen-week period or four-week period that ends within the applicable annualization period. However, an eligible taxpayer may only use this safe harbor if it is used for determining annualization periods for all required installments for the taxable year.

O. *Controlled foreign corporations, partnerships, and other pass-through entities*

One commentator suggested that the final regulations provide rules on how taxpayers should take into account distributions from a section 936 corporation or a controlled foreign corporation to determine annualized taxable income for an installment period. The commentator also suggested that the final regulations provide rules on how taxpayers should take into account a distributive share of income from passthrough entities other than partnerships, such as trusts, S corporations, and real estate investment trusts (REITs), to determine annualized taxable income for an installment period. The commentator requested that the final regulations expand the scope of §1.6655–2(f)(2)(vi) of the proposed regulations to incorporate the statutory provisions for section 936(h), section 951(a), and closely held REITs, and also provide rules to take into account the distributive share of income received from other types of passthrough entities.

Section 1.6655–2(f)(3)(v) of the final regulations expands the rule in §1.6655–2(f)(2)(vi) of the proposed regulations to provide for the statutory rules in section 6655(e)(4) and section 6655(e)(5) for taking into account subpart F income, income under section 936(h), and dividends received by closely held REITs when computing any annualized income installment. In addition, §1.6655–2(f)(3)(v)(D) adds a rule that requires items from passthrough entities other than partnerships and closely held REITs to be taken into account in computing any annualized income installment in a manner similar to the manner under which partnership items are taken into account under §1.6655–2(f)(3)(v)(A) of the final regulations.

3. *Comments Concerning §1.6655–3 (Adjusted Seasonal Installment Method) of the Proposed Regulations*

A. *Adjusted seasonal installment method and alternative minimum tax*

One commentator suggested that the determination of whether a corporation qualifies for the adjusted seasonal installment method under section 6655(e)(3), and the amount of the required installment under this method, is based only on the corporation's taxable income and tax on that taxable income. The commentator requested that the final regulations clarify that a corporation using the adjusted seasonal installment method is only required to make estimated tax payments with respect to taxable income and tax on that taxable income, and not on the alternative minimum tax (AMT) or any other tax. Any required installment must include AMT because AMT is included in the definition of tax in section 6655(g)(1) and §1.6655–1(g)(1) of the final regulations. Including AMT in the determination of tax is consistent with the general annualization method and adjusted seasonal installment method and recognizes the overall separate and parallel nature of the AMT. Therefore, §1.6655–3(d)(4) of the final regulations provides that the amount of an installment determined using the adjusted seasonal installment method must properly take into account the amount of any AMT under section 55 that would apply for the period of the computation. For this purpose, the amount of any AMT that would apply is determined by applying to alternative minimum taxable income, tentative minimum tax, and AMT, the rules provided in §1.6655–3(c) of the final regulations for determining the amount of an installment using the adjusted seasonal installment method.

B. *Adjusted seasonal installment method base period percentage*

Section 6655(e)(3)(D)(i) provides that the base period percentage for any period of months is the average percent that the taxable income for the corresponding months in each of the 3 preceding taxable years bears to the taxable income for the 3 preceding taxable years. One commentator requested that the final regulations clarify whether the base period percentage provided in §1.6655–3(d)(1) of the proposed regulations can be negative.

The rule provided in section 6655(e)(3)(D)(i) requires that the base period percentage be computed based on taxable income. The rule does not provide that taxpayers take into account a loss. Therefore, a taxpayer can never have a negative base period percentage. The lowest number the base period percentage can equal is zero. Section 1.6655–3(d)(1) of the final regulations provides that the base period percentage is computed based on taxable income, which the IRS and Treasury Department believe provides a clear rule that an overall loss for the applicable period of months used to calculate the base period percentage cannot be used to compute the base period percentage. If a taxpayer has an overall loss for an applicable period of months used in the computation of the base period percentage, the taxpayer must use zero in place of the loss.

4. *Comments Concerning §1.6655–4 (Large Corporations) of the Proposed Regulations*

A. *Section 381 transactions to determine large corporation status*

One commentator requested that the final regulations modify the rules in §1.6655–4(c)(2) of the proposed regulations to clarify that, when computing taxable income for a year in which there is a section 381 transaction to determine if a corporation is a large corporation, the adjustment for the section 381 transaction relates only to the portion of taxable income applicable to the transferred assets.

Generally, for a transaction to qualify under section 381, an acquiring corporation must acquire a majority of the assets of the acquired corporation. Section 1.6655–4(c)(2) of the proposed regulations provides that when determining if a corporation is a large corporation for a taxable year in which a section 381 transaction occurs, an acquiring corporation must include in its income the distributor or transferor corporation's income for the taxable year up to and including the date of distribution or transfer. This rule requires the acquiring corporation to include 100 percent of the distributor or transferor corporation's taxable income (or loss) in the acquiring corporation's income even if the acquiring corporation acquires less than 100 percent of the assets of the distributor or transferor corporation as long as section 381 applies to the transaction. The final regulations do not include a rule providing that the adjustment for a section 381 transaction relates only to the portion of taxable income applicable to the transferred assets when computing taxable income for a year in which there is a section 381 transaction to determine if a corporation is a large corporation. The IRS and Treasury Department believe that such a rule would be unnecessarily complex considering that the rule in the proposed regulations is both taxpayer favorable (if there are losses of the distributor or transferor corporation) and taxpayer unfavorable (if there is taxable income of the distributor or transferor corporation) and considering that in these transactions, the acquiring corporation generally acquires a majority of the distributor or transferor corporation's assets. However, §1.6655–4(c)(2)(i)(B) of the final regulations amends §1.6655–4(c)(2)(i)(B) of the proposed regulations to clarify that an acquiring corporation takes into account the distributor or transferor corporation's taxable income or loss for purposes of determining whether a corporation is a large corporation for a taxable year in which a section 381 transaction occurs.

B. *Aggregation*

One commentator suggested that the rule provided by §1.6655–4(d)(2) of the proposed regulations, which does not allow taxpayers to take into account a taxable loss of a member of a controlled group of corporations for a taxable year during the testing period, results in a distorted view of the taxable income of the controlled group of corporations. The commentator requested that the final regulations modify the rule in §1.6655–4(d)(2) of the proposed regulations to allow taxpayers to take into account losses of a member of a controlled group of corporations when determining whether a corporation is considered a large taxpayer because this is consistent with the principles for the computation of consolidated taxable income.

Section 6655(g)(2)(B)(ii) requires that the $1,000,000 exemption be divided among members of a controlled group under rules similar to the rules of section 1561. The purpose of the statute is to limit members of a controlled group, as an aggregate, to $1,000,000 of exemption from large corporation treatment. The aggregation rule in §1.6655–4(d)(2) is intended to allow a controlled group to quickly determine whether the controlled group must allocate the $1,000,000 limitation among the members of the group. It is not intended to treat the controlled group as a single taxpayer, in which all members of the group will be treated as a large corporation, if the taxable income of the controlled group, as an aggregate, is over $1,000,000. Thus, for example, if member A of a controlled group had taxable income of $900,000 and member B of the group had taxable income greater than $1,000,000, the controlled group could choose to allocate $900,000 to member A so that member A will not be treated as a large corporation, but member B would be treated as a large corporation no matter how much of the $1,000,000 limitation is allocated to member B. This is consistent with the rules under section 1561.

5. *Comments Concerning §1.6655–5 (Short Taxable Years) of the Proposed Regulations*

A. *Taxpayer's initial taxable year*

One commentator noted that a taxpayer is not required to choose its taxable year until it files a tax return on its chosen basis in accordance with §1.441–1(c)(1). The commentator requested that the final regulations modify the rule in §1.6655–5(c)(1)(ii) of the proposed regulations to provide that a taxpayer will not be penalized if, in its initial taxable year, it makes estimated tax payments based on a presumption that the taxpayer will have a taxable year that is a calendar year even if the taxpayer subsequently chooses a fiscal year.

Because a taxpayer has until the date it files its initial tax return to choose its taxable year, the final regulations modify the rule in §1.6655–5(c)(1)(ii) of the proposed regulations to allow a taxpayer with an initial short taxable year to make estimated tax payments as though it chose to be a calendar year taxpayer until the taxpayer files its return for its initial short taxable year. Pursuant to this modified rule, a taxpayer with an initial short taxable year may make estimated tax payments as though it were a calendar year taxpayer until it files its tax return for its initial taxable year.

B. *Taxpayer's final taxable year*

One commentator suggested that §§1.6655–5(d)(1), 1.6655–5(d)(2), and 1.6655–5(d)(3) of the proposed regulations provide rules that may require taxpayers with short taxable years to make installment payments based on an applicable percentage that is more than the standard 25 percent per installment period. The commentator suggested that these rules may result in a section 6655 addition to tax being imposed on a taxpayer who makes annualization payments based on 25 percent of its annualized tax and later in the year discovers that, due to an unforeseen termination of its tax year, it should have made its annualization payments based on a higher applicable percentage because it will have fewer than four installment payments. The commentator also suggested that the rule in §1.6655–2(h) of the proposed regulations, which addresses events arising after an installment due date that were not reasonably foreseeable, does not appear to protect a taxpayer that makes an installment payment based on 25 percent of its annualized tax and later discovers that it should have based its installment payment on a higher applicable percentage because it had an unforeseen termination of its tax year resulting in a short taxable year. The commentator requested that the final regulations revise the rules in §§1.6655–5(d)(1), 1.6655–5(d)(2), and 1.6655–5(d)(3) of the proposed regulations so that payments made for an installment period in a short taxable year do not exceed 25 percent. As an alternative, the commentator requested that the final regulations revise the rules in §1.6655–2(h) of the proposed regulations to allow a taxpayer with an unexpected termination of its tax year to make a payment with its final required installment equal to the remaining portion of 100 percent of its required annual payment to avoid a penalty on its earlier required installments.

A taxpayer should not be penalized for making payments based on the applicable percentage of 25 percent for each installment period when it does not know that it will have an early termination year that will result in it making less than four installment payments. Therefore, §1.6655–5(d)(4) of the final regulations provides a rule addressing the applicable percentage for an installment period in which the taxpayer does not reasonably expect that the taxable year will be an early termination year. In the case of any required installment determined under section 6655(e) in which the taxpayer does not know that the taxable year will be an early termination year, the applicable percentage under section 6655(e)(2)(B)(ii) and §1.6655–5(d)(3)(i) of the final regulations is the applicable percentage for each installment period with the remaining balance of the estimated tax payment for the year due with the final installment.

C. *Internal Revenue Manual provisions and annualizing taxable income in an initial or final taxable year*

One commentator noted that Internal Revenue Manual Part 20.1.3.6.3(2) provides that a corporation filing a short period return that is either an initial or final return is not required to annualize its taxable income to compute the penalty. The commentator requested that the final regulations clarify this rule.

The rule in IRM 20.1.3.6.3(2) provides that if a taxpayer has a short taxable year that is either an initial or final year, the taxpayer should not annualize its taxable income based on a full 12 month period. Instead, the taxpayer should annualize its taxable income based on the number of months in the short taxable year. This rule was intended to be provided in §1.6655–5(g)(2) of the proposed regulations. However, the computational rule in §1.6655–5(g)(2) of the proposed regulations is incorrect and does not result in the computation of the correct amount for every installment payment during a short taxable year. The final regulations revise the rule in §1.6655–5(g)(2) of the proposed regulations to provide that a taxpayer computes its annualized income installment by determining the tax on the basis of the annualized income for the annualization period, dividing the resulting tax by 12, multiplying that result by the number of months in the short taxable year, and finally multiplying that result by the applicable percentage for the annualized income installment. The final regulations also revise an example to reflect the new computational rule.

D. *Preceding taxable year rule for large corporations when the preceding taxable year is a short year*

One commentator suggested that the rule provided in §1.6655–5(h) of the proposed regulations, which requires taxpayers to compute the preceding year tax on an annual basis if the preceding taxable year was a short taxable year when using section 6655(d)(2) to determine their first installment, is not authorized by section 6655. Consistent with §1.6655–1(g)(3), the final regulations do not adopt the rule provided in §1.6655–5(h) of the proposed regulations.

6. *Change in method of accounting*

The rule in §1.6655–6(b) of the proposed regulations provides that if a taxpayer is making a change in method of accounting for the current taxable year that is permitted to be made with the automatic consent of the Commissioner, the new method is used in determining any required installment if, and only if, a copy of the Form 3115 has been mailed to the IRS National Office on or before the last day of the annualization period. One commentator suggested that the rule provided by §1.6655–6(b) of the proposed regulations creates administrative burdens for taxpayers, is inconsistent with the depreciation and amortization rules provided in §1.6655–2(f)(2)(v) of the proposed regulations, and could result in the filing of incomplete Forms 3115. The commentator suggested that the rule in §1.6655–6(b) of the proposed regulations causes an administrative burden by requiring taxpayers to recompute taxable income using a different method of accounting than would be used to calculate taxpayers' tax provision for financial accounting purposes, which generally allows taxpayers to take into account an automatic accounting method change if they anticipate that the change will be timely filed.

Consistent with the rules for section 481(a) adjustments as discussed in heading (2)(M) above, the final regulations require a taxpayer to take into account any change in method of accounting for which the taxpayer has received the consent of the Commissioner in the same manner the taxpayer chooses to treat the section 481(a) adjustment resulting from such a change (for example, as of the first day of the taxable year or as of the date the Form 3115 was filed). For a change in accounting method that does not result in a section 481(a) adjustment, the final regulations provide that in the year of change the taxpayer will have the choice for annualization purposes to either use the new method as of the first day of the taxable year or as of the date the Form 3115 was filed.

Effect on Other Documents

The following publications are obsolete for tax years beginning after September 6, 2007:

Revenue Ruling 67–93, 1967–1 C.B. 366.

Revenue Ruling 76–450, 1976–2 C.B. 444.

Revenue Ruling 78–257, 1978–1 C.B. 440.

Revenue Ruling 67–93, 1967–1 C.B. 366, provides that the entire amount of a net operating loss carryover should be deducted from income prior to annualization under the annualized income installment method. The rationale underlying the conclusion in Rev. Rul. 67–93 was based on the position that each annualization period should be treated as a short taxable year. The final regulations specifically provide that an annualization period is not treated as a short taxable year. Therefore, Rev. Rul. 67–93 will be removed when the final regulations are effective.

Revenue Ruling 76–450, 1976–2 C.B. 444, provides that state property tax and franchise tax are deductible from the income for an annualization period on the date the taxpayer accrues the taxes under the taxpayer's method of accounting. Revenue Ruling 76–450 was issued prior to the enactment of section 461(h) and does not take into account the application of the economic performance requirements of section 461(h) for purposes of computing an estimated tax payment using the annualized income installment method. The final regulations provide specific rules related to address the application of section 461(h) and real property taxes for purposes of the annualized income installment method. As a result of the rules provided in the final regulations, Rev. Rul. 76–450 is no longer applicable and will be removed when the final regulations are effective. See §601.601(d)(2)(ii)(*b*).

Revenue Ruling 78–257, 1978–1 C.B. 440, provides that the term tax, as defined in section 6655, includes the amount of tax resulting from the recomputation of a prior year's investment credit at the applicable rate for the current year. In Rev. Rul. 78–257, a corporation incurred a net operating loss in 1975 but showed an amount of tax from the recomputation of the prior year's investment credit. For 1976 the corporation had a liability for income tax but made no deposits of estimated tax, relying on the former provision in section 6655 that allowed a taxpayer to base its estimated tax payments on an amount equal to the tax computed at the rates applicable to the taxable year but otherwise on the basis of the facts shown on the return of the corporation for, and the law applicable to, the preceding taxable year. The revenue ruling concludes that the corporation was subject to an addition to tax for the underpayment of estimated tax because it failed to pay on or before the prescribed installment due dates an amount equal to the tax resulting from the recomputation of the prior year's investment credit. However, as discussed in heading (1)(A) of the preamble, based on the holding in *Berkshire Hathaway, Inc. v. United States*, 802 F.2d 429 (Fed. Cir. 1986), §1.6655–1(g)(1)(iii) of the final regulations provides that, unless otherwise provided, for purposes of the definition of *tax* as used in section 6655, a recapture of tax, such as a recapture provided by section 50(a)(1)(A) and any other similar provision, is not considered to be a tax imposed by section 11. Therefore, Rev. Rul. 78–257 is no longer applicable and will be removed when the final regulations are effective. See §601.601(d)(2)(ii)(*b*).

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

Drafting Information

The principal authors of these regulations are Joseph P. Dewald, formerly of the Office of Associate Chief Counsel (Procedure and Administration), and Timothy S. Sheppard, Office of Associate Chief Counsel (Procedure and Administration).

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

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

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

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

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

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

* * * * *

(e) * * *

(5) Effective/applicability date.

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

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

* * * * *

(e) * * *

(4) *Estimating the book income adjustment for purposes of the estimated tax liability*. See §1.6655–7, as contained in 26 CFR part 1 revised as of April 1, 2007, for special rules for estimating the corporate alternative minimum tax book income adjustment under the annualization exception.

(5) *Effective/applicability date*. Paragraph (e)(4) of this section is applicable for taxable years beginning after September 6, 2007.

§§1.6154–1, 1.6154–2, 1.6154–3, 1.6154–4, and 1.6154–5 [Removed]

Par. 4. Sections 1.6154–1, 1.6154–2, 1.6154–3, 1.6154–4, and 1.6154–5 are removed.

Par. 5. Section 1.6425–2(a) is revised and paragraph (c) is added to read as follows:

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

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

(1) The sum of—

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

(ii) The tax imposed by section 55; over

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

* * * * *

(c) *Effective/applicability date*. Paragraph (a) of this section is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after September 6, 2007.

Par. 6. Section 1.6425–3 is amended by revising paragraph (f) to read as follows:

§1.6425–3 Allowance of adjustments.

* * * * *

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

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

(3) *Effective/applicability date*: This paragraph (f) is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after September 6, 2007.

Par. 7. Section 1.6655–0 is added to read as follows:

§1.6655–0 Table of contents.

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

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

(a) In general.

(b) Amount of underpayment.

(c) Period of the underpayment.

(d) Amount of required installment.

(1) In general.

(2) Exception.

(e) Large corporation required to pay 100 percent of current year tax.

(1) In general.

(2) May use last year's tax for first installment.

(f) Required installment due dates.

(1) Number of required installments.

(2) Time for payment of installments.

(i) Calendar year.

(ii) Fiscal year.

(iii) Short taxable year.

(iv) Partial month.

(g) Definitions.

(h) Special rules for consolidated returns.

(i) Overpayments applied to subsequent taxable year's estimated tax.

(1) In general.

(2) Subsequent examinations.

(j) Examples.

(k) Effective/applicability date.

§1.6655–2 Annualized income installment method.

(a) In general.

(b) Determination of annualized income installment—in general.

(c) Special rules.

(1) Applicable percentage.

(2) Partial month.

(3) Annualization period not a short taxable year.

(d) Election of different annualization periods.

(e) 52–53 week taxable year.

(f) Determination of taxable income for an annualization period.

(1) In general.

(i) Items of income.

(ii) Items of deduction.

(iii) Losses.

(2) Certain deductions required to be allocated in a reasonably accurate manner.

(i) In general.

(ii) Application of the reasonably accurate manner requirement to certain charitable contributions, recurring items, and 12-month rule items.

(iii) Reasonably accurate manner defined.

(iv) Special rule for certain real property tax liabilities.

(v) Examples.

(3) Special rules.

(i) Advance payments.

(A) Advance payments under §1.451–5(b)(1)(ii).

(B) Advance payments under Rev. Proc. 2004–34.

(ii) Extraordinary items.

(A) In general.

(B) *De minimis* extraordinary items.

(C) Special rules for net operating loss deductions and section 481(a) adjustments.

(iii) Credits.

(A) Current year credits.

(B) Credit carryovers.

(iv) Depreciation and amortization.

(A) Estimated annual depreciation and amortization.

(B) Safe harbors.

(*1*) Proportionate depreciation allowance.

(*2*) 90 percent of preceding year's depreciation.

(*3*) Safe harbor operational rules.

(C) Short taxable years.

(v) Distributive share of items.

(A) Member of partnership.

(B) Treatment of subpart F income and income under section 936(h).

(*1*) General rule.

(*2*) Prior year safe harbor.

(*i*) General rule.

(*ii*) Special rule for noncontrolling shareholder.

(C) Dividends from closely held real estate investment trust.

(*1*) General rule.

(*2*) Closely held real estate investment trust.

(D) Other passthrough entities.

(vi) Alternative minimum taxable income exemption amount.

(vii) Examples.

(g) Items that substantially affect taxable income but cannot be determined accurately by the installment due date.

(1) In general.

(2) Example.

(h) Effective/applicability date.

§1.6655–3 Adjusted seasonal installment method.

(a) In general.

(b) Limitation on application of section.

(c) Determination of amount.

(d) Special rules.

(1) Base period percentage.

(2) Filing month.

(3) Application of the rules related to the annualized income installment method to the adjusted seasonal installment method.

(4) Alternative minimum tax.

(e) Example.

(f) Effective/applicability date.

§1.6655–4 Large corporations.

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

§1.6655–5 Short taxable year.

(a) In general.
(b) Exception to payment of estimated tax.
(c) Installment due dates.
(1) In general.
(i) Taxable year of at least four months but less than twelve months.
(ii) Exceptions.
(2) Early termination of taxable year.
(i) In general.
(ii) Exception.
(d) Amount due for required installment.
(1) In general.
(2) Tax shown on the return for the preceding taxable year.
(3) Applicable percentage.
(4) Applicable percentage for installment period in which taxpayer does not reasonably expect that the taxable year will be an early termination year.
(e) Examples.
(f) 52 or 53 week taxable year.
(g) Use of annualized income or seasonal installment method.
(1) In general.
(2) Computation of annualized income installment.
(3) Annualization period for final required installment.
(4) Examples.
(h) Effective/applicability date.

§1.6655–6 Methods of accounting.

(a) In general.
(b) Accounting method changes.
(c) Examples.
(d) Effective/applicability date.

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

Par. 8. Sections 1.6655–1 and 1.6655–2 are revised to read as follows:

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

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

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

(1) The required installment; over

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

(c) *Period of the underpayment.* The period of the underpayment of any required installment runs from the date the installment was required to be paid to the 15th day of the 3rd month following the close of the taxable year, or to the date such underpayment is paid, whichever is earlier. For purposes of determining the period of the underpayment a payment of estimated tax will be credited against unpaid required installments in the order in which such installments are required to be paid.

(d) *Amount of required installment*—(1) *In general.* Except as otherwise provided in this section and §§1.6655–2 through 1.6655–7, the amount of any required installment is 25 percent of the lesser of—

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

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

(2) *Exception.* This paragraph (d)(1)(ii) does not apply if the preceding taxable year was not a taxable year of 12 months or the corporation did not file a return for the preceding taxable year showing a liability for tax.

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

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

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

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

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

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

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

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

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

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

(i) The sum of—

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

(B) The tax imposed by section 55; plus

(C) The tax imposed by section 887; over

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

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

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

(iii) Unless otherwise provided in the Internal Revenue Code or Treasury regulations, for purposes of the definition of "tax" as used in this section, a recapture of tax, such as a recapture provided by section 50(a)(1)(A), and any other similar provision, is not considered to be a tax imposed by section 11.

(iv) For the purposes of paragraph (d) of this section, the return for the preceding taxable year is the Federal income tax return for such taxable year that is required by section 6012(a)(2). However, if an amended Federal income tax return has been filed before the due date of an installment, then the return for the preceding taxable year is the Federal income tax return as amended. If an amended Federal income tax return has been filed on or after the due date for an installment, then the return for the preceding taxable year does not include for such installment period the Federal income tax return as amended subsequent to the due date for such installment. Paragraph (d) of this section will apply without regard to whether the taxpayer's Federal income tax return for the preceding taxable year is filed in a timely manner.

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

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

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

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

Example 1. (i) X, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2009, will be $85,000. X is not a large corporation as defined in section 6655(g)(2) and §1.6655–4. X reported a liability of $74,900 on its return for the taxable year ended December 31, 2008, with no credits against tax. X paid four installments of estimated tax, each in the amount of $18,725 (25 percent of $74,900), on April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively. X reported a tax liability of $88,900 on its return due March 15, 2010. X had a $5,000 credit against tax for tax year 2009 as provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code. X did not underpay its estimated tax for tax year 2009 for any of the four installments, determined as follows:

(A) Tax as defined in paragraph (g) of this section for 2009 ($88,900-$5,000) =	$83,900
(B) Tax as defined in paragraph (g) of this section for 2008 =	$74,900
(C) 100% of the lesser of this paragraph (j), *Example 1* (i)(A) or (i)(B) =	$74,900

(D) Amount of estimated tax required to be paid on or before each installment date (25% of $74,900) =	$18,725
(E) Deduct amount paid on or before each installment date =	$18,725
(F) Amount of underpayment for each installment date =	$0

(ii) [Reserved].

Example 2. (i) *Facts*. Y, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2009, will be $70,000. Y is not a large corporation as defined in section 6655(g)(2) and §1.6655–4. Y reported a Federal income tax liability of $90,000 for its taxable year ending December 31, 2008. Y paid no installment of estimated tax on or before April 15, 2009, June 15, 2009, or September 15, 2009, but made a payment of $63,000 on December 15, 2009. On March 15, 2010, Y filed its income tax return showing a tax of $70,000. Y had no credits against tax for tax year 2009. Of the $63,000 paid by Y on December 15, 2009, $17,500 is applied to each of the first three installments due on April 15, June 15, and September 15, 2009, and the remaining $10,500 is applied to the fourth installment. Y has an underpayment of estimated tax for each of the first three installments of $17,500 and for the fourth installment of $7,000. The addition to tax under section 6655(a) is computed as follows:

(A) Tax as defined in paragraph (g) of this section for 2009 =	$70,000
(B) Tax as defined in paragraph (g) of this section for 2008 =	$90,000
(C) 100% of the lesser of this paragraph (j), *Example 2* (i)(A) or (i)(B) =	$70,000
(D) Amount of estimated tax required to be paid on or before each installment date (25% of $70,000) =	$17,500
(E) Amount paid on or before the first, second, and third installment dates =	$0
(F) Amount paid on or before the fourth installment date =	$63,000
(G) Amount of underpayment for each of the first, second, and third installment dates =	$17,500
(H) Amount of underpayment for the fourth installment date =	$ 7,000

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

(A) First installment (underpayment period 4–16–09 through 12–15–09), computed as 244/365 X $17,500 X 8% =	$ 936
(B) Second installment (underpayment period 6–16–09 through 12–15–09), computed as 183/365 X $17,500 X 8% =	$ 702
(C) Third installment (underpayment period 9–16–09 through 12–15–09), computed as 91/365 X $17,500 X 8% =	$ 349
(D) Fourth installment (underpayment period 12–16–09 through 3–15–10), computed as 90/365 X $7,000 X 8% =	$ 138
(E) Total of this paragraph (j), *Example 2* (ii)(A) through (D) =	$2,125

(k) *Effective/applicability date*. This section applies to taxable years beginning after September 6, 2007.

§1.6655–2 Annualized income installment method.

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

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

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

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

(1) The product of the applicable percentage and the tax (after reducing the annualized tax by the amount of any allowable credits) for the taxable year computed by annualizing the taxable income and alternative minimum taxable income—

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

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

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

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

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

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

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

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

(3) *Annualization period not a short taxable year*. An annualization period is not treated as a short taxable year for purposes of determining the taxable income of an annualization period.

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

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

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

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

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

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

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

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

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

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

Example. (i) ABC, a calendar year corporation, had a taxable year of less than twelve months for tax year 2008 and no credits against tax for tax year 2009. ABC made an estimated tax payment of $15,000 on the installment dates of April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively. Assume that, under paragraph (d)(1) of this section, ABC elected Option 1 by timely filing Form 8842, in accordance with section 6655(e)(2)(C)(iii), and determined that its taxable income for the first 2, 4, 7 and 10 months was $25,000, $64,000, $125,000, and $175,000 respectively. The income for each period is annualized as follows:

$25,000 X 12/2 =	$150,000
$64,000 X 12/4 =	$192,000
$125,000 X 12/7 =	$214,286
$175,000 X 12/10 =	$210,000

(ii)(A) To determine whether the installment payment made on April 15, 2009, equals or exceeds the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 2-month period, the following computation is necessary:

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

(B) Because the total amount of estimated tax that was timely paid on or before the first installment date ($15,000) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period ($10,438), the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on April 15, 2009.

(iii)(A) To determine whether the installment payments made on or before June 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 4-month period, the following computation is necessary:

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

(B) Because the total amount of estimated tax actually paid on or before the second installment date ($19,562 ($15,000 second required installment payment plus $4,562 overpayment of first required installment)) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period ($18,627), the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on June 15, 2009.

(iv)(A) To determine whether the installment payments made on or before September 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 7-month period, the following computation is necessary:

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

(B) Because the total amount of estimated tax actually paid on or before the third installment date ($15,935 ($15,000 third required installment payment plus $935 overpayment of second required installment)) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period ($21,051), the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the September 15, 2009, installment unless another exception applies to this installment payment.

(v)(A) To determine whether the installment payments made on or before December 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 10-month period, the following computation is necessary:

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

(B) Because the total amount of estimated tax payments made on or before the fourth installment date that is available to be applied to the estimated tax due for the fourth installment ($9,884 ($15,000 fourth required installment payment less $5,116 underpayment for the third installment of estimated tax ($21,051 third installment of estimated tax due less $15,935 payments available to be applied to the third installment of estimated tax))) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 10-month period ($15,034), the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the December 15, 2009, installment unless another exception applies to this installment payment.

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

(A) First installment (no underpayment) =	$0
(B) Second installment (no underpayment) =	$0
(C) Third installment (underpayment period 9–16–09 through 12–15–09), computed as 91/365 X $5,116 X 8% =	$102
(D) Fourth installment (underpayment period 12–16–09 through 3–15–10), computed as 90/365 X $5,150 X 8% =	$102
(E) Total of this paragraph (d)(3), *Example* (vi)(A) through (D) =	$204

(e) *52–53 week taxable year*. (1) Generally, except as provided in the alternative rule in paragraph (e)(4) of this section, in the case of a taxpayer whose taxable year constitutes 52 or 53 weeks in accordance with section 441(f), the rules prescribed by §1.441–2 are applicable in determining—

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(4) As an alternative to using the 52/53 week taxable year rules provided in paragraphs (e)(1), (e)(2), and (e)(3) of this section, a taxpayer whose taxable year constitutes 52 or 53 weeks in accordance with section 441(f) may base its annualization period on the month that ends closest to the end of its applicable 4-week period or 13-week period that ends within the applicable annualization period. This alternative may only be used if it is used for determining annualization periods for all required installments for the taxable year.

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

Example 1. Corporation ABC, an accrual method taxpayer, uses a 52/53 week year-end ending on the last Friday in December and uses four thirteen-week periods. For its year beginning December 28, 2007, ABC uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installments. For purposes of computing its first and second required installments, the first 3 months of A's taxable year under paragraph (b)(1)(i) of this section will end on March 28th, the thirteenth Friday of ABC's taxable year. For purposes of its third required installment, the first 6 months of ABC's taxable year will end on June 27th, the twenty-sixth Friday of ABC's taxable year. For purposes of its fourth required installment, the first 9 months of ABC's taxable year will end on September 26th, the thirty-ninth Friday of ABC's taxable year.

Example 2. Same facts as *Example 1* except that ABC uses thirteen four-week periods and there are 52 weeks during ABC's taxable year beginning December 28, 2007, and ending December 26, 2008. For purposes of computing ABC's first and second required installments, ABC's annualized taxable income for the first three months will be the taxable income for the first three four-week periods of ABC's taxable year (December 28, 2007, through March 21, 2008) divided by 12 (number of full four-week periods in the first three months (3) multiplied by 4) and multiplied by 52 (the number of weeks in the taxable year). For purposes of computing ABC's third required installment, ABC's annualized taxable income for the first six months will be the taxable income for the first six four-week periods of ABC's taxable year (December 28, 2007, through June 13, 2008) divided by 24 and multiplied by 52. For purposes of computing ABC's fourth required installment, ABC's annualized taxable income for the first nine months will be the taxable income for the first nine four-week periods of ABC's taxable year (December 28, 2007, through September 5, 2008) divided by 36 and multiplied by 52.

Example 3. Same facts as *Example 1* except that ABC uses the alternative method under paragraph (e)(4) of this section for computing its required installments for 2008. For purposes of computing its first and second required installments, the first three months of ABC's taxable year under paragraph (b)(1)(i) of this section will end on March 31, 2008, the month that ends closest to the end of ABC's applicable thirteen-week period for the first and second required installments. For purposes of ABC's third required installment, the first six months of ABC's taxable year will end on June 30, 2008, the month that ends closest to the end of ABC's applicable thirteen-week period for the third required installment. For purposes of ABC's fourth required installment, the first nine months of ABC's taxable year will end on September 30, 2008, the month that ends closest to the end of ABC's applicable thirteen-week period for the fourth required installment.

(f) *Determination of taxable income for an annualization period*—(1) *In general*. This paragraph (f) applies for purposes of determining the applicability of the exception described in paragraphs (a) and (b) of this section (relating to the annualization of income) and the exception described in §1.6655–3 (relating to annualization of income for corporations with seasonal income). An item of income, deduction, gain or loss is to be taken into account in determining the taxable income and alternative minimum taxable income (and applicable tax and alternative minimum tax) for an annualization period in the manner provided in this paragraph (f). An item may not be taken into account in determining taxable income for any annualization period unless the item is properly taken into account by the last day of that annualization period and the item is properly taken into account in determining the taxpayer's taxable income and alternative minimum taxable income (and applicable tax and alternative minimum tax) for the taxable year that includes the annualization period.

(i) *Items of income*. An item of income is taken into account in the annualization period in which the item is properly includible under the method of accounting employed by the taxpayer with respect to the item and in accordance with the appropriate provision of the Internal Revenue Code (for example, section 451 for accrual method taxpayers, section 453 for installment sales or section 460 for long-term contracts).

(ii) *Items of deduction*. An item of deduction is taken into account in the annualization period in which the item is properly deductible under the method of accounting employed by the taxpayer with respect to the item and in accordance with the appropriate provision of the Internal Revenue Code (for example, under the cash receipts and disbursements method of accounting, the deduction must be paid under §1.461–1(a)(1) and be otherwise deductible in computing taxable income; under an accrual method of accounting, the deduction must be incurred under §1.461–1(a)(2) and be otherwise deductible in computing taxable income). Section 170(a)(2) and §1.170A–11(b) (charitable contributions by accrual method corporations) and §1.461–5 (recurring item exception) may not be taken into consideration by an accrual method taxpayer in any annualization period in determining whether an item of deduction has been incurred under §1.461–1(a)(2) during that annualization period.

(iii) *Losses*. An item of loss is to be taken into account during the annualization period in which events have occurred that permit the loss to be taken into account under the appropriate provision of the Internal Revenue Code.

(2) *Certain deductions required to be allocated in a reasonably accurate manner*—(i) *In general*. The following deductions allowed for a taxable year must be allocated throughout the taxable year in a reasonably accurate manner (as defined in paragraph (f)(2)(iii) of this section), regardless of the annualization period in which the item is paid or incurred:

(A) Real property tax deductions.

(B) Employee and independent contractor bonus compensation deductions (including the employer's share of employment taxes related to such compensation).

(C) Deductions under sections 404 (deferred compensation) and 419 (welfare benefit funds).

(D) Items allowed as a deduction for the taxable year by reason of section 170(a)(2) and §1.170A–11(b) (certain charitable contributions by accrual method corporations), §1.461–5 (recurring item exception) or §1.263(a)–4(f) (12-month rule).

(E) Items of deduction designated by the Secretary by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter).

(ii) *Application of the reasonably accurate manner requirement to certain charitable contributions, recurring items, and 12-month rule items*. For purposes of paragraph (f)(2)(i)(D) of this section, the total amount of the item deducted in the computation of taxable income for the taxable year must be allocated in a reasonably accurate manner, notwithstanding the fact that section 170(a)(2) and §1.170A–11(b), §1.461–5, or §1.263(a)–4(f) applies to only a portion of the total amount of the item deducted for the taxable year. For example, if a portion of a taxpayer's rebate liabilities are deducted in the computation of taxable income under the recurring item exception, all rebate liabilities deducted in the computation of taxable income for the taxable year must be allocated in a reasonably accurate manner.

(iii) *Reasonably accurate manner defined*. (A) An item is allocated throughout the taxable year in a reasonably accurate manner if the item is allocated ratably throughout the taxable year or if the allocation provides a reasonably accurate estimate of taxable income for the taxable year based upon the facts known as of the end of the annualization period. In determining that an allocation of an item provides a reasonably accurate estimate of taxable income for the taxable year, relevant considerations include—

(*1*) The extent to which the allocation is consistent with the taxpayer's accounting for the item on its non-tax books and records;

(*2*) The extent to which the allocable portion of the item becomes fixed and determinable (under §1.461–1(a)(2)) during the applicable annualization period; and

(*3*) The extent to which the allocation, if compared to the ratable allocation of the item, results in a better matching of the item of deduction to revenue, earnings, the use of property or the provision of services occurring during the annualization period.

(B) None of the relevant considerations above override the general requirement that the allocation must be done in a reasonably accurate manner based upon the facts known as of the end of the annualization period. For example, the fact that a liability for an annual expense becomes fixed and determinable during an annualization period will not establish that allocating all of the expense to that annualization period has been done in a reasonably accurate manner if the facts known as of the end of the annualization period indicate otherwise.

(iv) *Special rule for certain real property tax liabilities*. Notwithstanding paragraph (f)(2)(iii) of this section, real property tax liabilities for which an election under section 461(c) is in effect must be allocated ratably throughout the taxable year for purposes of this section.

(v) *Examples*. Unless otherwise stated, the following examples assume that the taxpayer uses the 3–3–6–9 annualization period:

Example 1. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has adopted a plan under which ABC pays an annual bonus to its employees. As of March 31, 2008, ABC estimates that it will pay a year-end bonus of $500,000 to its employees if earnings remain constant throughout the tax year. ABC does not pay any of the estimated bonus liability as of March 31, 2008. On October 31, 2008, ABC declares a $600,000 bonus to its employees which is paid out on November 15, 2008, and properly deducted in ABC's December 31, 2008, tax year. No other bonus liabilities are incurred by ABC during the tax year.

(ii) Under the general rule provided in paragraph (f)(2)(i) of this section, ABC is required to allocate its employee bonus liability in a reasonably accurate manner for annualization purposes. Under paragraph (f)(2)(iii) of this section, ABC's employee bonus liability will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC is permitted to recognize a $150,000 bonus deduction (one quarter of the $600,000 bonus liability properly recognized by ABC in the tax year ending December 31, 2008) in the first annualization period ending March 31, 2008.

Example 2. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has adopted a plan under which ABC pays an annual bonus to its employees. ABC's employee bonus plan generally calls for an annual bonus equal to 2% of earnings. A bonus reserve for this amount is reported each quarter in ABC's non-tax books and records. ABC's quarterly revenues throughout the year are $10,000,000; $6,000,000; $7,000,000; and $7,000,000 respectively. As of March 31, 2008, ABC estimates that it will pay a year-end bonus of $800,000 ($10,000,000 x 4 x 2%) to its employees if earnings remain constant throughout the year. ABC does not pay any of the estimated bonus payment as of March 31, 2008. On December 31, 2008, ABC declares a $600,000 bonus to its employees which is paid out on January 15, 2009, and properly deducted in ABC's December 31, 2008, tax year.

(ii) Under the general rule provided in paragraph (f)(2)(i) of this section, ABC must allocate its employee bonus liability in a reasonably accurate manner for annualization purposes. Under paragraph (f)(2)(iii) of this section, ABC's employee bonus liability will be deemed to be allocated in a reasonably accurate manner if the allocation provides a reasonable estimate of taxable income based upon the facts known as of the end of the annualization period. Based upon its earnings activities and other information available as of March 31, 2008, ABC estimated that its total deduction for employee bonuses for the taxable year ending December 31, 2008, would be $800,000 ($10,000,000 first quarter earnings x 4 x 2%). Allocating $200,000 ($10,000,000 x 2%) of ABC's annual bonus liability of $600,000 to ABC's first quarter based upon earnings during the quarter represents a better matching of ABC's bonus expense to earnings in the quarter as compared to allocating $150,000 to ABC's first quarter under a ratable accrual method and is consistent with the allocation provided in ABC's non-tax books and records. Accordingly, allocating ABC's employee bonus deductions based upon ABC's earnings will be considered allocated in a reasonably accurate manner.

Example 3. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has adopted a plan under which ABC pays a bonus to its employees each quarter based upon earnings for that quarter. On March 31, 2008, ABC pays out $2,000,000 to its employees as a quarterly bonus based upon the earnings of ABC for the period January 1, 2008, through March 31, 2008. The $2,000,000 bonus is recognized as an expense on ABC's audited financial statements in the quarter ending March 31, 2008. As of March 31, 2008, ABC anticipates that its earnings will continue throughout the year resulting in future quarterly bonus payments in 2008 similar to the $2,000,000 first quarter payment.

(ii) Under the general rule provided in paragraph (f)(2)(i) of this section, ABC is required to allocate its employee bonus liability in a reasonably accurate manner for annualization purposes. Under paragraph (f)(2)(iii) of this section , ABC's employee bonus liability will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC may recognize a $500,000 bonus deduction (one quarter of the $2,000,000 bonus liability properly recognized by ABC in the tax year ending December 31, 2008) in the first annualization period ending March 31, 2008 (as well as one quarter of any additional bonus liability properly recognized by ABC in the tax year ending December 31, 2008).

(iii) In addition, paragraph (f)(2)(iii) of this section provides that an allocation will be considered reasonable if the allocation provides an accurate estimate of taxable income for the taxable year based upon the facts known as of the end of the annualization period. Based upon its earnings activities and other information available as of March 31, 2008, ABC estimates that its total deduction for employee bonuses for the taxable year ending December 31, 2008, would be $8,000,000. In addition, the $2,000,000 bonus liability became fixed and determinable during the first quarter. Allocating $2,000,000 to ABC's first quarter earnings is also consistent with ABC's non-tax books and records and represents a better matching of ABC's bonus expense to earnings in the quarter as compared to a ratable accrual. Accordingly, allocating ABC's bonus liability based upon earnings will be considered a reasonably accurate manner for estimated tax purposes.

Example 4. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting with the recurring item exception and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2009 taxable year. ABC regularly incurs rebate obligations related to the sale of its products. Rebate coupons that are received and validated by ABC are generally paid in the following month. During the tax year ending December 31, 2009, ABC received, validated and paid $400,000 in rebates. In addition, as of the end of December 31, 2009, ABC had received and validated $100,000 in rebate claims that were paid in January of 2010 and deducted in ABC's December 31, 2009, tax year under the recurring item exception. Therefore, ABC properly recognized a $500,000 rebate liability deduction on ABC's December 31, 2009, tax return.

(ii) Under the rule provided in paragraph (f)(2)(ii) of this section, an item must be allocated in a reasonably accurate manner if any portion of the item is deducted under the recurring item exception. Therefore, ABC will be required to allocate its entire $500,000 rebate liability deduction in a reasonably accurate manner as defined in paragraph (f)(2)(iii) of this section.

(3) *Special rules*—(i) *Advance payments*—(A) *Advance payments under §1.451–5(b)(1)(ii)*. An advance payment for which the taxpayer uses the method of accounting provided in §1.451–5(b)(1)(ii) is includible in computing taxable income for an annualization period in accordance with that method of accounting except that, if §1.451–5(c) applies, any amount not included in computing taxable income by the end of the second taxable year following the year in which substantial advance payments are received, and not previously included in accordance with the taxpayer's accrual method of accounting, is includible in computing taxable income on the last day of such second taxable year.

(B) *Advance payments under Rev. Proc. 2004–34*. An advance payment for which the taxpayer uses the Deferral Method provided in section 5.02 of Rev. Proc. 2004–34, 2004–1 C.B. 991, (see §601.601(d)(2)(ii)(*b*) of this chapter) is includible in computing taxable income for an annualization period in accordance with that method of accounting, except that any amount not included in computing taxable income by the end of the taxable year succeeding the taxable year of receipt is includible in computing taxable income on the last day of such succeeding taxable year.

(ii) *Extraordinary items*—(A) *In general*. In general, extraordinary items must be taken into account after annualizing the taxable income for the annualization period. For purposes of the preceding sentence an extraordinary item is any item identified in §1.1502–76(b)(2)(ii)(C)(1), (2), (3), (4), (7), and (8), a net operating loss carryover, a section 481(a) adjustment, net gain or loss from the disposition of 25 percent or more of the fair market value of a taxpayer's business assets during a taxable year, and any other item designated by the Secretary by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).

(B) *De minimis extraordinary items*. A taxpayer may treat any *de minimis* extraordinary item, other than a net operating loss carryover or section 481(a) adjustment, as an item under the general rule of paragraph (f)(1) of this section rather than an extraordinary item as provided for in paragraph (f)(3)(ii) of this section. A *de minimis* extraordinary item is any item identified in paragraph (f)(3)(ii)(A) of this section resulting from a transaction in which the total extraordinary items resulting from such transaction is less than $1,000,000.

(C) *Special rule for net operating loss deductions and section 481(a) adjustments*. For purposes of paragraph (f)(3)(ii) of this section, a taxpayer must treat a net operating loss deduction and section 481(a) adjustment as extraordinary items arising on the first day of the tax year in which the item is taken into account in determining taxable income. Notwithstanding the preceding sentence, a taxpayer may choose to treat the portion of a section 481(a) adjustment recognized during the tax year of the accounting method change as an extraordinary item arising on the date the Form 3115, *"Application for Change in Accounting Method,"* requesting the change was filed with the national office of the Internal Revenue Service.

(iii) *Credits*—(A) *Current year credits*. With respect to a current year credit, the items upon which the credit is computed are annualized, the amount of the credit is computed based on the annualized items, and the amount of the credit is deducted from the annualized tax. For example, for an annualization period consisting of three months in a full 12-month taxable year, the items upon which the credit is based that are taken into account for the three month period are multiplied by four, the credit is determined based on the annualized amount of the items, and the credit reduces the annualized tax.

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

(iv) *Depreciation and amortization*—(A) *Estimated annual depreciation and amortization*. In general, in determining taxable income for any annualization period, a proportionate amount of the taxpayer's estimated annual depreciation and amortization (depreciation) expense may be taken into account. For purposes of the preceding sentence, estimated annual depreciation expense is the estimated depreciation expense to be properly taken into account in determining the taxpayer's taxable income for the taxable year. In determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, additional first-year depreciation and expense deductions and section 179 or any similar provision, and other events that, based on all the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current taxable year), are reasonably expected to occur or apply during the taxable year.

(B) *Safe harbors*—(*1*) *Proportionate depreciation allowance*. In determining taxable income for any annualization period, in lieu of the rule provided in paragraph (f)(3)(iv)(A) of this section a taxpayer may take into account a proportionate amount of the depreciation and amortization (depreciation) expense, including special depreciation and expense deductions such as those provided for in section 168(k) and section 179 or any similar provision, allowed for the taxable year from—

(*i*) Assets that were in service on the last day of the prior taxable year, are in service on the first day of the current taxable year, and that have not been disposed of during the annualization period;

(*ii*) Assets placed in service during the annualization period and have not been disposed of during that period; and

(*iii*) Assets that were in service on the last day of the prior taxable year and that are disposed of during the annualization period.

(*2*) *90 percent of preceding year's depreciation.* In determining taxable income for any annualization period, in lieu of the general rule provided in paragraph (f)(3)(iv)(A) of this section, a proportionate amount of 90 percent of the amount of depreciation and amortization (depreciation) expense taken on the taxpayer's Federal income tax return for the preceding taxable year may be taken into account. If the taxpayer's preceding taxable year is less than 12 months (a short taxable year), the amount of depreciation expense taken into account is annualized by multiplying the depreciation and amortization for the short taxable year by 12, and dividing the result by the number of months in the short taxable year.

(*3*) *Safe harbor operational rules.* If a taxpayer selects one of the two safe harbors provided in paragraph (f)(3)(iv)(B)(*1*) or paragraph (f)(3)(iv)(B)(*2*) of this section, the taxpayer must use that safe harbor for all depreciation expenses within the annualization period for the annualized income installment. However, a taxpayer may use either the method provided for in paragraph (f)(3)(iv)(A) of this section or a method provided for in this paragraph (f)(3)(iv)(B) of this section for each annualized income installment during the taxable year. For example, a taxpayer may use the safe harbor provided in paragraph (f)(3)(iv)(B)(*1*) of this section for its first annualized income installment and may use the general rule provided in paragraph (f)(3)(iv)(A) of this section for its second annualized income installment.

(C) *Short taxable years.* If the taxable year is, or will be, a short taxable year (based on all relevant information available as of the last day of the annualization period), annual depreciation expense is computed using the rules applicable for computing depreciation during a short taxable year for purposes of determining the annual depreciation expense to be allocated to an annualization period. For this purpose, the rules applicable for computing depreciation during a short taxable year are applied on the basis of the date the taxable year is expected to end based on all relevant information available as of the last day of the annualization period. See Rev. Proc. 89–15, 1989–1 C.B. 816, for computing depreciation expense under section 168 (see §601.601(d)(2)(ii)(*b*) of this chapter). An annualization period is not treated as a short taxable year for purposes of determining the depreciation expense for an annualization period. See paragraph (c)(3) of this section.

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

(B) *Treatment of subpart F income and income under section 936(h)*—(*1*) *General rule.* Any amounts required to be included in gross income under section 936(h) or section 951(a), and credits properly allocable thereto, are taken into account in computing any annualized income installment in a manner similar to the manner under which partnership inclusions, and credits properly allocable thereto, are taken into account in accordance with paragraph (f)(3)(v)(A) of this section.

(*2*) *Prior year safe harbor*—(*i*) *General rule.* If a taxpayer elects to have the safe harbor in this paragraph (f)(3)(v)(B)(*2*) apply for any taxable year, then paragraph (f)(3)(v)(B)(*1*) of this section does not apply; and, for purposes of computing any annualized income installment for the taxable year, the taxpayer is treated as having received ratably during the taxable year items of income and credit described in paragraph (f)(3)(v)(B)(*1*) of this section in an amount equal to 115 percent of the amount of such items shown on the return of the taxpayer for the preceding taxable year (the second preceding taxable year in the case of the first and second required installments for such taxable year).

(*ii*) *Special rule for noncontrolling shareholder.* If a taxpayer making the election under paragraph (f)(3)(v)(B)(*2*)(*i*) of this section is a noncontrolling shareholder of a corporation, paragraph (f)(3)(v)(B)(*2*)(*i*) of this section is applied with respect to items of such corporation by substituting "100 percent" for "115 percent". For purposes of paragraph (f)(3)(v)(B)(*2*)(*ii*) of this section, the term *noncontrolling shareholder* means, with respect to any corporation, a shareholder that, as of the beginning of the taxable year for which the installment is being made, does not own within the meaning of section 958(a), and is not treated as owning within the meaning of section 958(b), more than 50 percent by vote or value of the stock in the corporation.

(C) *Dividends from closely held real estate investment trust*—(*1*) *General rule.* Any dividend received from a closely held real estate investment trust by any person that owns, after the application of section 856(d)(5), 10 percent or more by vote or value of the stock or beneficial interests in the trust is taken into account in computing annualized income installments in a manner similar to the manner under which partnership income inclusions are taken into account.

(*2*) *Closely held real estate investment trust.* For purposes of paragraph (f)(3)(v)(C)(*1*) of this section, the term *closely held real estate investment trust* means a real estate investment trust with respect to which 5 or fewer persons own, after the application of section 856(d)(5), 50 percent or more by vote or value of the stock or beneficial interests in the trust.

(D) *Other passthrough entities.* A taxpayer's distributive share of items from a passthrough entity, other than those described in paragraphs (f)(3)(v)(A) and (f)(3)(v)(C) of this section, is taken into account in computing any annualized income installment in a manner similar to the manner under which partnership items are taken into account under paragraph (f)(3)(v)(A) of this section.

(vi) *Alternative minimum taxable income exemption amount.* The alternative minimum taxable income exemption amount provided by section 55(d)(2) is applied after the alternative minimum taxable income for the annualization period is annualized.

(vii) *Examples*. The provisions of this paragraph (f) are illustrated by the following examples. Unless otherwise stated, the following examples assume that the taxpayer uses the 3–3-6–9 annualization period.

Example 1. Expense paid or incurred in the installment period. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has licensed technology from Corporation XYZ. Pursuant to the license agreement, ABC pays a license fee to XYZ equal to $.01 for every dollar of gross receipts earned by ABC. For 2008, ABC projects gross receipts of $200,000,000, of which $100,000,000 is earned by March 31, 2008. Pursuant to paragraph (f)(1) of this section, a license fee expense of $1,000,000 ($100,000,000 X $.01) is incurred by March 31, 2008, and may be taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment.

Example 2. Expense not paid or incurred in the installment period. Same facts as *Example 1* except that ABC does not earn any gross receipts by March 31, 2008. In accordance with paragraph (f)(1) of this section, because the license fee expense was not incurred under §1.461–1(a)(2) by the last day of the annualization period, no license fee expense is taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year.

Example 3. Bad debt expense. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. As of December 31, 2007, ABC had a $100,000 account receivable due from XYZ related to the sale of goods from ABC to XYZ during 2007. On March 30, 2008, ABC determined that its receivable from XYZ was worthless under section 166 and the regulations. No other receivables were determined to be worthless between January 1, 2008, and March 31, 2008. In accordance with paragraph (f)(1) of this section, a $100,000 bad debt write-off is taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment.

Example 4. Bad debt expense. Same facts as *Example 3* except that ABC determines that the receivable from XYZ was worthless under section 166 and the regulations on April 10, 2008. As of March 31, 2008, ABC had not determined that any receivables were worthless under section 166 and the regulations. In accordance with paragraph (f)(1) of this section, the $100,000 bad debt expense attributable to the receivable from XYZ is not taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because the receivable from XYZ became worthless after the last day of the annualization period.

Example 5. Employer deductions under section 404 and 419. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On March 1, 2008, the board of directors of ABC makes a binding, irrevocable commitment to fund a minimum contribution of $10,000,000 to ABC's qualified retirement plan by March 14, 2009. ABC remits a $1,000,000 payment to the retirement plan on March 1, 2008, and a $9,000,000 payment on March 3, 2009. ABC does not incur any other related retirement plan deductions during its 2008 taxable year.

(ii) Under the rule provided in paragraph (f)(2)(i) of this section, ABC's employer deduction for payment made to the qualified plan must be allocated throughout the tax year for estimated tax purposes in a reasonably accurate manner. Therefore, ABC will not be permitted to allocate the $10,000,000 deduction to its first installment period. Under paragraph (f)(2)(iii) of this section, ABC's qualified plan deduction will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC will be permitted to allocate $2,500,000 of its qualified plan deduction in its first installment period.

Example 6. Prepaid expense. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and does not capitalize qualifying costs under the exception provided for in §1.263(a)–4(f). ABC uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On July 1, 2008, ABC purchases an annual business license from State X which permits ABC to operate its business in State X from July 1, 2008, through June 30, 2009. An annual payment of $12,000 is due on July 1, 2008, and ABC pays the fee on this date. ABC has not elected out of the 12-month rule provided by §1.263(a)–4(f) and therefore ABC is not required to capitalize any amount paid for the license and will recognize a $12,000 deduction for the tax year ending December 31, 2008, with respect to this license.

(ii) Under the rule provided in paragraph (f)(2)(ii) of this section, ABC's $12,000 business license expense must be allocated in a reasonably accurate manner because ABC utilizes the 12-month rule exception provided for in the §1.263(a)–4(f). Under paragraph (f)(2)(iii) of this section, ABC's deduction will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC will be permitted to allocate $3,000 of its business license deduction in its first installment period.

Example 7. Real property tax liability. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC owns real property in State Y and uses the real property in its trade or business. ABC incurs a $400,000 deduction for State Y real estate taxes during ABC's December 31, 2008, taxable year. ABC has elected to recognize its real property taxes ratably under section 461(c).

(ii) Under the rule provided in paragraph (f)(2)(i) of this section, ABC's $400,000 real property tax liabilities must be allocated in a reasonably accurate manner. However, paragraph (f)(2)(iv) of this section provides that with respect to real property taxes for which an election has been made under section 461(c), ratable accrual is the only method which will be considered a reasonably accurate method. Therefore, ABC will be required to allocate its $400,000 real property taxes ratably for estimated tax purposes and thus $100,000 will be allocated to the ABC's first annualized income installment.

Example 8. NOL (Net Operating Loss) deduction. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has a net operating loss carryover to 2008 of $2,000,000. ABC's taxable income from January 1, 2008, through March 31, 2008, without regard to any net operating loss deduction, is $1,500,000 (pre-NOL taxable income). Under the special rule for net operating loss deductions provided in paragraph (f)(3)(ii) of this section, the NOL deduction is treated as an extraordinary item incurred on the first day of ABC's December 31, 2008, tax year. Therefore, the NOL deduction is taken into account after annualization for purposes of determining ABC's first annualized income installment.

Example 9. Advance payment. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 and 2009 taxable years. ABC is in the business of giving dancing lessons and receives advance payments. For Federal income tax purposes, ABC uses the Deferral Method provided in section 5.02 of Rev. Proc. 2004–34 for the advance payments it receives for dance lessons. On November 1, 2008, ABC receives an advance payment of $2,400 for a 2-year contract commencing on November 1, 2008, and providing for up to 24 individual, 1-hour lessons. ABC provides 2 lessons in 2008, 12 lessons in 2009, and 10 lessons in 2010. ABC recognizes $200 in revenues in its financial statements for the last quarter of 2008. ABC recognizes $300 in revenues in its financial statements for each quarter of 2009 for a total of $1,200 in 2009. ABC recognizes the remaining $1,000 in revenues in its financial statements during 2010. For tax purposes, ABC recognizes $200 into revenue in 2008 and $2,200 into revenue in 2009 under Rev. Proc. 2004–34. See §601.601(d)(2)(ii)(*b*).

(ii) Pursuant to paragraph (f)(3)(i)(B) of this section, ABC is not required to take into account any of the advance payment for purposes of computing any required installment payment for ABC's 2008 taxable year because no part of the $2,400 advance payment was recognized as income in ABC's financial statements during the first nine months of ABC's 2008 taxable year. In 2009, ABC must take into account $300 of revenue for purposes of computing its first and second required installment payments, $600 of revenue for purposes of computing its third required installment payment and $900 for purposes of computing its fourth required installment payment. Pursuant to paragraph (f)(3)(i)(B) of this section, the remaining deferred revenue is recognized on December 31, 2009, for purposes of computing ABC's annualized income installments for 2009.

Example 10. Section 481(a) adjustment. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On December 20, 2008, ABC files a Form 3115 requesting permission to change its method of accounting. The requested change results in a negative section 481(a) adjustment of $80,000. ABC subsequently receives the consent of the Commissioner to make the change and therefore, the negative $80,000 section 481(a) adjustment is properly recognized in ABC's tax return for the year ending December 31, 2008. Under paragraph (f)(3)(ii) of this section ABC is permitted to recognize the negative $80,000 section 481(a) adjustment as an extraordinary item occurring on January 1, 2008 (the first day of ABC's December 31, 2008, tax year), or December 20, 2008 (the date ABC filed the Form 3115). ABC chooses to recognize the negative $80,000 section 481(a) adjustment as an extraordinary item occurring in January 1, 2008. Accordingly, $80,000 of the negative section 481(a) adjustment is taken into account after annualization for purposes of determining ABC's first annualized income installment. In addition, under §1.6655–6(b), ABC is required to use its new method of accounting as of January 1, 2008 for estimated tax purposes, consistent with the recognition of the section 481(a) adjustment for estimated tax purposes. Therefore, ABC will be required to use the new method of accounting in determining taxable income to be annualized in computing ABC's first annualized income installment.

Example 11. Section 481(a) adjustment. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On June 15, 2008, ABC files a Form 3115 requesting permission to change its method of accounting. The requested change results in a positive section 481(a) adjustment of $240,000. ABC subsequently receives the consent of the Commissioner to make the change and therefore, $60,000 of the section 481(a) adjustment (one quarter of the positive $240,000 section 481(a) adjustment) is properly recognized in ABC's tax return for the year ending December 31, 2008. Under paragraph (f)(3)(ii) of this section, ABC is permitted to recognize the positive $60,000 section 481(a) adjustment as an extraordinary item occurring on January 1, 2008 (the first day of ABC's December 31, 2008, tax year), or June 15, 2008 (the date ABC filed the Form 3115). ABC chooses to recognize the positive $60,000 section 481(a) adjustment as an extraordinary item occurring on June 15, 2008. Accordingly, the $60,000 positive section 481(a) adjustment is not taken into account for purposes of determining ABC's first annualized income installment. However, in all futures years any portion of the section 481(a) adjustment related to this change in method of accounting will be treated as an extraordinary item occurring on the first day of the tax year under paragraph (f)(3)(ii) of this section. In addition, under §1.6655–6(b), ABC is required to use its new method of accounting as of June 15, 2008 for estimated tax purposes, consistent with the recognition of the section 481(a) adjustment for estimated tax purposes. Therefore, ABC will be required to use the new method of accounting (as of the beginning of the tax year) for purposes of determining taxable income to be annualized in computing ABC's third and fourth annualized income installments (which are based upon annualization periods that include June 15, 2008.)

Example 12. Extraordinary item. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On May 10, 2008, ABC reaches a settlement agreement with XYZ over a tort action filed by ABC. As a result, ABC receives a payment of $10,000,000 on June 15, 2006, that is recognized as income by ABC. The settlement of a tort action is an extraordinary item defined in paragraph (f)(3)(ii)(A) of this section. Accordingly, the $10,000,000 of income will be taken into account by ABC on May 10, 2008, for purposes of computing ABC's annualized income installments for 2008. Therefore, the $10,000,000 settlement will only be taken into account in computing ABC's third and fourth annualized income installments (which are based upon annualization periods that include May 10, 2008.) In addition, the $10,000,000 settlement income will be taken into account as an extraordinary item of income after annualization for purposes of determining ABC's third and fourth annualized installment payments.

Example 13. Credit carryover. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC projects its annualized tax for its 2008 taxable year, based on annualizing ABC's taxable income for its first annualization period from January 1, 2008, through March 31, 2008, to be $1,500,000 before reduction for any credits. ABC has an unused section 38 credit from 2007 for increasing research activities from 2007 of $500,000 that is carried over to 2008. For purposes of determining ABC's first annualized income installment, ABC's annualized tax for 2008 is $1,000,000, determined as the tax for the taxable year computed by placing on an annualized basis ABC's taxable income from its first annualization period from January 1, 2008, through March 31, 2008 ($1,500,000) reduced by the $500,000 credit carryover from 2007. Therefore, ABC's first required installment payment for 2008 is $250,000 ($1,000,000 x 25%).

Example 14. Current year credit. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC projects its annualized tax for its 2008 taxable year, based on annualizing ABC's taxable income for its first annualization period from January 1, 2008, through March 31, 2008, to be $2,000,000 before reduction for any credits. ABC has historically earned a section 41 credit for increasing research activities and, for 2008, ABC estimates that it will earn a credit for increasing research activities under section 41 of $1,200,000. However, pursuant to paragraph (f)(3)(iii) of this section, if ABC were to annualize all components involved in computing the current year credit based on ABC's activity from January 1, 2008, through March 31, 2008, ABC would generate a credit of $1,600,000 for 2008. For purposes of determining ABC's first annualized income installment, ABC's annualized tax for 2008 is $400,000, determined as the tax for the 2008 taxable year ($2,000,000) computed by placing on an annualized basis ABC's taxable income from its first annualization period January 1, 2008, through March 31, 2008, reduced by a $1,600,000 current year section 41 credit from increasing research activities. Therefore, ABC's first required installment payment for 2008 is $100,000 ($400,000 x 25%).

Example 15. Current year credit. Same facts as *Example 14* except that ABC does not begin any research activities until April 3, 2008, and will not incur any research expenses described in paragraph (f)(1)(ii) of this section. As a result, if ABC were to annualize all components involved in computing the current year credit based on ABC's activity from January 1, 2008, through March 31, 2008, ABC would generate no section 41 research credit for purposes of determining its first annualized income installment. Pursuant to paragraph (f)(3)(iii) of this section, ABC cannot take into account any credit for its first annualization period because ABC did not incur any qualified research expenses by the last day of the first annualization period. Accordingly, for purposes of determining ABC's first annualized income installment, ABC's annualized tax for its first annualization period January 1, 2008, through March 31, 2008, is $2,000,000. Therefore, ABC's first required installment payment for 2008 is $500,000 ($2,000,000 x 25%).

Example 16. Depreciation and amortization expense. Corporation ABC, a calendar year taxpayer that began business on January 2, 2007, adopted an accrual method of accounting and will use the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On January 2, 2007, ABC purchased and placed in service a tangible depreciable asset that costs $50,000 and is 5-year property under section 168(e). ABC depreciates its 5-year property placed in service in 2007 under the general depreciation system using the 200-percent declining balance method, a 5-year recovery period, and the half year convention. On January 2, 2008, ABC purchased and placed in service qualified Gulf Opportunity Zone property (GO Zone property) that costs $30,000 and is 5-year property under section 168(e). ABC will depreciate its 5-year property placed in service in 2008 under the general depreciation system using the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. ABC will deduct the 50% additional first year depreciation deduction under section 1400N(d) with respect to the GO Zone property. For tax year 2007, ABC takes a depreciation deduction under section 168 of $10,000 ($50,000 X 20% = $10,000). ABC does not anticipate being subject to the mid-quarter convention for the 2008 taxable year, does not anticipate making any depreciation elections for any class of property, does not anticipate making a section 179 election, does not anticipate any sales or other dispositions of depreciable property, and no events have occurred, nor does ABC know, based on all relevant information available as of the due date of ABC's first required installment for 2008, of any event that will occur to cause ABC's 2008 taxable year to be a short taxable year. The optional amounts of depreciation expense ABC may take into account for its first annualized income installment for its 2008 taxable year are determined as follows:

(i) *General rule — Estimated annual depreciation.* In accordance with the general rule provided in paragraph (f)(3)(iv)(A) of this section, ABC may take a depreciation expense of $8,500 ($34,000 X 3/12 = $8,500) into account in computing ABC's January 1, 2008, through March 31, 2008, taxable income. ABC's estimated annual depreciation expense for 2008 of $34,000 is computed as follows: $15,000 for the 50% additional first year depreciation deduction under section 1400N(d) ($30,000 X 50% = $15,000) plus annual depreciation of $16,000 ($40,000 X 40% = $16,000) and $3,000 ($15,000 X 20% = $3,000). Under paragraphs (c)(3) and (f)(3)(iv)(C) of this section, ABC may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

(ii) *Safe Harbor — Proportionate depreciation allowance.* In accordance with the safe harbor provided in paragraph (f)(3)(iv)(B)(*1*) of this section, ABC may take a depreciation expense of $8,500 ($34,000 X 3/12 = $8,500) into account in computing ABC's January 1, 2008, through March 31, 2008, taxable income based on annual depreciation expense for 2008 of $34,000, computed as follows: $15,000 for the 50% additional first year depreciation deduction under section 1400N(d) ($30,000 X 50% = $15,000) plus annual depreciation of $16,000 ($40,000 X 40% = $16,000) and $3,000 ($15,000 X 20% = $3,000). Under paragraphs (c)(3) and (f)(3)(iv)(C) of this section, ABC may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

(iii) *Safe Harbor — 90 percent of preceding year's depreciation.* In accordance with the safe harbor in paragraph (f)(3)(iv)(B)(*2*) of this section, ABC may take a depreciation expense of $2,250 ($10,000 prior year's depreciation X 90% = $9,000 X 3/12 = $2,250) into account in computing ABC's January 1, 2008, through March 31, 2008, taxable income. Under paragraphs (c)(3) and (f)(3)(iv)(C) of this section, ABC may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

(g) *Items that substantially affect taxable income but cannot be determined accurately by the installment due date*—(1) *In general.* In determining the applicability of the annualization exceptions described in paragraphs (a) and (b) of this section and §1.6655–3, reasonable estimates may be made from existing data for items that substantially affect income if the amount of such items cannot be determined accurately by the installment due date. This paragraph (g) applies only to the inflation index for taxpayers using the dollar-value LIFO (last-in, first-out) inventory method, adjustments required under section 263A, the computation of a taxpayer's section 199 deduction, intercompany adjustments for taxpayers that file consolidated returns, the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year, deferred gain on a qualifying conversion or exchange of property under sections 1031 and 1033 that the taxpayer reasonably believes will be replaced with qualifying replacement property, and any other item designated by the Secretary by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter).

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

Example. Section 199 deduction. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC engages in production activities that generate qualified production activities income (QPAI), as defined in §1.199–1(c), and projects taxable income of $50,000 for its first annualization period from January 1, 2008, through March 31, 2008, without taking into account the section 199 deduction. During its first annualization period from January 1, 2008, through March 31, 2008, ABC incurs W–2 wages allocable to domestic production gross receipts pursuant to section 199(b)(2) of $10,000. Pursuant to paragraph (g)(1) of this section, ABC is permitted to take into account its estimated section 199 deduction before annualizing taxable income based on the lesser of its estimated QPAI or taxable income and W–2 wages for its first installment period for 2008. For the first installment period in 2008, ABC is permitted to recognize a deduction under section 199 of $3,000 ($50,000 x .06 = $3,000) subject to the wage limitation of $5,000 (50 percent of $10,000 of W–2 wages incurred during the first installment period). Accordingly, ABC's annualized income for the first installment for 2008 is $188,000 (($50,000 - $3,000) x 12/3 = $188,000). The tax on $188,000 is $56,570 and ABC's first required installment for 2008 is $14,143 ($56,570 x .25 = $14,143).

(h) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

Par. 8a. Section 1.6655–3 is revised to read as follows:

§1.6655–3 Adjusted seasonal installment method.

(a) *In general.* In the case of any required installment, the amount of the adjusted seasonal installment is the excess (if any) of—

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

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

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

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

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

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

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

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

(d) *Special rules*—(1) *Base period percentage.* The base period percentage for any period of months is the average percent that the taxable income for the corresponding months in each of the three preceding taxable years bears to the taxable income for the three preceding taxable years. If there is no taxable income for the corresponding months, taxable income for this purpose is zero.

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

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

of estimated tax under the adjusted seasonal installment method.

(4) *Alternative minimum tax*. The amount determined under paragraph (c) of this section must properly take into account the amount of any alternative minimum tax under section 55 that would apply for the period of the computation. The amount of any alternative minimum tax that would apply is determined by applying to alternative minimum taxable income, tentative minimum tax, and alternative minimum tax, the rules described in paragraph (c) of this section for taxable income and tax.

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

Example. (i) X, a corporation that reports on a calendar year basis, expects to have an estimated tax liability of $1,200,000 for its taxable year ending December 31, 2009. On its 2008 tax return, X reports a tax liability of $652,800. X pays four installments of estimated tax, each in the amount of $250,000, $250,000, $250,000, and $450,000 on April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively. X reports a tax liability of $1,152,600 on its return due March 15, 2010, with no credits against tax. Under the general provision of section 6655(b) and section 6655(d), there was an underpayment in the amount of $76,300 for the second installment through September 15, 2009, and $114,450 for the third installment through December 15, 2009, determined as follows:

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

(ii) X wants to determine if it qualifies for the adjusted seasonal installment method. X determines that its monthly taxable income for the preceding three taxable years and for the current taxable year 2009 is as follows:

January	*February*	*March*	*April*	*May*	*June*
2006					
$100,000	$ 90,000	$ 80,000	$ 70,000	$ 60,000	$ 20,000
2007					
$200,000	$170,000	$170,000	$130,000	$125,000	$ 45,000
2008					
$410,000	$350,000	$330,000	$270,000	$240,000	$ 80,000
2009					
$600,000	$680,000	$650,000	$560,000	$460,000	$170,000

July	*August*	*September*	*October*	*November*	*December*
2006					
$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
2007					
$21,000	$19,000	$20,000	$20,000	$20,000	$20,000
2008					
$40,000	$40,000	$40,000	$40,000	$40,000	$40,000
2009					
$70,000	$60,000	$50,000	$40,000	$30,000	$20,000

(iii) X must initially determine if its base period percentage for the same 6 consecutive months of the 3 preceding taxable years equals or exceeds 70 percent (see section 6655(e)(3) and paragraphs (b) and (c) of this section). By using its taxable income for the first 6 months of 2006, 2007, and 2008, X qualifies for the adjusted seasonal installment method because its base period percentage is 87.5 percent (which exceeds 70 percent) computed as follows:

(A) Taxable income for first 6 months of 2006 =	$ 420,000
(B) Total taxable income for 2006 =	$ 480,000
(C) Divide this paragraph (e), *Example* (iii)(A) by this paragraph (e), *Example* (iii)(B) =	.875
(D) Taxable income for first 6 months of 2007 =	$ 840,000
(E) Total taxable income for 2007 =	$ 960,000
(F) Divide this paragraph (e), *Example* (iii)(D) by this paragraph (e), *Example* (iii)(E) =	.875
(G) Taxable income for first 6 months of 2008 =	$1,680,000
(H) Total taxable income for 2008 =	$1,920,000
(I) Divide this paragraph (e), *Example* (iii)(G) by this paragraph (e), *Example* (iii)(H) =	.875
(J) Add this paragraph (e), *Example* (iii)(C), (F), and (I) =	2.625
(K) Divide this paragraph (e), *Example* (iii)(J) by 3 =	.875

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

(A) Taxable income for first 3 months of 2009 =	$1,930,000
(B) Taxable income for first 3 months of 2006 ($270,000) divided by total taxable income for 2006 ($480,000) =	.5625
(C) Taxable income for first 3 months of 2007 ($540,000) divided by total taxable income for 2007 ($960,000) =	.5625
(D) Taxable income for first 3 months of 2008 ($1,090,000) divided by total taxable income for 2008 ($1,920,000) =	.5677
(E) Add this paragraph (e), *Example* (iv)(B), (C), and (D) and divide by 3 =	.5642
(F) Divide this paragraph (e), *Example* (iv)(A) by this paragraph (e), *Example* (iv)(E) =	$3,420,773
(G) Determine the tax on this paragraph (e), *Example* (iv)(F) =	$1,163,049
(H) Taxable income for first 4 months of 2006 ($340,000) divided by total taxable income for 2006 ($480,000) =	.7083
(I) Taxable income for first 4 months of 2007 ($670,000) divided by total taxable income for 2007 ($960,000) =	.6979
(J) Taxable income for first 4 months of 2008 ($1,360,000) divided by total taxable income for 2008 (1,920,000) =	.7083
(K) Add this paragraph (e), *Example* (iv)(H), (I), and (J) and divide by 3 =	.7048
(L) Multiply this paragraph (e), *Example* (iv)(G) by this paragraph (e), *Example* (iv)(K) =	$ 819,717

(M) 100% of this paragraph (e), *Example* (iv)(L) =	$ 819,717
(N) Amount of all prior required installments for 2009 =	$0
(O) Amount of adjusted seasonal installment for the first installment payment (this paragraph (e), *Example* (iv)(M) less this paragraph (e), *Example* (iv)(N)) =	$ 819,717

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

(A) Taxable income for first 5 months of 2009 =	$2,950,000
(B) Taxable income for first 5 months of 2006 ($400,000) divided by total taxable income for 2006 ($480,000) =	.8333
(C) Taxable income for first 5 months of 2007 ($795,000) divided by total taxable income for 2007 ($960,000) =	.8281
(D) Taxable income for first 5 months of 2008 ($1,600,000) divided by total taxable income for 2008 ($1,920,000) =	.8333
(E) Add this paragraph (e), *Example* (v)(B), (C), and (D) and divide by 3 =	.8316
(F) Divide this paragraph (e), *Example* (v)(A) by this paragraph (e), *Example* (v)(E) =	$3,547,379
(G) Determine the tax on this paragraph (e), *Example* (v)(F) =	$1,206,109
(H) Taxable income for first 6 months of 2006 ($420,000) divided by total taxable income for 2006 ($480,000) =	.875
(I) Taxable income for first 6 months of 2007 ($840,000) divided by total taxable income for 2007 ($960,000) =	.875
(J) Taxable income for first 6 months of 2008 ($1,680,000) divided by total taxable income for 2008 ($1,920,000) =	.875
(K) Add this paragraph (e), *Example* (v)(H), (I), and (J) and divide by 3 =	.875
(L) Multiply this paragraph (e), *Example* (v)(G) by this paragraph (e), *Example* (v)(K) =	$1,055,345
(M) 100% of this paragraph (e), *Example* (v)(L) =	$1,055,345
(N) Amount of all prior required installments for 2009 =	$ 163,200
(O) Amount of adjusted seasonal installment for the second installment payment (this paragraph (e), *Example* (v)(M) less this paragraph (e), *Example* (v)(N)) =	$ 892,145

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

(A) Taxable income for first 8 months of 2009 =	$3,250,000
(B) Taxable income for first 8 months of 2006 ($440,000) divided by total taxable income for 2006 ($480,000) =	.9167
(C) Taxable income for first 8 months of 2007 ($880,000) divided by total taxable income for 2007 ($960,000) =	.9167
(D) Taxable income for first 8 months of 2008 ($1,760,000) divided by total taxable income for 2008 ($1,920,000) =	.9167
(E) Add this paragraph (e), *Example* (vi)(B), (C), and (D) and divide by 3 =	.9167
(F) Divide this paragraph (e), *Example* (vi)(A) by this paragraph (e), *Example* (vi)(E) =	$3,545,326
(G) Determine the tax on this paragraph (e), *Example* (vi)(F) =	$1,205,411
(H) Taxable income for first 9 months of 2006 ($450,000) divided by total taxable income for 2006 ($480,000) =	.9375
(I) Taxable income for first 9 months of 2007 ($900,000) divided by total taxable income for 2007 ($960,000) =	.9375

(J) Taxable income for first 9 months of 2008 ($1,800,000) divided by total taxable income for 2008 ($1,920,000) =	.9375
(K) Add this paragraph (e), *Example* (vi)(H), (I), and (J) and divide by 3 =	.9375
(L) Multiply this paragraph (e), *Example* (vi)(G) by this paragraph (e), *Example* (vi)(K) =	$1,130,073
(M) 100% of this paragraph (e), *Example* (vi)(L) =	$1,130,073
(N) Amount of all prior required installments for 2009 =	$ 576,300
(O) Amount of adjusted seasonal installment for the third installment payment (this paragraph (e), *Example* (vi)(M) less this paragraph (e), *Example* (vi)(N)) =	$ 553,773

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

(A) Taxable income for first 11 months of 2009 =	$3,370,000
(B) Taxable income for first 11 months of 2006 ($470,000) divided by total taxable income for 2006 ($480,000) =	.9792
(C) Taxable income for first 11 months of 2007 ($940,000) divided by total taxable income for 2007 ($960,000) =	.9792
(D) Taxable income for first 11 months of 2008 ($1,880,000) divided by total taxable income for 2008 ($1,920,000) =	.9792
(E) Add this paragraph (e), *Example* (vii)(B), (C), and (D) and divide by 3 =	.9792
(F) Divide this paragraph (e), *Example* (vii)(A) by this paragraph (e), *Example* (vii)(E) =	$3,441,585
(G) Determine the tax on this paragraph (e), *Example* (vii)(F) =	$1,170,139
(H) Taxable income for first 12 months of 2006 ($480,000) divided by total taxable income for 2006 ($480,000) =	1.0000
(I) Taxable income for first 12 months of 2007 ($960,000) divided by total taxable income for 2007 ($960,000) =	1.0000
(J) Taxable income for first 12 months of 2008 ($1,920,000) divided by total taxable income for 2008 ($1,920,000) =	1.0000
(K) Add this paragraph (e), *Example* (vii)(H), (I), and (J) and divide by 3 =	1.0000
(L) Multiply this paragraph (e), *Example* (vii)(G) by this paragraph (e), *Example* (vi)(K) =	$1,170,139
(M) 100% of this paragraph (e), *Example* (vii)(L) =	$1,170,139
(N) Amount of all prior required installments for 2009 =	$ 864,450
(O) Amount of adjusted seasonal installment for the fourth installment payment (this paragraph (e), *Example* (vii)(M) less this paragraph (e), *Example* (vii)(N)) =	$ 305,689

(viii) Because the total amount of each required estimated tax payment determined under section 6655(e)(3) and paragraph (a) of this section exceeds the amount of each required estimated tax payment determined under section 6655(d) and §1.6655–1(d) and (e), the exception described in section 6655(e) and this section does not apply and the addition to the tax with respect to the underpayment for the June 15, 2009, and September 15, 2009, installments will be imposed unless another exception (for example, see section 6655(e)(2)) applies with respect to these installments.

(f) *Effective/applicability date*. This section applies to taxable years beginning after September 6, 2007.

Par. 9. Section 1.6655–4 is added to read as follows:

§1.6655–4 Large corporations.

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

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

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

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

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

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

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

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

(ii) For purposes of determining whether a transferor or distributor corporation had taxable income of $1,000,000 or more for a taxable year in which a section 381 transaction occurs, the distributor or transferor corporation's taxable income (or loss) is reduced by the amount of taxable income (or loss) that is included in the acquiring corporation's taxable income for the taxable year in which the distribution or transfer (as defined in §1.381(b)–1(b)) occurs, as described in paragraph (c)(2)(i)(B) of this section.

(d) *Members of controlled group*—(1) *In general.* For purposes of applying paragraph (a) of this section, the taxable income of members of a controlled group of corporations (as defined in section 1563(a)) must be aggregated for each year of the testing period. The provisions of this section do not apply to a controlled group for any taxable year in which the aggregate taxable income of the members of the controlled group is less than $1,000,000.

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

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

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

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

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

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

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

Example. Y Corporation and Z Corporation are calendar year taxpayers. In 2008, Z acquires all of the assets of Y in a transaction to which section 381 applies. Z's taxable income for both 2006 and 2007 was less than $1,000,000. Y's taxable income for 2008 is determined under paragraph (c)(2) of this section to be $300,000 for that portion of Y's taxable year corresponding to Z's taxable year up to and including the date of transfer. Z's taxable income for 2008 is $800,000. Under the provisions of paragraph (c)(2) of this section, Z's 2008 taxable income for purposes of determining whether it is a large corporation for taxable year 2009 is $1,100,000 ($800,000 + $300,000). Thus, Z is a large corporation for the 2009 taxable year. In addition, if Z's 2008 taxable income, as determined under paragraph (c)(2) of this section, had been less than $1,000,000 but Y's taxable income in 2006 or 2007 had been $1,000,000 or more, Z would be a large corporation for taxable year 2009 because Y is a predecessor corporation.

(h) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

§1.6655–7 [Removed]

Par. 10. Section 1.6655–7 is removed.

§1.6655–5 [Redesignated as §1.6655–7]

Par. 11. Section 1.6655–5 is redesignated as §1.6655–7.

Par. 12. Sections 1.6655–5 and 1.6655–6 are added to read as follows:

§1.6655–5 Short taxable year.

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

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

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

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

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

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

(B) A taxpayer with an initial short taxable year may make estimated tax payments as though it were a calendar year taxpayer until it files its tax return for its initial taxable year and will not be subject to an addition to tax under section 6655 for making estimated tax payments as though it were a calendar year taxpayer for the period beginning with its initial short taxable year to the time it files its tax return for its initial short taxable year if, when filing its tax return for its initial short taxable year, the taxpayer chooses to be a fiscal year taxpayer.

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

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

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

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

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

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

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

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

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

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

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

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

(4) *Applicable percentage for installment period in which taxpayer does not reasonably expect that the taxable year will be an early termination year*. In the case of any required installment determined under section 6655(e) in which the taxpayer does not reasonably expect that the taxable year will be an early termination year, the applicable percentage under section 6655(e)(2)(B)(ii) is the applicable percentage provided by paragraph (d)(3)(i) of this section with the remaining balance of the estimated tax payment for the year due with the final installment.

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

Example 1. Short year of less than 4 months. Corporation A is a calendar year taxpayer that was acquired by corporation B, a member of a consolidated group (as defined in §1.1502–1(h)) on April 16, 2009, resulting in A having a short taxable year from January 1, 2009, through April 16, 2009. Because A has a taxable year of less than four full calendar months, no estimated tax payments are required by A for the short taxable year.

Example 2. Initial short year with four required installments. Corporation B began business on January 9, 2009, and adopted a calendar year as its taxable year. B computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655–1(f)(2)(i), the due dates of B's required installments for B's initial taxable year from January 9, 2009, through December 31, 2009, are April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 25% of the required annual payment for B's first required installment, 50% of the required annual payment for B's second required installment, 75% of the required annual payment for B's third required installment, and 100% of the required annual payment for B's fourth required installment.

Example 3. Initial short year with three required installments. Corporation C began business on February 12, 2009, and adopted a calendar year as its taxable year. C computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655–1(f)(2)(i), the due dates of C's required installments for C's initial taxable year from February 12, 2009, through December 31, 2009, are April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009. However, in accordance with paragraph (c)(1)(ii)(A) of this section, C's first required installment is due June 15, 2009, because April 15, 2009, is earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second required installment is due September 15, 2009, and C's third (and last) installment is due December 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 33.33% of the required annual payment for C's first required installment, 66.67% of the required annual payment for C's second required installment, and 100% of the required annual payment for C's third (and last) required installment.

Example 4. Initial short year with two required installments. Same facts as *Example 3* except C began business on April 10, 2009. In accordance with paragraph (c)(1)(ii)(A) of this section, C's first required installment is due September 15, 2009, because April 15, 2009, and June 15, 2009, are earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second (and last) required installment is due December 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for C's first required installment, and 100% of the required annual payment for C's second (and last) required installment.

Example 5. Initial short year for fiscal year taxpayer with two required installments. Corporation D began business on February 12, 2009, and adopted a fiscal year ending October 31 as its taxable year. D computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655–1(f)(2)(ii), the due dates of D's required installments for D's initial taxable year from February 12, 2009, through October 31, 2009, are

February 15, 2009, April 15, 2009, July 15, 2009, and October 15, 2009. However, in accordance with paragraph (c)(1)(ii)(A) of this section, D's first required installment is due July 15, 2009, because February 15, 2009, and April 15, 2009, are earlier than the fifteenth day of the fourth month of D's taxable year. As a result, D's second (and last) installment is due October 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for D's first required installment, and 100% of the required annual payment for D's second (and last) required installment.

Example 6. Initial short year for fiscal year taxpayer with one required installment. Same facts as *Example 5* except D corporation began business on May 11, 2009. In accordance with paragraph (c)(1)(ii)(A) of this section, D's first (and last) installment is due October 15, 2009, because July 15, 2009, is earlier than the fifteenth day of the fourth month of D's taxable year. Pursuant to paragraph (d)(1) of this section, the amount due with D's required installment is 100% of the required annual payment, computed as 100% divided by the number of required installments due for the short taxable year.

Example 7. Short termination year with three required installments. Corporation E is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). E computes its 2009 required installments based on a projected 2009 total tax liability of $600,000. On July 31, 2009, E is acquired by corporation F, a member of a consolidated group (as defined in §1.1502–1(h)), resulting in E having a short taxable year from January 1, 2009, through July 31, 2009. E determines that its total tax liability for the short period is $350,000. The due dates for E's first and second required installments are April 15, 2009, and June 15, 2009, respectively. Pursuant to section 6655(d)(1)(A), E paid $150,000 with each required installment. Pursuant to paragraph (c)(2) of this section, E's third (and last) required installment of estimated tax is due on September 15, 2009, and the percentage of the required annual payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. Accordingly, E is required to pay $50,000 with its final required installment on September 15, 2009 ($350,000 total tax liability for the short taxable year less prior installment payments of $300,000).

Example 8. Unexpected short termination year with three required installments using the annualization method. Same facts as *Example 7* except that E uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2009 taxable year. In addition, E does not reasonably expect until July 28, 2009, that it will have a short termination year caused by E being acquired by F on July 31, 2009. Had E known about its acquisition by F in the first quarter of 2009, E's applicable percentages for computing the amount of its three required installments would be 33.33%, 66.67%, and 100% for the first, second, and third (last) required installments, respectively, pursuant to paragraph (d)(3)(ii) of this section. However, because E had an unexpected short termination year that E was not aware of until after its second required installment payment, E's applicable percentages for computing the amount of its three required installment are 25%, 50%, and 100% for the first, second, and third (last) required installments, respectively, pursuant to paragraph (d)(4) of this section.

Example 9. Short termination year ending within 30 days of the regular final installment due date. Same facts as *Example 7* except that E is acquired by F on August 31, 2009. Pursuant to paragraph (c)(2)(ii) of this section, E's third (and last) required installment of estimated tax is due on October 15, 2009, because September 15, 2009, the date that would have been the due date of E's next required installment if F's acquisition of E had not occurred, is within thirty days of the last day of E's short taxable year, and 100% of the required annual payment is due with such installment.

Example 10. Short termination year ending within 30 days of the regular final installment due date. Corporation F is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). F computes its 2009 estimated tax payments based on a projected 2009 total tax liability of $900,000. On December 3, 2009, F is acquired by corporation G, a member of a consolidated group (as defined in §1.1502–2(h)), resulting in F having a short taxable year from January 1, 2009, through December 3, 2009. F determined its total tax liability for the short period to be $800,000. The due dates for F's first, second, and third required installments are April 15, 2009, June 15, 2009, and September 15, 2009, respectively. Pursuant to section 6655(d)(1)(A), F paid $225,000 with each required installment. Pursuant to paragraph (c)(2)(ii) of this section, F's fourth (and last) required installment of estimated tax is due on February 15, 2010, and the percentage of the required annual payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. However, because the due date for the fourth required installment falls on a legal holiday, F's required installment payment will be timely if paid on or before the first business day following the actual due date of the fourth required installment, that is, February 16, 2010. Accordingly, F is required to pay $125,000 with its final required installment on February 16, 2010 ($800,000 total tax liability for the short taxable year less prior installment payments of $675,000).

Example 11. Short termination year using the tax shown on the return for the preceding taxable year. Corporation G, a calendar year taxpayer, reported a tax liability of $75,000 on its return for the taxable year ending December 31, 2008, and is not a large corporation as defined in section 6655(g). On July 31, 2009, G makes a final distribution of its assets, in connection with a plan of complete liquidation, resulting in a short taxable year from January 1, 2009, through July 31, 2009. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii) for payments determined by reference to the tax shown on the return of the corporation for the preceding taxable year, pursuant to paragraph (d)(2) of this section, G must pay in a proportionate amount of its 2008 tax liability based on the number of months in the current taxable year. Accordingly, G must pay $43,750 ($75,000 X 7/12) through payments of estimated tax payments in 2009, with $14,583 due on April 15, 2009, June 15, 2009, and September 15, 2009.

Example 12. Short termination year using the tax shown on the return for the preceding taxable year. Same facts as *Example 11* except that G makes a final distribution of its assets, in connection with a plan of complete liquidation, on October 1, 2009, resulting in a short taxable year from January 1, 2009, through October 1, 2009. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii), G must pay $56,250 ($75,000 x 9/12) through payments of estimated tax in 2009, with $14,063 due on April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively.

Example 13. Short initial year with three required installments resulting in an underpayment. (i) Corporation H began business on February 17, 2009, and adopted a calendar year. H computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). H estimated at the beginning of its short taxable year that its estimated tax liability for short taxable year February 17, 2009, through December 31, 2009, would be $180,000. H paid its first required installment of estimated tax of $60,000 on June 15, 2009, its second required installment of estimated tax of $60,000 on September 15, 2009, and its third (and last) required installment of estimated tax of $60,000 on December 15, 2009 ($180,000 total estimated tax liability for the short taxable year less prior installment payments of $120,000). H reported a tax liability of $240,000 on its return for the short period February 17, 2009, through December 31, 2009, with no credits against tax. There was an underpayment in the amount of $20,000 on the first installment date through September 15, 2009, $40,000 on the second installment date through December 15, 2009, and $60,000 on the third (and last) installment date through March 15, 2010, determined as follows:

(A) Tax as defined in section 6655(d)(1)(B)(i) =	$240,000
(B) 100% of this paragraph (e), *Example 13* (A) =	$240,000
(C) Amount of estimated tax required to be paid by the first installment date (33.33% of $240,000) =	$ 80,000

(D) Amount of estimated tax required to be paid by the second installment date (66.67% of $240,000 less $80,000 (amount due with first installment)) =	$ 80,000
(E) Amount of estimated tax required to be paid by the third installment date (100% of $240,000 less $160,000 (amount due with first and second installment)) =	$ 80,000
(F) Deduction of amount paid on or before the first installment date =	$ 60,000
(G) Amount of underpayment for the first installment date (this paragraph (e), *Example 13* (i)(C) minus this paragraph (e), *Example 13* (i)(F)) =	$ 20,000
(H) Deduction of amount available for the second installment date ($60,000 second installment payment less this paragraph (e), *Example 13* (i)(G) applied towards the first installment underpayment) =	$ 40,000
(I) Amount of underpayment for the second installment date (this paragraph (e), *Example 13* (i)(D) minus this paragraph (e), *Example 13* (i)(H)) =	$ 40,000
(J) Deduction of amount available for the third installment date ($60,000 third installment payment less this paragraph (e), *Example 13* (i)(I) applied towards the second installment underpayment) =	$ 20,000
(K) Amount of underpayment for the third installment date (this paragraph (e), *Example 1* (i)(E) minus this paragraph (e), *Example 13* (i)(J)) =	$ 60,000

(ii) [Reserved].

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

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

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

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

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

Example 1. Corporation X began business on February 12, 2009, and adopted a calendar year as its taxable year. X adopts an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2009 taxable year. Pursuant to §1.6655–1(f)(2)(i), the due dates of X's required installments for X's initial taxable year from February 12, 2009, through December 31, 2009, are April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009. However, in accordance with paragraph (c)(1)(ii)(A) of this section, X's first required installment is due June 15, 2009. As a result, X's second required installment is due September 15, 2009, and X's third (and last) required installment is due December 15, 2009. The amount of X's first and second required installments are each based on annualizing X's taxable income from February 12, 2009, through April 30, 2009, (the first three months of X's taxable year) and X's third (and last) required installment is based on annualizing X's taxable income from February 12, 2009, through July 31, 2009 (the first six months of X's taxable year). Because X will have three required installments due for its short taxable year, pursuant to paragraph (d)(3)(ii) of this section, the applicable percentage is 33.33% for X's first required installment, 66.67% for X's second required installment, and 100% for X's third (and last) required installment.

Example 2. (i) Y, a calendar year corporation, made a final distribution of its assets, in connection with a plan of complete liquidation, on August 3, 2009. Y filed a timely election to use the alternative annualization periods described under section 6655(e)(2)(C)(i) and determined that its taxable income for the first 2, 4 and 7 months of the taxable year was $25,000, $50,000 and $140,000. The due dates for Y's required installments for its short taxable year January 1, 2009, through August 3, 2009, are April 15, 2009, June 15, 2009, and September 15, 2009. Y made installment payments of $10,000, $10,000, and $20,000, respectively, on April 15, 2009, June 15, 2009, and September 15, 2009. The taxable income for each period is annualized as follows:

$25,000 X 12/2 =	$150,000
$50,000 X 12/4 =	$150,000
$140,000 x 12/7 =	$240,000

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

(*1*) Annualized income for the 2 month period =	$150,000
(*2*) Tax on this paragraph (g)(4), *Example 2* (ii)(A)(*1*) =	$ 41,750
(*3*) Tax determined under this paragraph (g)(4), *Example 2* (ii)(A)(*2*) divided by 12 multiplied by 7 (the number of months in the short taxable year) =	$ 24,354

(*4*) 100% of this paragraph (g)(4), *Example 2* (ii)(A)(*3*) =	$ 24,354
(*5*) 33.33% of this paragraph (g)(4), *Example 2* (ii)(A)(*4*) =	$ 8,117

(B) Because the total amount of estimated tax that is timely paid on or before the first installment date ($10,000) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period taking into account the number of months in the short taxable year, the exception described in §1.6655–2(a) applies and no addition to tax will be imposed for the installment due on April 15, 2009.

(iii)(A) To determine whether the required installments made on or before June 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 4-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 4 month period =	$150,000
(*2*) Tax on this paragraph (g)(4), *Example 2* (iii)(A)(*1*) =	$ 41,750
(*3*) Tax determined under this paragraph (g)(4), *Example 2* (iii)(A)(*2*) divided by 12 multiplied by 7 (the number of months in the short taxable year) =	$ 24,354
(*4*) 100% of this paragraph (g)(4), *Example 2* (iii)(A)(*3*) =	$ 24,354
(*5*) 66.67% of this paragraph (g)(4), *Example 2* (iii)(A)(*4*) less $8,117 (amount due with first installment) =	$ 8,120

(B) Because the total amount of estimated tax available to apply towards the amount due for the second installment ($11,883 ($10,000 paid on the second installment date plus $1,883 overpayment of the first installment)) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in §1.6655–2(a) applies and no addition to tax will be imposed for the installment due on June 15, 2009.

(iv)(A) Pursuant to paragraph (c) and (d) of this section, the final required installment is due by September 15, 2009, and the applicable percentage due for the final required installment is 100%. To determine whether the installment payments made on or before September 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 7-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 7 month period =	$240,000
(*2*) Tax on this paragraph (g)(4), *Example 2* (iv)(A)(*1*) =	$ 76,850
(*3*) Tax determined under this paragraph (g)(4), *Example 2* (iv)(A)(*2*) divided by 12 multiplied by 7 (the number of months in the short taxable year) =	$ 44,829
(*4*) 100% of this paragraph (g)(4), *Example 2* (iv)(A)(*3*) =	$ 44,829
(*5*) 100% of this paragraph (g)(4), *Example 2* (iv)(A)(*4*) less $16,237 (amount due with first and second installment) =	$ 28,592

(B) Because the total amount of estimated tax available to apply towards the amount due for the final installment ($23,763 ($20,000 that is timely paid on the third installment date plus $3,763 overpayment of the second installment)) does not exceed the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in §1.6655–2(a) does not apply and an addition to tax will be imposed for the final installment due on September 15, 2009, unless another exception (for example, see section 6655(e)(3)) applies with respect to these installments.

(h) *Effective/applicability date*. This section applies to taxable years beginning after September 6, 2007.

§1.6655–6 Methods of accounting.

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

(b) *Accounting method changes*. A taxpayer that changes its method of accounting with the consent of the Commissioner for the current taxable year must use the new method of accounting (as of the beginning of the taxable year) in the determination of taxable income for annualization periods ending on or after the date the related section 481(a) adjustment is treated as arising. See §1.6655–2(f)(3)(ii)(C) for the date a section 481(a) adjustment is treated as arising. If the change in method of accounting does not result in a section 481(a) adjustment, the taxpayer may choose to use the new method of accounting (as of the beginning of the taxable year) in the determination of taxable income for all annualization periods during the year of change or only those annualization periods ending on or after the date the Form 3115 *"Application for Change in Accounting Method"* was filed with the national office of the Internal Revenue Service. This paragraph (b) only applies to the extent a taxpayer changes a method of accounting for the taxable year with the consent of the Commissioner. Therefore, a taxpayer may be subject to a section 6655 addition to tax for an underpayment of estimated tax if an underpayment results from a change in a method of accounting the taxpayer anticipates making for the taxable year but for which the consent of the Commissioner is not subsequently received.

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

Example 1. Accounting method used in computing taxable income for the taxable year. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate all of its 2008 required installments. ABC receives advance payments each taxable year with respect to agreements for the sale of goods properly includible in ABC's inventory. The advance payments received by ABC qualify for deferral under §1.451–5(c). Although ABC is eligible to defer the advance payments in accordance with §1.451–5(c), ABC's method of accounting with respect to the advance payments is to include the advance payments in income when received and ABC does not change its accounting method for advance payments for the 2008 taxable year. ABC must use its current method of recognizing advance payments as income in the year received for purposes of computing its 2008 required installments.

Example 2. Change of accounting method. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate all of its 2008 required installments. On June 15, 2008, ABC files a Form 3115 requesting permission to change its method of accounting for future litigation reserves for the tax year ending December 31, 2008. On February 15, 2009, ABC receives consent from the Commissioner to make the change for the tax year ending December 31, 2008. The change results in a positive section 481(a) adjustment of $100,000. Under the provisions of §1.6655–2(f)(3)(ii), ABC chooses to treat the section 481(a) adjustment as arising on the date the Form 3115 is filed with the national office of the Internal Revenue Service. Therefore, ABC is required to use the new method of accounting (as of the beginning of the year) in the determination of taxable income for annualization periods ending on or after June 15, 2008.

(d) *Effective/applicability date*. This section applies to taxable years beginning after September 6, 2007.

Par. 13. Newly-designated §1.6655–7 is revised to read as follows:

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

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

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

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

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

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

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

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

Example. (i) Corporation X, a calendar year taxpayer, had an underpayment as defined in section 6655(b), for its fourth installment of estimated tax that was due on December 15, 2009, in the amount of $10,000. On January 4, 2010, X filed an application for adjustment of overpayment of estimated income tax for 2009 in the amount of $20,000.

(ii) On February 16, 2010, the Internal Revenue Service, in response to the application, refunded $20,000 to X. On March 15, 2010, X filed its 2009 tax return and made a payment in settlement of its total tax liability. Assuming that the addition to tax is computed under section 6621(a)(2) at a rate of 8% *per annum* for the applicable periods of underpayment, under section 6655(a), X is subject to an addition to tax in the amount of $197 (90/365 X $10,000 X 8%) on account of X's December 15, 2009, underpayment. Under section 6655(h), X is subject to an addition to tax in the amount of $118 (27/365 X $20,000 X 8%) on account of X's excessive adjustment under section 6425. In determining the amount of the addition to tax under section 6655(a) for failure to pay estimated income tax, the excessive adjustment under section 6425 is not taken into account.

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

(g) *Effective/applicability date*: This section applies to taxable years beginning after September 6, 2007.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 14. The authority citation for part 301 continues to read in part as follows:

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

§301.6154–1 [Removed]

Par. 15. Section 301.6154–1 is removed.

Par. 16. Section 301.6655–1 is revised to read as follows:

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

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

(b) *Effective/applicability date*: This section applies to taxable years beginning after September 6, 2007.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 17. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§602.101 [Amended]

Par. 18. Section 602.101, paragraph (b) is amended by removing the entries for §§1.6154–2, 1.6154–3, 1.6154–5, 1.6655–1, 1.6655–2, 1.6655–3 and 1.6655–7.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 17, 2007.

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

(Filed by the Office of the Federal Register on August 6, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 7, 2007, 72 F.R. 44337)

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Public Inspection of Material Relating to Tax-Exempt Organizations

REG–116215–07

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that amend existing regulations issued under sections 6104 and 6110 of the Internal Revenue Code. The purpose of the proposed regulations is to clarify rules relating to information that is made available by the IRS for public inspection under section 6104(a) and materials that are made publicly available under section 6110. The changes reflect IRS practice as well as the United States Court of Appeals for the District of Columbia Circuit's decision in *Tax Analysts v. IRS*, 350 F.3d 100 (D.C. Cir. 2003). The *Tax Analysts* decision invalidated the portions of §§301.6104(a)–1(i) and 301.6110–1(a) that excepted rulings that denied or revoked an organization's tax exempt status from the public disclosure provisions of both sections 6104 and 6110. The proposed regulations will affect organizations exempt from Federal income tax under section 501(a) or 527, organizations that were exempt but are no longer exempt from Federal income tax, and organizations that were denied tax-exempt status.

DATES: Written or electronic comments and requests for a public hearing must be received by November 13, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–116215–07), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–116215–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–116215–07).

FOR FURTHER INFORMATION CONTACT: Concerning submission of comments, Kelly Banks, (202) 622–7180 (not a toll-free number); concerning the proposed regulations, Mary Ellen Keys, (202) 622–4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Since 1950, the Internal Revenue Code has provided for the public inspection of information that is submitted to the IRS by certain exempt organizations and certain trusts. Under section 6104(a), the IRS makes available for public inspection approved applications for exemption from Federal income tax for organizations described in section 501(c) or (d) and exempt under section 501(a), notices of status filed under section 527(i) by political organizations exempt from taxation under section 527, and certain related documents. Section 6104(a) also permits the IRS to disclose whether an organization is currently recognized as exempt and the subsection and paragraph number of section 501 under which it is recognized. Section 6104(b) imposes an additional obligation on the IRS to make available for public inspection annual information returns filed by organizations exempt from Federal income tax. Section 6104(c) governs when the IRS may disclose certain information about charitable and certain other exempt organizations to state officials. Section 6104(d) imposes a parallel obligation on organizations and trusts to make available for public inspection annual returns, applications for exemption and notices of status. The proposed regulations do not address the obligations imposed by subsections (b), (c) and (d).

The decision in *Tax Analysts v. IRS*, 350 F.3d 100 (D.C. Cir. 2003), invalidated the portions of existing §301.6104(a)–1(i)(1), (2), and (3) and §301.6110–1(a) that excluded rulings that denied or revoked an organization's tax exempt status from the public disclosure provisions of both sections 6104 and 6110. Sections 301.6104(a)–1(i)(1), (2) and (3) excluded from disclosure by the IRS unfavorable rulings or determination letters in response to exemption applications, rulings or determination letters that make or modify a favorable determination letter, and technical advice memoranda that relate to a disapproved exemption application or the revocation or modification of a favorable determination letter. Thus, because §301.6110–1(a) provided that the disclosure of such rulings, determination letters and technical advice memoranda is to be determined under section 6104, they also were not available under section 6110. The IRS has already modified its administrative practice to follow the court's holding by making these documents available to the public. See AOD 2004–2, 2004–29 I.R.B., §601.601(d)(2)(ii)(a). The Treasury Department and IRS now propose to revise the existing regulations at §301.6104(a)–1 and §301.6110–1(a) to conform to the court's holding in *Tax Analysts*.

Explanation of Provisions

The proposed regulations remove existing §301.6104(a)–1(i) and portions of §301.6110–1(a), in light of the holding in *Tax Analysts*. The proposed regulations clarify that the term "application" includes information submitted to the IRS relating to group exemption applications. The proposed regulations provide that notices of status filed under section 527(i) and the documents comprising the notices are available for public inspection under section 6104(a). The proposed regulations also add to the material that is available for public inspection the letters or documents filed with or issued by the IRS relating to an organization's status as an organization described in sections 509(a), 4942(j)(3), or 4943(f), including a final determination letter that the organization is or is not a private foundation.

The proposed regulations clarify that the IRS may disclose, in response to or in anticipation of a request, the subsection and paragraph number of section 501 under which an organization or group has been determined, on the basis of its application, to qualify for exemption from Federal income tax, and whether an organization or group is currently recognized as exempt.

Section 6104(a) applies to the publication of certain information related to organizations that are exempt from Federal income taxation under section 501(a). The information covered by section 6104(a) includes material for any taxable year during which the organization was exempt. Under the proposed regulations, written determinations issued by the IRS, including, for example, unfavorable rulings or determination letters issued in response to applications for tax exemption and rulings or determination letters revoking or modifying a favorable determination letter, are made available for public inspection under section 6110.

Other changes to the existing regulations

The proposed regulations reorganize or revise certain provisions of the existing regulations to eliminate redundancy and/or to provide greater clarity. First, §301.6104(a)–1(a) is revised to clarify that applications for exemption from Federal income tax and supporting documents shall be open for public inspection, even if the IRS subsequently revokes the organization's exempt status.

Second, new §301.6104(a)–1(b) is added to clarify that notices of status filed by political organizations described in section 527 are open for public inspection.

Third, §301.6104(a)–1(c) (formerly §301.6104(a)–1(b)) is revised to clarify that group exemption letters are included among the information that is available for public inspection under section 6104(a).

Fourth, §301.6104(a)–1(d) (formerly §301.6104(a)–1(c)) is revised to clarify that, where an organization is determined to be exempt for any taxable year, material shall not be withheld on the basis that the organization is determined not to be exempt for any other taxable year.

Fifth, §301.6104(a)–1(g) (formerly §301.6104(a)–1(e)), which defines the term "supporting document" with respect to an application for exemption from Federal income tax, is revised to clarify that there are no supporting documents with respect to notices of status filed by political organizations.

Sixth, new §301.6104(a)–1(h) is added to clarify that the IRS may disclose, in response to or in anticipation of a request, the subsection and paragraph number of section 501 under which an organization or group has been determined to be exempt from Federal income taxation, whether an organization or group is exempt, or whether the IRS has revoked an organization's or group's exemption under section 501(c)(3).

Finally, new §301.6104(a)–1(i) is added to refer the reader to section 6033(j), added to the Code by the Pension Protection Act of 2006, Pub. L. 109–280, 120 Stat. 780, which is an additional statutory provision that requires disclosure of information by the IRS regarding organizations formerly exempt from Federal income tax. Section 6033(j) governs the publication and maintenance of a list of organizations whose tax exempt status was revoked for failure to file required returns or notices for three consecutive years. Likewise, this paragraph cross-references section 7428(c), which relates to the revocation of a determination of exempt status, and section 501(p), added to the Code by the Military Family Tax Relief Act of 2003, Pub. L. 108–121, 117 Stat. 1335, which relates to suspension of the tax-exempt status of terrorist organizations, including public notice of suspensions.

Special Analyses

It has been determined that the proposed regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to the regulations, and, therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small businesses.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of the regulations is Mary Ellen Keys, Office of the Associate Chief Counsel (Procedure & Administration).

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. §301.6104(a)–1 is revised to read as follows:

§301.6104(a)–1 Public inspection of material relating to tax-exempt organizations.

(a) *Applications for exemption from Federal income tax, applications for a group exemption letter and supporting documents.* If the Internal Revenue Service determines that an organization described in section 501(c) or (d) is exempt from Federal income tax for any taxable year, the application upon which the determination is based, together with any supporting documents, shall be open to public inspection. Such applications and supporting documents shall be open for public inspection even after any revocation of the Internal Revenue Service's determination that the organization is exempt from Federal income tax. Some applications have been destroyed and therefore are not available for inspection. For purposes of determining the availability for public inspection, a claim for exemption from Federal income tax filed to reestablish exempt status after denial thereof under the provisions of section 503 or 504 (as in effect on December 31, 1969), or under the corresponding provisions of any prior revenue law, is considered an application for exemption from Federal income tax.

(b) *Notices of status filed by political organizations*. If, in accordance with section 527(i), an organization notifies the Internal Revenue Service that it is a political organization as described in section 527, exempt from Federal income tax for any taxable year, the notice of status filed by the political organization shall be open to public inspection.

(c) *Letters or documents issued by the Internal Revenue Service with respect to an application for exemption from Federal income tax*. If an application for exemption from Federal income tax is filed with the Internal Revenue Service after October 31, 1976, and is open to public inspection under paragraph (a) of this section, then any letter or document issued to the applicant by the Internal Revenue Service that relates to the application is also open to public inspection. For rules relating to when a letter or document is issued, see §301.6110–2(h). Letters or documents to which this paragraph applies include, but are not limited to—

(1) Favorable rulings and determination letters, including group exemption letters, issued in response to applications for exemption from Federal income tax;

(2) Technical advice memoranda issued with respect to the approval, or subsequent approval, of an application for exemption from Federal income tax;

(3) Letters issued in response to an application for exemption from Federal income tax (including applications for a group exemption letter) that propose a finding that the applicant is not entitled to be exempt from Federal income tax, if the applicant is subsequently determined, on the basis of that application, to be exempt from Federal income tax; and

(4) Any letter or document issued by the Internal Revenue Service relating to an organization's status as an organization described in sections 509(a), 4942(j)(3), or 4943(f), including a final determination letter that the organization is or is not a private foundation.

(d) *Requirement of exempt status*. An application for exemption from Federal income tax (including applications for a group exemption letter), supporting documents, and letters or documents issued by the Internal Revenue Service that relate to the application shall not be open to public inspection before the organization is determined, on the basis of that application, to be exempt from Federal income tax for any taxable year. If an organization is determined to be exempt from Federal income tax for any taxable year, these materials shall not be withheld from public inspection on the basis that the organization is subsequently determined not to be exempt for any other taxable year.

(e) *Documents included in the term "application for exemption from Federal income tax*." For purposes of this section—

(1) *Prescribed application form*. If a form is prescribed for an organization's application for exemption from Federal income tax, the application includes the form and all documents and statements that the Internal Revenue Service requires to be filed with the form, any amendments or revisions to the original application, or any resubmitted applications where the original application was submitted in draft form or was withdrawn. An application submitted in draft form or an application submitted and later withdrawn is not considered an application.

(2) *No prescribed application form*. If no form is prescribed for an organization's application for exemption from Federal income tax, the application includes the submission by letter requesting recognition of tax exemption and any statements or documents as prescribed by Revenue Procedure 2007–52, 2007–30 I.R.B. 222, and any successor guidance. (See §601.201(n)(7)(i) of the Statement of Procedural Rules, 26 CFR part 601.)

(3) *Application for a Group Exemption Letter*. The application for a group exemption letter includes the letter submitted by or on behalf of subordinate organizations that seek exempt status pursuant to a group exemption letter and any statements or documents as prescribed by Revenue Procedure 80–27, 1980–1 C.B. 677, and any successor guidance. (See §601.201(n)(8)(i) of the Statement of Procedural Rules, 26 CFR part 601.)

(4) *Notice of status filed under section 527(i)*. For purposes of this section, documents included in the term "notice of status filed under section 527(i)" include—

(i) Form 8871, *Political Organization Notice of Section 527 Status*;

(ii) Form 8453–X, *Political Organization Declaration for Electronic Filing of Notice of Section 527 Status*; and

(iii) Any other additional forms or documents that the Internal Revenue Service may prescribe.

(f) *Material open to public inspection under section 6110*. Under section 6110, certain written determinations issued by the Internal Revenue Service are made available for public inspection. Section 6110 does not apply, however, to material that is open to public inspection under section 6104. See section 6110(l)(1).

(g) *Supporting documents defined*. For purposes of this section, "supporting documents," with respect to an application for exemption from Federal income tax, means any statement or document not described in paragraph (e) of this section that is submitted by the organization or group in support of its application prior to a determination described in paragraph (c) of this section. Items submitted in connection with an application in draft form, or with an application submitted and later withdrawn, are not supporting documents. There are no supporting documents with respect to Notices of Status filed by political organizations.

(h) *Statement of exempt status*. For efficient tax administration, the Internal Revenue Service may publish, in paper or electronic format, the names of organizations currently recognized as exempt from Federal income tax, including organizations recognized as exempt from Federal income tax under particular paragraphs of section 501(c) or section 501(d). In addition to having the opportunity to inspect material relating to an organization exempt from Federal income tax, a person may request a statement, or the Internal Revenue Service may disclose, in response to or in anticipation of a request, the following information—

(1) The subsection and paragraph of section 501 (or the corresponding provision of any prior revenue law) under which the organization or group has been determined, on the basis of an application open

to public inspection, to qualify for exemption from Federal income tax; and

(2) Whether an organization or group is currently recognized as exempt from Federal income tax.

(i) *Publication of non-exempt status*—(1) For publication of the notice of the revocation of a determination that an organization is described in section 501(c)(3), see section 7428(c).

(2) For publication of a list including any organization the tax exemption of which is revoked for failure to file required returns or notices for three consecutive years, see section 6033(j).

(3) For publication of notice of suspension of tax exemption of terrorist organizations, see section 501(p).

(j) *Withholding of certain information from public inspection*. For rules relating to certain information contained in an application for exemption from Federal income tax and supporting documents that will be withheld from public inspection, see §301.6104(a)–5(a).

(k) *Procedures for inspection*. For rules relating to procedures for public inspection of applications for exemption from Federal income tax and supporting documents, see §301.6104(a)–6.

(l) *Effective/applicability date*. The rules of this section apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register.**

Par. 3. §301.6110–1 is amended by:

1. Revising paragraph (a).
2. Adding paragraph (d).

The addition and revision read as follows:

§301.6110–1 Public inspection of written determinations and background file documents.

(a) *General rule*. Except as provided in §301.6110–3, relating to deletion of certain information, §301.6110–5(b), relating to actions to restrain disclosure, paragraph (b)(2) of this section, relating to technical advice memoranda involving civil fraud and criminal investigations, and jeopardy and termination assessments, and paragraph (b)(3) of this section, relating to general written determinations relating to accounting or funding periods and methods, the text of any written determination (as defined in §301.6110–2(a)) issued pursuant to a request postmarked or hand delivered after October 31, 1976, shall be open to public inspection in the places provided in paragraph (c)(1) of this section. The text of any written determination issued pursuant to a request postmarked or hand delivered before November 1, 1976, shall be open to public inspection pursuant to section 6110(h) and §301.6110–6, when funds are appropriated by Congress for such purpose. The procedures and rules set forth in §§301.6110–1 through 301.6110–5 and §301.6110–7 do not apply to written determinations issued pursuant to requests postmarked or hand delivered before November 1, 1976, unless §301.6110–6 states otherwise. There shall also be open to public inspection in each place of public inspection an index to the written determinations subject to inspection at such place. Each such index shall be arranged by section of the Internal Revenue Code, related statute or tax treaty and by subject matter description within such section in such manner as the Commissioner may from time to time provide. The Commissioner shall not be required to make any written determination or background file document open to public inspection pursuant to section 6110 or refrain from disclosure of any such documents or any information therein, except as provided by section 6110 or with respect to a discovery order made in connection with a judicial proceeding. The provisions of section 6110 shall not apply to material that is open to public inspection under section 6104. See section 6110(l)(1).

* * * * *

(d) *Effective/applicability date*. The rules of paragraph (a) of this section apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 13, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 14, 2007, 72 F.R. 45394)

Qualified Films Under Section 199; Correction

Announcement 2007–77

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to a notice of proposed rulemaking (REG–103842–07, 2007–28 I.R.B. 79) that was published in the **Federal Register** on Thursday, June 7, 2007 (72 FR 31478). These regulations involve the deduction for income attributable to domestic production activities under section 199 and affect taxpayers who produce qualified films under section 199(c)(4)(A)(i)(II) and (c)(6) and taxpayers who are members of an expanded affiliated group under section 199(d)(4).

FOR FURTHER INFORMATION CONTACT: Concerning §1.199–3(k) of the proposed regulations, David McDonnell at (202) 622–3040; concerning §1.199–7 of the proposed regulations, Ken Cohen (202) 622–7790 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–103842–07) that is the subject of the correction is under section 199 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–103842–07) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG–103842–07), that is the subject of FR Doc. E7–10821, is corrected as follows:

1. On page 31480, column 2, in the preamble, under the paragraph heading "*Expanded Affiliated Groups*", second paragraph of the column, lines 25 through 28,

the language "assume that X and Y each have $60 of taxable income and QPAI in 2007, Z has $170 of taxable income and QPAI in 2008, and that X, Y, and Z each have" is corrected to read "assume that X and Y each has $60 of taxable income and QPAI in 2007, Z has $170 of taxable income and QPAI in 2008, and that X, Y, and Z each has".

§1.199–3 [Corrected]

2. On page 31482, column 1, §1.199–3(k)(7)(i), line 2 from the bottom of the paragraph, the language "Paragraph (g)(4)(ii)(A) of this section" is corrected to read "Paragraph (g)(3)(ii)(A) of this section".

§1.199–7 [Corrected]

3. On page 31482, column 3, §1.199–7(e) *Example 10.* paragraph (i), line 5 of the paragraph, the language "B each use the section 861 method for" is corrected to read "B each uses the section 861 method for".

4. On page 31482, column 3, §1.199–7(e) *Example 10.* paragraph (iii), line 8 of the paragraph, the language "B becomes a non-member of the consolidated" is corrected to read "B becomes a nonmember of the consolidated".

5. On page 31483, column 1, §1.199–7(g)(3) *Example.* paragraph (i), lines 9 through 11 of the paragraph, the language "year, neither X, Y, nor Z join in the filing of a consolidated Federal income tax return. Assume that X, Y, and Z each have W–2" is corrected to read "year, neither X, Y, nor Z joins in the filing of a consolidated Federal income tax return. Assume that X, Y, and Z each has W–2".

6. On page 31483, column 1, §1.199–7(g)(3) *Example.* paragraph (ii), line 5 from the bottom of the column, the language "allocated $96 of the deduction. For the" is corrected to read "allocated $96 of the EAG's section 199 deduction. For the".

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on July 19, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2007, 72 F.R. 39770)

Application of Section 409A to Nonqualified Deferred Compensation Plans; Correction

Announcement 2007–78

ACTION: Correcting amendments.

AGENCY: Internal Revenue Service (IRS), Treasury.

SUMMARY: This document contains corrections to final regulations (T.D. 9321, 2007–19 I.R.B. 1123) that were published in the **Federal Register** on Tuesday, April 17, 2007 (73 FR 19234), relating to section 409A.

DATES: This correction is effective April 17, 2007.

FOR FURTHER INFORMATION CONTACT: Stephen Tackney, (202) 622–9639 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to these corrections are under section 409A of the Internal Revenue Code.

Need for Correction

As published, final regulations (T.D. 9321) contain errors that may prove misleading and are in need of clarification.

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

* * * * *

Part 1—INCOME TAXES

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

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

§1.409A–1 [Corrected]

Par. 2. Section 1.409A–1 is amended as follows:

1. Paragraph (a)(3)(i) is revised.

2. The first and second sentences of paragraph (a)(5) are revised.

3. The first sentences of paragraphs (b)(4)(i) and (b)(4)(i)(D) are revised.

4. *Examples 3* and *5* in paragraph (b)(4)(iii) are amended by revising the last sentences of the paragraphs.

5. Paragraph (b)(5)(iv)(B)(*2*)(*ii*) is revised.

6. In paragraph (b)(8)(iii) the first sentence is revised.

7. The first sentence of paragraph (b)(9)(v)(A) is revised.

8. Paragraph (c)(2)(i)(H) is revised.

9. Paragraph (c)(3)(viii) is revised.

10. The last sentence of paragraph (f)(1) is revised.

11. The ninth sentence of paragraph (h)(1)(ii) is revised.

12. The first sentence of paragraph (i)(2) is revised.

§1.409A–1 Definitions and covered plans.

(a) * * *

(3) * * *

(i) * * * With respect to an individual for a taxable year, the term *nonqualified deferred compensation plan* does not include any scheme, trust, arrangement, or plan maintained with respect to such individual, to the extent contributions made by or on behalf of such individual to such scheme, trust, arrangement, or plan, or credited allocations, accrued benefits, earnings, or other amounts constituting income, of such individual under such scheme, trust, arrangement, or plan, are excludable by such individual for Federal income tax purposes pursuant to any bilateral income tax convention, or other bilateral or multilateral agreement, to which the United States is a party.

* * * * *

(5) * * * The term *nonqualified deferred compensation plan* does not include a plan, or a portion of a plan, to the extent that the plan provides *bona fide* vacation leave, sick leave, compensatory time, disability pay, or death benefits. For these purposes, the terms "disability pay" and "death benefits" have the same meanings as provided in §31.3121(v)(2)–1(b)(4)(iv)(C) of this chapter, provided that for purposes of this paragraph, such disability pay and death benefits may be provided through insurance and the lifetime benefits payable

under the plan are not treated as including the value of any taxable term life insurance coverage or taxable disability insurance coverage provided under the plan. * * *

(b) * * *

(4) * * * (i) *In general.* A deferral of compensation does not occur under a plan with respect to any payment (as defined in §1.409A–2(b)(2)) that is not a deferred payment, provided that the service provider actually or constructively receives such payment on or before the last day of the applicable 2½ month period. * * *

* * * * *

(D) A payment is a deferred payment if it is made pursuant to a provision of a plan that provides for the payment to be made or completed on or after any date, or upon or after the occurrence of any event, that will or may occur later than the end of the applicable 2½ month period, such as a separation from service, death, disability, change in control event, specified time or schedule of payment, or unforeseeable emergency, regardless of whether an amount is actually paid as a result of the occurrence of such a payment date or event during the applicable 2½ month period. * * *

* * * * *

(iii) * * *

Example 3. * * * The bonus plan will not be considered to have provided for a deferral of compensation if the bonus is paid or made available to Employee C on or before March 15, 2011.

* * * * *

Example 5. * * * The bonus plan provides for a deferral of compensation, and will not qualify as a short-term deferral regardless of whether the bonus is paid or made available on or before March 15, 2011 (and generally any payment before June 1, 2011 would constitute an impermissible acceleration of a payment).

* * * * *

(5) * * *

(iv) * * *

(B) * * *

(*2*) * * *

(*ii*) A valuation based upon a formula that, if used as part of a nonlapse restriction (as defined in §1.83–3(h)) with respect to the stock, would be considered to be the fair market value of the stock pursuant to §1.83–5, provided that such stock is valued in the same manner for purposes of any transfer of any shares of such class of stock (or any substantially similar class of stock) to the issuer or any person that owns stock possessing more than 10 percent of the total combined voting power of all classes of stock of the issuer (applying the stock attribution rules of §1.424–1(d)), other than an arm's length transaction involving the sale of all or substantially all of the outstanding stock of the issuer, and such valuation method is used consistently for all such purposes, and provided further that this paragraph (b)(5)(iv)(B)(*2*)(*ii*) does not apply with respect to stock subject to a stock right payable in stock, where the stock acquired pursuant to the exercise of the stock right is transferable other than through the operation of a nonlapse restriction.

* * * * *

(8) * * *

(iii) * * * A tax equalization agreement does not provide for a deferral of compensation if payments made under such tax equalization agreement are made no later than the end of the second taxable year of the service provider beginning after the taxable year of the service provider in which the service provider's U.S. Federal income tax return is required to be filed (including any extensions) for the year to which the compensation subject to the tax equalization payment relates, or, if later, the second taxable year of the service provider beginning after the latest such taxable year in which the service provider's foreign tax return or payment is required to be filed or made for the year to which the compensation subject to the tax equalization payment relates. * * *

* * * * *

(9) * * *

(v) * * *

(A) * * * To the extent a separation pay plan (including a plan providing payments upon a voluntary separation from service) entitles a service provider to payment by the service recipient of reimbursements that are not otherwise excludible from gross income for expenses that the service provider could otherwise deduct under section 162 or section 167 as business expenses incurred in connection with the performance of services (ignoring any applicable limitation based on adjusted gross income), or of reasonable outplacement expenses and reasonable moving expenses actually incurred by the service provider and directly related to the termination of services for the service recipient, such plan does not provide for a deferral of compensation to the extent such rights apply during a limited period of time (regardless of whether such rights extend beyond the limited period of time). * * *

* * * * *

(c) * * *

(2) * * *

(i) * * *

(H) All deferrals of compensation with respect to that service provider under all plans of the service recipient to the extent such plans are stock rights (as defined in paragraph (l) of this section) subject to section 409A, are treated as deferred under a single plan.

* * * * *

(3) * * *

(viii) * * * The plan aggregation rules of paragraph (c)(2)(i) of this section do not apply to the written plan requirements of this paragraph (c)(3). Accordingly, deferrals of compensation under an agreement, method, program, or other arrangement that fails to meet the requirements of section 409A solely due to a failure to meet the written plan requirements of this paragraph (c)(3) are not aggregated with deferrals of compensation under other agreements, methods, programs, or other arrangements that meet such requirements.

* * * * *

(f) * * *

(1) *In general.* * * * The term *service provider* generally includes a person who has separated from service (a former service provider).

* * * * *

(h) * * *

(1) * * *

(ii) *Termination of employment.* * * * Notwithstanding the foregoing provisions of this paragraph (h)(1)(ii), a plan may treat another level of reasonably anticipated permanent reduction in the level of *bona fide* services as a separation from service, provided that the level of reduction required must be designated in writing as a specific percentage, and the reasonably anticipated reduced level of *bona fide* services must be greater than 20 percent but less that 50 percent of the average level of *bona fide* services provided in the immediately preceding 36 months. * * *

* * * * *

(i) * * *

(2) * * * For purposes of identifying a specified employee by applying the requirements of section 416(i)(1)(A)(i), (ii), and (iii), the definition of compensation under §1.415(c)–2(a) is used, applied as if the service recipient were not using any safe harbor provided in §1.415(c)–2(d), were not using any of the elective special timing rules provided in §1.415(c)–2(e), and were not using any of the elective special rules provided in §1.415(c)–2(g). * * *

* * * * *

§1.409A–2 [Corrected]

Par. 3. Section 1.409A–2 is amended as follows:

1. The first sentences of paragraphs (a)(6) and (a)(9) are revised.

2. The third sentence of paragraph (b)(2)(ii)(A) is revised.

3. A new sentence is added after the third sentence of paragraph (b)(2)(ii)(A).

§1.409A–2 Deferral elections.

(a) * * *

(6) * * * In the case of a service recipient with a taxable year that is not the same as the taxable year of the service provider, a plan may provide that fiscal year compensation may be deferred at the service provider's election if the election to defer such compensation is made not later than the close of the service recipient's taxable year immediately preceding the first taxable year of the service recipient in which any services are performed for which such compensation is payable. * * *

* * * * *

(9) * * * If a nonqualified deferred compensation plan provides that the amount deferred under the plan is determined under the formula for determining benefits under a qualified employer plan (as defined in §1.409A–1(a)(2)) or a broad-based foreign retirement plan (as defined in §1.409A–1(a)(3)(v)) maintained by the service recipient but applied without regard to one or more limitations applicable to the qualified employer plan under the Internal Revenue Code or to the broad-based foreign retirement plan under other applicable law, or that the amount deferred under the nonqualified deferred compensation plan is determined as an amount offset by some or all of the benefits provided under the qualified employer plan or the broad-based foreign retirement plan, an increase in amounts deferred under the nonqualified deferred compensation plan that results directly from the operation of the qualified employer plan or broad-based foreign retirement plan (other than service provider actions described in paragraphs (a)(9)(iii) and (iv) of this section) including changes in benefit limitations applicable to the qualified employer plan or the broad-based foreign retirement plan under the Internal Revenue Code or other applicable law does not constitute a deferral election under the nonqualified deferred compensation plan, provided that such operation does not otherwise result in a change in the time or form of a payment under the nonqualified deferred compensation plan, and provided further that such change in the amounts deferred under the nonqualified deferred compensation plan does not exceed that change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable. * * *

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(A) * * * For purposes of §1.409A–1, this section, and §§1.409A–3 through 1.409A–6, the term *life annuity* means a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider, or a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider, followed upon the death or end of the life expectancy of the service provider by a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider's designated beneficiary (if any). Notwithstanding the foregoing, a schedule of payments does not fail to be an annuity solely because such plan provides for an immediate payment of the actuarial present value of all remaining annuity payments if the actuarial present value of the remaining annuity payments falls below a predetermined amount, and the immediate payment of such amount does not constitute an accelerated payment for purposes of §1.409A–3(j), provided that such feature, including the predetermined amount, is established by no later than the time and form of payment is otherwise required to be established, and provided further that any change in such feature, including the predetermined amount, is a change in the time and form of payment. * * *

* * * * *

§1.409A–3 [Corrected]

Par. 4. Section 1.409A–3 is amended as follows:

1. The first sentence of paragraph (c) is revised.

2. The last sentence of paragraph (i)(1)(ii)(B) is revised.

3. The fourth sentence of paragraph (i)(3)(ii) is revised.

4. The last sentence of paragraph (j)(4)(vi) is revised.

5. The last sentence of paragraph (j)(4)(ix)(B) is revised.

6. The first sentence of paragraph (j)(5) is revised.

7. Paragraph (j)(5)(iv) is revised.

§1.409A–3 Permissible payments.

* * * * *

(c) * * * Except as otherwise provided in this paragraph (c), for an amount of deferred compensation under a plan, the plan may designate only one time and form of payment upon the occurrence of each event described in paragraph (a)(1), (2), (3), (5), or (6) of this section. * * *

* * * * *

(i) * * *

(1) * * *

(ii) * * *

(B) * * * A change in the limitation or a change in the time and form of payment of any payment that is not otherwise made at the scheduled payment date due to application of the formula limitation is subject to the requirements of §1.409A–2(b) (subsequent deferral elections) and paragraph (j) of this section (accelerated payments).

* * * * *

(3) * * *

(ii) * * * However, the determination of amounts reasonably necessary to satisfy the emergency need is not required to take into account any additional compensation that is available from a qualified employer plan as defined in §1.409A–1(a)(2) (including any amount available by obtaining a loan under the plan), or that due to the unforeseeable emergency is available under another nonqualified deferred compensation plan (including a plan that would provide for deferred compensation except due to the application of the effective date provisions under §1.409A–6). * * *

* * * * *

(j) * * *

(4) * * *

(vi) * * * However, the total payment under this acceleration provision must not exceed the aggregate of the FICA or RRTA amount, and the income tax withholding related to such FICA or RRTA amount.

* * * * *

(ix) * * *

(B) * * * Solely for purposes of this paragraph (j)(4)(ix)(B), the applicable service recipient with the discretion to liquidate and terminate the agreements, methods, programs, and other arrangements is the service recipient that is primarily liable immediately after the transaction for the payment of the deferred compensation.

* * * * *

(5) * * * If a nonqualified deferred compensation plan provides that the amount deferred under the plan is the amount determined under the formula determining benefits under a qualified employer plan (as defined in §1.409A–1(a)(2)), or a broad-based foreign retirement plan (as defined in §1.409A–1(a)(3)(v)) maintained by the service recipient but applied without regard to one or more limitations applicable to the qualified employer plan under the Internal Revenue Code or to the broad-based foreign retirement plan under other applicable law, or that the amount deferred under the nonqualified deferred compensation plan is determined as an amount offset by some or all of the benefits provided under the qualified employer plan or broad-based foreign retirement plan, a decrease in amounts deferred under the nonqualified deferred compensation plan that results directly from the operation of the qualified employer plan or broad-based foreign retirement plan (other than service provider actions described in paragraphs (j)(5)(iii) and (iv) of this section) including changes in benefit limitations applicable to the qualified employer plan or the broad-based foreign retirement plan under the Internal Revenue Code or other applicable law does not constitute an acceleration of a payment under the nonqualified deferred compensation plan, provided that such operation does not otherwise result in a change in the time or form of a payment under the nonqualified deferred compensation plan, and provided further that the change in the amounts deferred under the nonqualified deferred compensation plan does not exceed such change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable. * * *

* * * * *

(iv) A service provider's action or inaction under a qualified employer plan with respect to elective deferrals and other employee pre-tax contributions subject to the contributions restrictions under section 401(a)(30) or section 402(g), and after-tax contributions by the service provider to a qualified employer plan that provides for such contributions, that affects the amounts that are credited under one or more nonqualified deferred compensation plans as matching amounts or other similar amounts contingent on such elective deferrals, pre-tax contributions, or after-tax contributions, provided that the total of such matching or contingent amounts, as applicable, never exceeds 100 percent of the matching or contingent amounts that would be provided under the qualified employer plan absent any plan-based restrictions that reflect limits on qualified plan contributions under the Internal Revenue Code.

* * * * *

§1.409A–6 [Corrected]

Par. 5. Section 1.409A–6 is amended by revising paragraphs (a)(3)(i) and (ii) and (a)(4)(iv) to read as follows:

§1.409A–6 Application of section 409A and effective dates.

* * * * *

(a) * * *

(3) * * *

(i) * * * The amount of compensation deferred before January 1, 2005, under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in §1.409A–1(c)(2)(i)(C)), equals the present value of the amount to which the service provider would have been entitled under the plan if the service provider voluntarily terminated services without cause on December 31, 2004, and received a payment of the benefits available from the plan on the earliest possible date allowed under the plan to receive a payment of benefits following the termination of services, and received the benefits in the form with the maximum value. * * *

(ii) * * * The amount of compensation deferred before January 1, 2005, under a nonqualified deferred compensation plan that is an account balance plan (as defined in §1.409A–1(c)(2)(i)(A)), equals the portion of the service provider's account balance as of December 31, 2004, the right to which was earned and vested (as defined in paragraph (a)(2) of this section) as of December 31, 2004, plus any future contributions to the account, the right to which was earned and vested (as defined in paragraph (a)(2) of this section) as of December 31, 2004, to the extent such contributions are actually made.

* * * * *

(4) * * *

(iv) * * * With respect to an account balance plan (as defined in §1.409A–1(c)(2)(i)(A)), it is not a material modification to change a notional investment measure to, or to add to an existing investment measure, an investment measure that qualifies as a predetermined actual investment within the meaning of §31.3121(v)(2)–1(d)(2) of this chapter or, for any given taxable year, reflects a reasonable rate of interest (determined in accordance with §31.3121(v)(2)–1(d)(2)(i)(C) of this chapter). * * *

* * * * *

Guy R. Traynor,
Federal Register Liaison,
Legal Processing Division,
Publication & Regulations Branch,
Associate Chief Counsel
(Procedure & Administration).

(Filed by the Office of the Federal Register on July 30, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 31, 2007, 72 F.R. 41620)

Built-in Gains and Losses Under Section 382(h); Correction

Announcement 2007–80

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendments.

SUMMARY: This document contains corrections to temporary regulations (T.D. 9330, 2007–31 I.R.B. 239) that were published in the **Federal Register** on Thursday, June 14, 2007 (72 FR 32792) applying to corporations that have undergone ownership changes within the meaning of section 382. These regulations provide guidance regarding the treatment of prepaid income under the built-in gain provisions of section 382(h).

DATES: These corrections are effective August 1, 2007.

FOR FURTHER INFORMATION CONTACT: Keith Stanley at (202) 622–7750 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations that are the subject of this document are under section 382 of the Internal Revenue Code.

Need for Correction

As published, temporary regulations (T.D. 9330) contain errors that may prove to be misleading and are in need of clarification.

* * * * *

Correction of Publication

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.382–7T is amended by revising paragraph (b)(2) to read as follows:

§1.382–7T Built-in gains and losses (temporary).

* * * * *

(b) * * *

(2) The applicability of this section expires on June 14, 2010.

Par. 3. The signature block is revised by adding the language "Approved: June 4, 2007."

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on July 31, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 1, 2007, 72 F.R. 41891)

Grantor Retained Interest Trusts — Application of Sections 2036 and 2039; Hearing

Announcement 2007–81

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Change of location for public hearing.

SUMMARY: This document provides a change of location for a public hearing on proposed regulations (REG–119097–05, 2007–28 I.R.B. 74) providing guidance on the portion of a trust properly includible in a grantor's gross estate under Internal Revenue Code sections 2036 and 2039 if the grantor has retained the use of property in a trust or the right to annuity, unitrust, or other income payment from such trust for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not in fact end before the grantor's death.

DATES: The public hearing is being held on Wednesday, September 26, 2007, at 10 a.m.

ADDRESSES: The public hearing was originally being held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. The hearing location has changed. The public hearing will be held in room 2116, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: LaNita Van Dyke, (202) 622–3215 or Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov*.

SUPPLEMENTARY INFORMATION:

The subject of the public hearing is a notice of proposed rulemaking (REG–119097–05) that was published in the **Federal Register** on Thursday, June 7, 2007 (72 FR 31487).

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons, who submit written comments and outlines by September 5, 2007, may present oral comments at the hearing.

A period of 10 minutes is allotted to each person for presenting oral comments. The IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available, free of charge, at the hearing.

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on August 20, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 21, 2007, 72 F.R. 46586)

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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