Internal Revenue
bulletin

Bulletin No. 2007-50
December 10, 2007

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. 2007–70, page 1158.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for December 2007.

Rev. Rul. 2007–72, page 1154.

Diagnostic medical procedures. This ruling holds that amounts paid by individuals for certain diagnostic and similar procedures and devices are medical care expenses deductible under section 213 of the Code.

REG–127770–07, page 1171.

Proposed regulations under section 860G of the Code expand the list of permitted loan modifications to include certain modifications of commercial mortgages. Changes to the regulations are necessary to better accommodate evolving commercial mortgage industry practices. These changes will affect lenders, borrowers, servicers, and sponsors of securitizations of mortgages in REMICs.

Notice 2007–98, page 1160.

This notice announces the phase-out of the qualified hybrid motor vehicle credit and the new advanced lean burn technology motor vehicle credit for passenger automobiles and light trucks manufactured by American Honda Motor Company, Inc., that are purchased for use or lease in the United States beginning on January 1, 2008.

Rev. Proc. 2007–70, page 1162.

Optional standard mileage rates. This procedure announces 50.5 cents as the optional rate for deducting or accounting for expenses for business use of an automobile, 14 cents as the optional rate for use of an automobile as a charitable contribution, and 19 cents as the optional rate for use of an automobile as a medical or moving expense for 2008. The procedure also provides rules for substantiating the deductible expenses of using an automobile for business, moving, medical, or charitable purposes. Rev. Proc. 2006–49 superseded.

Announcement 2007–112, page 1175.

This announcement revises Revenue Procedure 2007–65, 2007–45 I.R.B. 967, by adding the following language to Section 3: "The requirements set forth in this revenue procedure that must be satisfied in order to qualify for the Safe Harbor, however, are not intended to provide substantive rules and are not to be used as audit guidelines," and replacing "will not challenge" with "will respect" in Section 6.

Announcement 2007–114, page 1176.

This document announces that proposed Form 8926, *Disqualified Corporate Interest Expense Disallowed Under Section 163(j) and Related Information*, is being posted to the IRS website.

EMPLOYEE PLANS

Rev. Rul. 2007–71, page 1155.

2008 covered compensation tables; permitted disparity. The covered compensation tables under section 401 of the Code for the year 2008 are provided for use in determining contributions to defined benefit plans and permitted disparity.

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Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

Announcement 2007–112, page 1175.
This announcement revises Revenue Procedure 2007–65, 2007–45 I.R.B. 967, by adding the following language to Section 3: "The requirements set forth in this revenue procedure that must be satisfied in order to qualify for the Safe Harbor, however, are not intended to provide substantive rules and are not to be used as audit guidelines," and replacing "will not challenge" with "will respect" in Section 6.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 213.—Medical, Dental, etc., Expenses

26 CFR 1.213–1: Medical, dental, etc., expenses.

Diagnostic medical procedures. This ruling holds that amounts paid by individuals for certain diagnostic and similar procedures and devices are medical care expenses deductible under section 213 of the Code.

Rev. Rul. 2007–72

ISSUE

Are amounts paid by individuals for diagnostic and certain similar procedures and devices, not compensated by insurance or otherwise, medical care expenses deductible under § 213(a) of the Internal Revenue Code?

FACTS

In the situations described below, the costs paid by the taxpayers are not compensated by insurance or otherwise, and the taxpayers are not experiencing any symptoms of illness.

Situation 1

Taxpayer *A* undergoes an annual physical examination, which is performed by a physician. *A* pays for the physician's services and laboratory tests.

Situation 2

Taxpayer *B* pays for a full-body electronic scan, a relatively high-cost procedure, performed by a technician at a clinic. The scan examines the condition of *B*'s internal organs and may identify disease or other abnormalities. *B* has not consulted a physician before undergoing the procedure, which can be obtained without a physician's direction, or determined if less expensive alternatives are available.

Situation 3

Taxpayer *C* buys a test kit and uses it to determine whether she is pregnant.

LAW

Section 213(a) allows a deduction for expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, spouse, or dependent, to the extent that the expenses exceed 7.5 percent of adjusted gross income. Medical care includes amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body. Section 213(d)(1)(A).

Medical care includes X-rays and laboratory and other diagnostic services. Amounts paid for obstetrical services are deemed to be for the purpose of affecting a structure or function of the body and therefore are paid for medical care. Section 1.213–1(e)(1)(ii) of the Income Tax Regulations.

"Diagnosis" is the determination of a medical condition, such as a disease, by physical examination or study of symptoms. *Black's Law Dictionary* (8th ed., 2004). A diagnosis may encompass a determination that disease is absent. The determination of a medical condition may include testing for changes in the functions of the body, such as those resulting from pregnancy, that are unrelated to disease.

In determining whether an expense is for either medical or personal reasons, the recommendation of a physician is important. *Havey v. Commissioner*, 12 T.C. 409, 412 (1949). However, this determination is unnecessary in the case of expenses for items that are wholly medical in nature and serve no other function in everyday life. *Stringham v. Commissioner*, 12 T.C. 580, 584 (court reviewed), *aff'd* 183 F.2d 579 (6th Cir. 1950).

The amount of the deduction under § 213 is not limited by a ceiling and, although additional costs for personal convenience are not allowable, § 213 does not limit the deduction to amounts paid for the least expensive form of medical care available. *Ferris v. Commissioner*, 582 F.2d 1112, 1116 (7th Cir. 1978).

ANALYSIS

In *Situation 1,* the amount *A* pays for the annual physical examination is for diagnosis and qualifies as an expense for medical care even though *A* is not experiencing any symptoms of illness.

In *Situation 2*, the amount *B* pays for the full-body scan is for diagnosis and qualifies as an expense for medical care even though *B* is not experiencing symptoms of illness and has not obtained a physician's recommendation before undergoing the procedure. The procedure serves no non-medical function and the expense is not disallowed because of the high cost or possible existence of less expensive alternatives.

In *Situation 3*, the amount *C* pays for the pregnancy test qualifies as an expense for medical care even though its purpose is to test the healthy functioning of the body rather than to detect disease.

Therefore, the amounts paid by Taxpayers *A*, *B*, and *C* for the physical examination, the full-body scan, and the pregnancy test kit are deductible under § 213(a), subject to the 7.5 percent floor.

HOLDING

Amounts paid by individuals for diagnostic and certain similar procedures and devices, not compensated by insurance or otherwise, are medical care expenses deductible under § 213(a), subject to the limitations of that section.

DRAFTING INFORMATION

For further information regarding this revenue ruling, contact Dan Cassano at (202) 622–7900 (not a toll-free call).

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

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

The adjusted applicable federal long-term rate is set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(l)–1: Permitted disparity in employer-provided contributions or benefits.

2008 covered compensation tables; permitted disparity. The covered compensation tables under section 401 of the Code for the year 2008 are provided for use in determining contributions to defined benefit plans and permitted disparity.

Rev. Rul. 2007–71

This revenue ruling provides tables of covered compensation under § 401(l)(5)(E) of the Internal Revenue Code (the "Code") and the Income Tax Regulations, thereunder, for the 2008 plan year.

Section 401(l)(5)(E)(i) defines covered compensation with respect to an employee, as the average of the contribution and benefit bases in effect under section 230 of the Social Security Act (the "Act") for each year in the 35-year period ending with the year in which the employee attains social security retirement age.

Section 401(l)(5)(E)(ii) of the Code states that the determination for any year preceding the year in which the employee attains social security retirement age shall be made by assuming that there is no increase in covered compensation after the determination year and before the employee attains social security retirement age.

Section 1.401(l)–1(c)(34) defines the taxable wage base as the contribution and benefit base under section 230 of the Act.

Section 1.401(l)–1(c)(7)(i) defines covered compensation for an employee as the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35-year period ending with the last day of the calendar year in which the employee attains (or will attain) social security retirement age. A 35-year period is used for all individuals regardless of the year of birth of the individual. In determining an employee's covered compensation for a plan year, the taxable wage base for all calendar years beginning after the first day of the plan year is assumed to be the same as the taxable wage base in effect as of the beginning of the plan year. An employee's covered compensation for a plan year beginning after the 35-year period applicable under § 1.401(l)–1(c)(7)(i) is the employee's covered compensation for a plan year during which the 35-year period ends. An employee's covered compensation for a plan year beginning before the 35-year period applicable under § 1.401(l)–1(c)(7)(i) is the taxable wage base in effect as of the beginning of the plan year.

Section 1.401(l)–1(c)(7)(ii) provides that, for purposes of determining the amount of an employee's covered compensation under § 1.401(l)–1(c)(7)(i), a plan may use tables, provided by the Commissioner, that are developed by rounding the actual amounts of covered compensation for different years of birth.

For purposes of determining covered compensation for the 2008 year the taxable wage base is $102,000.

The following tables provide covered compensation for 2008:

ATTACHMENT I

2008 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2008 COVERED COMPENSATION TABLE II
1907	1972	$4,488
1908	1973	4,704
1909	1974	5,004
1910	1975	5,316
1911	1976	5,664
1912	1977	6,060
1913	1978	6,480
1914	1979	7,044
1915	1980	7,692
1916	1981	8,460
1917	1982	9,300
1918	1983	10,236
1919	1984	11,232
1920	1985	12,276
1921	1986	13,368

ATTACHMENT I

2008 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2008 COVERED COMPENSATION TABLE II
1922	1987	14,520
1923	1988	15,708
1924	1989	16,968
1925	1990	18,312
1926	1991	19,728
1927	1992	21,192
1928	1993	22,716
1929	1994	24,312
1930	1995	25,920
1931	1996	27,576
1932	1997	29,304
1933	1998	31,128
1934	1999	33,060
1935	2000	35,100
1936	2001	37,212
1937	2002	39,444
1938	2004	43,992
1939	2005	46,344
1940	2006	48,816
1941	2007	51,348
1942	2008	53,952
1943	2009	56,484
1944	2010	58,992
1945	2011	61,476
1946	2012	63,912
1947	2013	66,324
1948	2014	68,580
1949	2015	70,764
1950	2016	72,828
1951	2017	74,820
1952	2018	76,704
1953	2019	78,540
1954	2020	80,328
1955	2022	83,700
1956	2023	85,332
1957	2024	86,880
1958	2025	88,320
1959	2026	89,712
1960	2027	91,044
1961	2028	92,304
1962	2029	93,492
1963	2030	94,656
1964	2031	95,784
1965	2032	96,828
1966	2033	97,788
1967	2034	98,628
1968	2035	99,360
1969	2036	99,984
1970	2037	100,464
1971	2038	100,896

ATTACHMENT I

2008 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2008 COVERED COMPENSATION TABLE II
1972	2039	101,304
1973	2040	101,640
1974	2041	101,868
1975 and Later	2042	102,000

2008 Rounded Covered Compensation Table

Year of Birth	Covered Compensation
1937	39,000
1938 - 1939	45,000
1940	48,000
1941	51,000
1942	54,000
1943	57,000
1944 - 1945	60,000
1946	63,000
1947	66,000
1948	69,000
1949 - 1950	72,000
1951	75,000
1952 - 1953	78,000
1954	81,000
1955 - 1956	84,000
1957 - 1958	87,000
1959 - 1960	90,000
1961 - 1962	93,000
1963 - 1965	96,000
1966 - 1970	99,000
1971 and Later	102,000

DRAFTING INFORMATION

The principal author of this revenue ruling is Wayne Bradley of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact the Employee Plans taxpayer assistance telephone service at 1–877–829–5500, between the hours of 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday (a toll-free number). Mr. Bradley may be reached via e-mail at *RetirementPlanQuestions@irs.gov*.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

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

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

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for December 2007.

Rev. Rul. 2007–70

This revenue ruling provides various prescribed rates for federal income tax purposes for December 2007 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the 2008 interest rate for sections 846 and 807.

REV. RUL. 2007–70 TABLE 1

Applicable Federal Rates (AFR) for December 2007

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	3.88%	3.84%	3.82%	3.81%
110% AFR	4.26%	4.22%	4.20%	4.18%
120% AFR	4.66%	4.61%	4.58%	4.57%
130% AFR	5.05%	4.99%	4.96%	4.94%
Mid-term				
AFR	4.13%	4.09%	4.07%	4.06%
110% AFR	4.55%	4.50%	4.47%	4.46%
120% AFR	4.97%	4.91%	4.88%	4.86%
130% AFR	5.39%	5.32%	5.29%	5.26%
150% AFR	6.23%	6.14%	6.09%	6.06%
175% AFR	7.29%	7.16%	7.10%	7.06%
Long-term				
AFR	4.72%	4.67%	4.64%	4.63%
110% AFR	5.21%	5.14%	5.11%	5.09%
120% AFR	5.68%	5.60%	5.56%	5.54%
130% AFR	6.16%	6.07%	6.02%	5.99%

REV. RUL. 2007–70 TABLE 2

Adjusted AFR for December 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.40%	3.37%	3.36%	3.35%
Mid-term adjusted AFR	3.67%	3.64%	3.62%	3.61%
Long-term adjusted AFR	4.34%	4.29%	4.27%	4.25%

REV. RUL. 2007–70 TABLE 3

Rates Under Section 382 for December 2007

Adjusted federal long-term rate for the current month	4.34%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.49%

REV. RUL. 2007–70 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for December 2007

Appropriate percentage for the 70% present value low-income housing credit	8.03%
Appropriate percentage for the 30% present value low-income housing credit	3.44%

REV. RUL. 2007–70 TABLE 5

Rate Under Section 7520 for December 2007

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.0%

REV. RUL. 2007–70 TABLE 6

Applicable rate of interest for 2008 for purposes of section 846 and 807	4.06%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Part III. Administrative, Procedural, and Miscellaneous

Phase-out of Credit for New Qualified Hybrid Motor Vehicles and New Advanced Lean Burn Technology Motor Vehicles

Notice 2007–98

SECTION 1. PURPOSE

This notice announces the credit phase-out schedule for new advanced lean burn technology motor vehicles and new qualified hybrid passenger automobiles and light trucks manufactured by American Honda Motor Company, Inc.

SECTION 2. BACKGROUND

Section 30B(a)(2) of the Internal Revenue Code provides for a credit determined under § 30B(c) for certain new advanced lean burn technology motor vehicles. Section 30B(a)(3) provides for a credit determined under § 30B(d) for certain new qualified hybrid motor vehicles. Both the new advanced lean burn technology motor vehicle credit and the new qualified hybrid motor vehicle credit begin to phase out for a manufacturer's passenger automobiles and light trucks in the second calendar quarter after the calendar quarter in which at least 60,000 of the manufacturer's passenger automobiles and light trucks that qualify for either credit have been sold for use or lease in the United States (determined on a cumulative basis for sales after December 31, 2005). Taxpayers purchasing the manufacturer's vehicles during the first two calendar quarters of the phase-out period may claim only 50 percent of the otherwise allowable credit. Taxpayers purchasing the manufacturer's vehicles during the third and fourth quarters of the phase-out period may claim only 25 percent of the otherwise allowable credit. No credit is available for vehicles purchased after the last day of the fourth quarter of the phase-out period.

Notice 2006–9, 2006–6 C.B. 413, provides procedures for a vehicle manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) to certify to the Internal Revenue Service (Service) both (1) that a particular make, model, and model year of vehicle qualifies for either the advanced lean burn technology motor vehicle credit or the new qualified hybrid motor vehicle credit and (2) the amount of the credit allowable with respect to that vehicle.

Section 5.05 of Notice 2006–9 requires a manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) that has received from the Service an acknowledgement of its certification for a particular make, model, and model year of vehicle to submit to the Service a report of the number of qualified vehicles sold by the manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) to retail dealers during the calendar quarter. A qualified vehicle is defined for this purpose as any passenger automobile or light truck that is a new advanced lean burn technology motor vehicle or a new qualified hybrid motor vehicle.

In accordance with section 5.05 of Notice 2006–9, American Honda Motor Company, Inc. has submitted quarterly reports that indicate that its cumulative sales of qualified vehicles to retail dealers reached the 60,000-vehicle limit during the calendar quarter ending September 30, 2007. Accordingly, the credit for all new advanced lean burn technology motor vehicles or new qualified hybrid passenger automobiles or light trucks manufactured by American Honda Motor Company, Inc. will begin to phase out on January 1, 2008.

SECTION 3. SCOPE OF NOTICE

This notice applies to any make, model, or model year of new advanced lean burn technology motor vehicle or new qualified hybrid passenger automobile or light truck that is—

(1) manufactured by American Honda Motor Company, Inc.; and

(2) purchased for use or lease in the United States on or after January 1, 2008.

SECTION 4. CREDIT AMOUNT

.01 *In general.* If a new advanced lean burn technology motor vehicle or new qualified hybrid passenger automobile or light truck manufactured by American Honda Motor Company, Inc. is purchased for use or lease after December 31, 2007, the allowable credit is as follows:

(1) For vehicles purchased for use or lease on or after January 1, 2008, and on or before June 30, 2008, the credit is 50 percent of the otherwise allowable amount determined under § 30B(c) or (d) (whichever is applicable);

(2) For vehicles purchased for use or lease on or after July 1, 2008, and on or before December 31, 2008, the credit is 25 percent of the otherwise allowable amount determined under § 30B(c) or (d) (whichever is applicable); and

(3) For vehicles purchased for use or lease on or after January 1, 2009, no credit is allowable.

.02 Certified Vehicles. The following tables set forth the credit available on or after January 1, 2008, for hybrid motor vehicles for which American Honda Motor Company, Inc. received an acknowledgement of its certification from the Service on or before November 19, 2007:

Table 1

January 1, 2008 — June 30, 2008		
Model Year	**Model**	**Credit Amount**
2005	Accord Hybrid AT	$325
2005	Accord Hybrid Navi AT	$325
2005	Civic Hybrid MT	$850
2005	Civic Hybrid CVT	$850
2005	Insight CVT	$725
2006	Accord Hybrid AT with updated calibration	$650
2006	Accord Hybrid Navi AT with updated calibration	$650
2006	Accord Hybrid AT without updated calibration	$325
2006	Accord Hybrid Navi AT without updated calibration	$325
2006	Civic Hybrid CVT	$1050
2006	Insight CVT	$725
2007	Accord Hybrid AT	$650
2007	Accord Hybrid Navi AT	$650
2007	Civic Hybrid CVT	$1050
2008	Civic Hybrid CVT	$1050

Table 2

July 1, 2008 — December 31, 2008		
Model Year	**Model**	**Credit Amount**
2005	Accord Hybrid AT	$162.50
2005	Accord Hybrid Navi AT	$162.50
2005	Civic Hybrid MT	$425
2005	Civic Hybrid CVT	$425
2005	Insight CVT	$362.50
2006	Accord Hybrid AT with updated calibration	$325
2006	Accord Hybrid Navi AT with updated calibration	$325
2006	Accord Hybrid AT without updated calibration	$162.50
2006	Accord Hybrid Navi AT without updated calibration	$162.50

Model Year	Model	Credit Amount
2006	Civic Hybrid CVT	$525
2006	Insight CVT	$362.50
2007	Accord Hybrid AT	$325
2007	Accord Hybrid Navi AT	$325
2007	Civic Hybrid CVT	$525
2008	Civic Hybrid CVT	$525

Table 3

On or After January 1, 2009		
Model Year	**Model**	**Credit Amount**
2005	Accord Hybrid AT	$0.00
2005	Accord Hybrid Navi AT	$0.00
2005	Civic Hybrid MT	$0.00
2005	Civic Hybrid CVT	$0.00
2005	Insight CVT	$0.00
2006	Accord Hybrid AT with updated calibration	$0.00
2006	Accord Hybrid Navi AT with updated calibration	$0.00
2006	Accord Hybrid AT without updated calibration	$0.00
2006	Accord Hybrid Navi AT without updated calibration	$0.00
2006	Civic Hybrid CVT	$0.00
2006	Insight CVT	$0.00
2007	Accord Hybrid AT	$0.00
2007	Accord Hybrid Navi AT	$0.00
2007	Civic Hybrid CVT	$0.00
2008	Civic Hybrid CVT	$0.00

The principal author of this notice is Nicole R. Cimino of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Ms. Cimino at (202) 622–3110 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 62, 162, 170, 213, 217, 274, 1016; 1.62–2, 1.162–17, 1.170A–1, 1.213–1, 1.217–2, 1.274–5, 1.1016–3.)

Rev. Proc. 2007–70

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2006–49, 2006–47 I.R.B. 936, and provides optional standard mileage rates for employees, self-employed individuals, or other taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes. This revenue procedure also provides rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee are deemed substantiated under § 1.274–5 of the Income Tax Regulations if a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance ar-

rangement to pay for the expenses. Use of a method of substantiation described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. The Internal Revenue Service prospectively adjusts the business and medical and moving standard mileage rates annually (to the extent warranted).

SECTION 2. SUMMARY OF STANDARD MILEAGE RATES

.01 *Standard mileage rates*

(1) Business (section 5 below)	50.5 cents per mile
(2) Charitable contribution (section 7 below)	14 cents per mile
(3) Medical and moving (section 7 below)	19 cents per mile

.02 *Determination of standard mileage rates*. The business and medical and moving standard mileage rates reflected in this revenue procedure are based on an annual study of the fixed and variable costs of operating an automobile conducted on behalf of the Service by an independent contractor. The charitable contribution standard mileage rate is provided in § 170(i) of the Internal Revenue Code.

SECTION 3. BACKGROUND AND CHANGES

.01 Section 162(a) allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct the cost of operating an automobile to the extent that it is used in a trade or business. However, under § 262, no portion of the cost of operating an automobile that is attributable to personal use is deductible.

.02 Section 274(d) provides, in part, that no deduction is allowed under § 162 with respect to any listed property (as defined in § 280F(d)(4) to include passenger automobiles and any other property used as a means of transportation) unless the taxpayer complies with certain substantiation requirements. Section 274(d) further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by the regulations.

.03 Section 1.274–5(j), in part, grants the Commissioner of Internal Revenue the authority to establish a method under which a taxpayer may use mileage rates to substantiate, for purposes of § 274(d), the amount of the ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home.

.04 Section 1.274–5(g), in part, grants the Commissioner the authority to prescribe rules relating to mileage allowances for ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which the allowances, if in accordance with reasonable business practice, will be regarded as (1) equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of the travel and transportation expenses for purposes of § 1.274–5(c), and (2) satisfying the requirements of an adequate accounting to the employer of the amount of the expenses for purposes of § 1.274–5(f).

.05 Section 62(a)(2)(A) allows an employee, in determining adjusted gross income, a deduction for the expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.06 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 62(c) further provides that the substantiation requirements described therein do not apply to any expense to the extent that, under the grant of regulatory authority in § 274(d), the Commissioner has provided that substantiation is not required for the expense.

.07 Under § 1.62–2(c), a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan and are excluded from income and wages. If an arrangement does not meet these requirements, all amounts paid under the arrangement are treated as paid under a nonaccountable plan and are included in the employee's gross income, must be reported as wages or compensation on the employee's Form W–2, and are subject to the withholding and payment of employment taxes. Section 1.62–2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274–5(g) will be treated as substantiation of the amount of the expenses for purposes of § 1.62–2. Under § 1.62–2(f)(2), the Commissioner may prescribe rules under which an arrangement providing mileage allowances is treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of the allowance that relates to miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the

employee is required to return any portion of the allowance that relates to miles of travel not substantiated.

.08 Section 1.62–2(h)(2)(i)(B) provides that if a payor pays a mileage allowance under an arrangement that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to miles of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee's expenses deemed substantiated for the travel pursuant to rules prescribed under § 274(d) and § 1.274–5(g), and that the employee is not required to return, is subject to withholding and payment of employment taxes. *See* §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401(a)–4 of the Employment Tax Regulations. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this excess portion.

.09 Under § 1.62–2(h)(2)(i)(B)(4), the Commissioner may provide special rules regarding the timing of withholding and payment of employment taxes on mileage allowances.

.10 Sections 9.09 and 10.03 of this revenue procedure refer to Rev. Rul. 2006–56, 2006–46 I.R.B. 874, which describes circumstances when a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder.

SECTION 4. DEFINITIONS

.01 *Standard mileage rate*. The term "standard mileage rate" means the applicable amount provided by the Service for optional use by employees or self-employed individuals in computing the deductible costs of operating automobiles (including vans, pickups, or panel trucks) they own or lease for business purposes, or by taxpayers in computing the deductible costs of operating automobiles for charitable, medical, or moving expense purposes.

.02 *Transportation expenses*. The term "transportation expenses" means the expenses of operating an automobile for local travel or transportation away from home.

.03 *Mileage allowance*. The term "mileage allowance" means a payment under a reimbursement or other expense allowance arrangement that is:

(1) paid with respect to the ordinary and necessary business expenses incurred, or that the payor reasonably anticipates will be incurred, by an employee for transportation expenses in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at the applicable standard mileage rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.04 *Flat rate or stated schedule*. A mileage allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 4.03 of this revenue procedure. The allowance may be paid periodically at a fixed rate, at a cents-per-mile rate, at a variable rate based on a stated schedule, at a rate that combines any of these rates, or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, a periodic payment at a fixed rate to cover the fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving an automobile in connection with the performance of services as an employee of the employer, coupled with a periodic payment at a cents-per-mile rate to cover the variable costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of using an automobile for those purposes, is an allowance paid at a flat rate or stated schedule. Likewise, a periodic payment at a variable rate based on a stated schedule for different locales to cover the costs of driving an automobile in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

SECTION 5. BUSINESS STANDARD MILEAGE RATE

.01 *In general*. The standard mileage rate for transportation expenses is 50.5 cents per mile for all miles of use for business purposes.

.02 *Use of the business standard mileage rate*. A taxpayer may use the business standard mileage rate with respect to an automobile that is either owned or leased by the taxpayer. A taxpayer generally may deduct an amount equal to either the business standard mileage rate times the number of business miles traveled or the actual costs (both fixed and variable) paid or incurred by the taxpayer that are allocable to traveling those business miles.

.03 *Business standard mileage rate in lieu of fixed and variable costs*. A deduction using the business standard mileage rate is computed on a yearly basis and is in lieu of all fixed and variable costs of the automobile allocable to business purposes (except as provided in section 9.06 of this revenue procedure). Items such as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, and license and registration fees are included in fixed and variable costs for this purpose.

.04 *Parking fees, tolls, interest, and taxes*. Parking fees and tolls attributable to use of the automobile for business purposes may be deducted as separate items. Likewise, interest relating to the purchase of the automobile as well as state and local personal property taxes may be deducted as separate items, but only to the extent allowable under § 163 or § 164, respectively. Section 163(h)(2)(A) expressly provides that interest is nondeductible personal interest if it is paid or accrued on indebtedness properly allocable to the trade or business of performing services as an employee. Section 164 expressly provides that state and local taxes that are paid or accrued by a taxpayer in connection with an acquisition or disposition of property are treated as part of the cost of the acquired property or as a reduction in the amount realized on the disposition of the property. If the automobile is operated less than 100 percent for business purposes, an allocation is required to determine the business and nonbusiness portion of the taxes and interest deduction allowable.

.05 *Depreciation*. For owned automobiles placed in service for business purposes, and for which the business standard mileage rate has been used for any year, depreciation is considered to have been allowed at the rate of 16 cents per mile for 2003 and 2004, 17 cents per mile for 2005 and 2006, 19 cents per mile for 2007, and 21 cents per mile for 2008 for

those years in which the business standard mileage rate was used. If actual costs were used for one or more of those years, these rates do not apply to any year in which actual costs were used. The depreciation described above reduces the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016.

.06 *Limitations*.

(1) The business standard mileage rate may not be used to compute the deductible expenses of (a) automobiles used for hire, such as taxicabs, or (b) five or more automobiles owned or leased by a taxpayer and used simultaneously (such as in fleet operations).

(2) The business standard mileage rate may not be used to compute the deductible business expenses of an automobile leased by a taxpayer unless the taxpayer uses either the business standard mileage rate or a fixed and variable rate allowance (FAVR allowance) (as provided in section 8 of this revenue procedure) to compute the deductible business expenses of the automobile for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(3) The business standard mileage rate may not be used to compute the deductible expenses of an automobile for which the taxpayer has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, (c) claimed the special depreciation allowance under § 168(k), or (d) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. By using the business standard mileage rate, the taxpayer has elected to exclude the automobile (if owned) from MACRS pursuant to § 168(f)(1). If, after using the business standard mileage rate, the taxpayer uses actual costs, the taxpayer must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(4) The business standard mileage rate and this revenue procedure may not be used to compute the amount of the deductible automobile expenses of an employee of the United States Postal Service incurred in performing services involving the collection and delivery of mail on a rural route if the employee receives qualified reimbursements (as defined in § 162(o)) for the expenses. *See* § 162(o) for the rules that apply to these qualified reimbursements.

SECTION 6. RESERVED

SECTION 7. CHARITABLE AND MEDICAL AND MOVING STANDARD MILEAGE RATES

.01 *Charitable*. Section 170(i) provides a standard mileage rate of 14 cents per mile for purposes of computing the charitable contribution deduction for use of an automobile in connection with rendering gratuitous services to a charitable organization under § 170.

.02 *Medical and moving*. The standard mileage rate is 19 cents per mile for use of an automobile (1) to obtain medical care described in § 213, or (2) as part of a move for which the expenses are deductible under § 217.

.03 *Charitable or medical and moving standard mileage rates in lieu of variable expenses*. A deduction computed using the applicable standard mileage rate for charitable, medical, or moving expense miles is in lieu of all variable expenses (including gasoline and oil) of the automobile allocable to those purposes. Costs for items such as depreciation (or lease payments), insurance, and license and registration fees are not deductible, and are not included in the charitable or medical and moving standard mileage rates.

.04 *Parking fees, tolls, interest, and taxes*. Parking fees and tolls attributable to the use of the automobile for charitable, medical, or moving expense purposes may be deducted as separate items. Interest relating to the purchase of the automobile and state and local personal property taxes are not deductible as charitable, medical, or moving expenses, but they may be deducted as separate items to the extent allowable under § 163 or § 164, respectively.

SECTION 8. FIXED AND VARIABLE RATE ALLOWANCE

.01 *In general*.

(1) The ordinary and necessary expenses paid or incurred by an employee in driving an automobile owned or leased by the employee in connection with the performance of services as an employee of the employer are deemed substantiated (in an amount determined under section 9 of this revenue procedure) when a payor reimburses those expenses with a mileage allowance using a flat rate or stated schedule that combines periodic fixed and variable rate payments that meet all the requirements of section 8 of this revenue procedure (a FAVR allowance).

(2) The amount of a FAVR allowance must be based on data that (a) is derived from the base locality, (b) reflects retail prices paid by consumers, and (c) is reasonable and statistically defensible in approximating the actual expenses employees receiving the allowance would incur as owners of the standard automobile.

.02 *Computation of FAVR allowance*.

(1) *FAVR allowance*. A FAVR allowance includes periodic fixed payments and periodic variable payments. A payor may maintain more than one FAVR allowance. A FAVR allowance that uses the same payor, standard automobile (or an automobile of the same make and model that is comparably equipped), retention period, and business use percentage is considered one FAVR allowance, even though other features of the allowance may vary. A FAVR allowance also includes any optional high mileage payments; however, optional high mileage payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes when paid. *See* section 9.05 of this revenue procedure. An optional high mileage payment covers the additional depreciation for a standard automobile attributable to business miles driven and substantiated by the employee for a calendar year in excess of the annual business mileage for that year. If an employee is covered by the FAVR allowance for less than the entire calendar year, the annual business mileage may be prorated on a monthly basis for purposes of the preceding sentence.

(2) *Periodic fixed payment*. A periodic fixed payment covers the projected fixed costs (including depreciation (or lease payments), insurance, registration and license

fees, and personal property taxes) of driving the standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. A periodic fixed payment may be computed by (a) dividing the total projected fixed costs of the standard automobile for all years of the retention period, determined at the beginning of the retention period, by the number of periodic fixed payments in the retention period, and (b) multiplying the resulting amount by the business use percentage.

(3) *Periodic variable payment*. A periodic variable payment covers the projected variable costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of driving a standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. The rate of a periodic variable payment for a computation period may be computed by dividing the total projected variable costs for the standard automobile for the computation period, determined at the beginning of the computation period, by the computation period mileage. A computation period can be any period of a year or less. Computation period mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a computation period and equals the retention mileage divided by the number of computation periods in the retention period. For each business mile substantiated by the employee for the computation period, the periodic variable payment must be paid at a rate that does not exceed the rate for that computation period.

(4) *Base locality*. A base locality is the particular geographic locality or region of the United States in which the costs of driving an automobile in connection with the performance of services as an employee of the employer are generally paid or incurred by the employee. Thus, for purposes of determining the amount of fixed costs, the base locality is generally the geographic locality or region in which the employee resides. For purposes of determining the amount of variable costs, the base locality is generally the geographic locality or region in which the employee drives the automobile in connection with the performance of services as an employee of the employer.

(5) *Standard automobile*. A standard automobile is the automobile selected by the payor on which a specific FAVR allowance is based.

(6) *Standard automobile cost*. The standard automobile cost for a calendar year may not exceed 95 percent of the sum of (a) the retail dealer invoice cost of the standard automobile in the base locality, and (b) state and local sales or use taxes applicable on the purchase of the automobile. Further, the standard automobile cost may not exceed $27,500.

(7) *Annual mileage*. Annual mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a calendar year. Annual mileage equals the annual business mileage divided by the business use percentage.

(8) *Annual business mileage*. Annual business mileage is the mileage a payor reasonably projects a standard automobile will be driven by an employee in connection with the performance of services as an employee of the employer during the calendar year, but may not be less than 6,250 miles for a calendar year. Annual business mileage equals the annual mileage multiplied by the business use percentage.

(9) *Business use percentage*. A business use percentage is determined by dividing the annual business mileage by the annual mileage. The business use percentage may not exceed 75 percent. In lieu of demonstrating the reasonableness of the business use percentage based on records of total mileage and business mileage driven by the employees annually, a payor may use a business use percentage that is less than or equal to the following percentages for a FAVR allowance that is paid for the following annual business mileage:

Annual business mileage	*Business use percentage*
6,250 or more but less than 10,000	45 percent
10,000 or more but less than 15,000	55 percent
15,000 or more but less than 20,000	65 percent
20,000 or more	75 percent

(10) *Retention period*. A retention period is the period in calendar years selected by the payor during which the payor expects an employee to drive a standard automobile in connection with the performance of services as an employee of the employer before the automobile is replaced. The period may not be less than two calendar years.

(11) *Retention mileage*. Retention mileage is the annual mileage multiplied by the number of calendar years in the retention period.

(12) *Residual value*. The residual value of a standard automobile is the projected amount for which it could be sold at the end of the retention period after being driven the retention mileage. The Service will accept the following safe harbor residual values for a standard automobile computed as a percentage of the standard automobile cost:

Retention period	*Residual value*
2-year	70 percent
3-year	60 percent
4-year	50 percent

.03 *FAVR allowance in lieu of fixed and variable costs*.

(1) A reimbursement computed using a FAVR allowance is in lieu of the employee's deduction of all the fixed and variable costs paid or incurred by an employee in driving the automobile in connection with the performance of services as an employee of the employer, except as provided in section 9.06 of this revenue procedure. Items such as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, license and registration fees, and personal property taxes are included in fixed and variable costs for this purpose.

(2) Parking fees and tolls attributable to an employee driving the standard automobile in connection with the performance of services as an employee of the employer are not included in fixed and variable costs and may be deducted as separate items. Similarly, interest relating to the purchase of the standard automobile may be deducted as a separate item, but only to the extent that the interest is an allowable deduction under § 163.

.04 *Depreciation*.

(1) A FAVR allowance may not be paid with respect to an automobile for which the employee has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, (c) claimed the special depreciation allowance under § 168(k), or (d) used ACRS under former § 168 or MACRS under current § 168. If an employee uses actual costs for an owned automobile that has been covered by a FAVR allowance, the employee must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(2) Except as provided in section 8.04(3) of this revenue procedure, the total amount of the depreciation component for the retention period taken into account in computing the periodic fixed payments for that retention period may not exceed the excess of the standard automobile cost over the residual value of the standard automobile. In addition, the total amount of the depreciation component may not exceed the sum of the annual § 280F limitations on depreciation (in effect at the beginning of the retention period) that apply to the standard automobile during the retention period.

(3) If the depreciation component of periodic fixed payments exceeds the limitations in section 8.04(2) of this revenue procedure, that section will be treated as satisfied in any year during which the total annual amount of the periodic fixed payments and the periodic variable payments made to an employee driving 80 percent of the annual business mileage of the standard automobile does not exceed the amount obtained by multiplying 80 percent of the annual business mileage of the standard automobile by the business standard mileage rate for that year (under section 5.01 of the applicable revenue procedure).

(4) The depreciation included in each periodic fixed payment portion of a FAVR allowance paid with respect to an automobile reduces the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016. *See* section 8.07(2) of this revenue procedure for the requirement that the employer report the depreciation component of a periodic fixed payment to the employee.

.05 *FAVR allowance limitations*.

(1) A FAVR allowance may be paid only to an employee who substantiates to the payor for a calendar year at least 5,000 miles driven in connection with the performance of services as an employee of the employer or, if greater, 80 percent of the annual business mileage of that FAVR allowance. If the employee is covered by the FAVR allowance for less than the entire calendar year, these limits may be prorated on a monthly basis.

(2) A FAVR allowance may not be paid to a control employee (as defined in § 1.61–21(f)(5) and (6), excluding the $100,000 limitation in paragraph (f)(5)(iii)).

(3) An employer may not pay a FAVR allowance if at any time during a calendar year a majority of the employees covered by the FAVR allowance are management employees.

(4) An employer may not pay a FAVR allowance to any employee unless at all times during a calendar year at least five employees in total are covered by FAVR allowances provided by the employer.

(5) A FAVR allowance may be paid only with respect to an automobile (a) owned or leased by the employee receiving the payment, (b) the cost of which, as a new vehicle (whether or not purchased new by the employee), was at least 90 percent of the standard automobile cost taken into account for purposes of determining the FAVR allowance for the first calendar year the employee receives the allowance with respect to that automobile, and (c) the model year of which does not differ from the current calendar year by more than the number of years in the retention period.

(6) A FAVR allowance may not be paid with respect to an automobile leased by an employee for which the employee has used actual expenses to compute the deductible business expenses of the automobile for any year during the entire lease period. For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(7) The insurance cost component of a FAVR allowance must be based on the rates charged in the base locality for insurance coverage on the standard automobile during the current calendar year without taking into account rate-increasing factors such as poor driving records or young drivers.

(8) A FAVR allowance may be paid only to an employee whose insurance coverage limits on the automobile with respect to which the FAVR allowance is paid are at

least equal to the insurance coverage limits used to compute the periodic fixed payment under that FAVR allowance.

.06 *Employee reporting*. Within 30 days after an employee's automobile is initially covered by a FAVR allowance, or is again covered by a FAVR allowance if coverage has lapsed, the employee by written declaration must provide the payor with the following information: (1) the make, model, and year of the employee's automobile, (2) written proof of the insurance coverage limits on the automobile, (3) the odometer reading of the automobile, (4) if owned, the purchase price of the automobile or, if leased, the price at which the automobile is ordinarily sold by retailers (the gross capitalized cost of the automobile), and (5) if owned, whether the employee has claimed depreciation with respect to the automobile using any of the depreciation methods prohibited by section 8.04(1) of this revenue procedure or, if leased, whether the employee has computed deductible business expenses with respect to the automobile using actual expenses. The information described in (1), (2), and (3) of the preceding sentence also must be supplied by the employee to the payor within 30 days after the beginning of each calendar year that the employee's automobile is covered by a FAVR allowance.

.07 *Payor recordkeeping and reporting*.

(1) The payor or its agent must maintain written records setting forth (a) the statistical data and projections on which the FAVR allowance payments are based, and (b) the information provided by the employees pursuant to section 8.06 of this revenue procedure.

(2) Within 30 days of the end of each calendar year, the employer must provide each employee covered by a FAVR allowance during that year with a statement that, for automobile owners, lists the amount of depreciation included in each periodic fixed payment portion of the FAVR allowance paid during that calendar year and explains that by receiving a FAVR allowance the employee has elected to exclude the automobile from the Modified Accelerated Cost Recovery System pursuant to § 168(f)(1). For automobile lessees, the statement must explain that by receiving the FAVR allowance the employee may not compute the deductible business expenses of the automobile using actual expenses for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

.08 *Failure to meet section 8 requirements*. If an employee receives a mileage allowance that fails to meet one or more of the requirements of section 8 of this revenue procedure, the employee may not be treated as covered by any FAVR allowance of the payor during the period of the failure. Nevertheless, the expenses to which that mileage allowance relates may be deemed substantiated using the method described in sections 5, 9.01(1), and 9.02 of this revenue procedure to the extent the requirements of those sections are met.

SECTION 9. APPLICATION

.01 If a payor pays a mileage allowance in lieu of reimbursing actual transportation expenses incurred or to be incurred by an employee, the amount of the expenses that is deemed substantiated to the payor is either:

(1) for any mileage allowance other than a FAVR allowance, the lesser of the amount paid under the mileage allowance or the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee; or

(2) for a FAVR allowance, the amount paid under the FAVR allowance less the sum of (a) any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return to the payor although required to do so, (b) any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return to the payor although required to do so, and (c) any optional high mileage payments.

.02 If the amount of transportation expenses is deemed substantiated under the rules provided in section 9.01 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place (or use), and business purpose of the transportation expenses in accordance with paragraphs (b)(2) (travel away from home) and (b)(6) (listed property, which includes passenger automobiles and any other property used as a means of transportation) of § 1.274–5T, and paragraph (c) of § 1.274–5, the employee is deemed to satisfy the adequate accounting requirements of § 1.274–5(f) as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5(c). *See also* § 1.62–2(e)(1) for the rule that, in order to satisfy the substantiation requirement of an accountable plan, an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.03 An arrangement providing mileage allowances will be treated as satisfying the requirement of § 1.62–2(f)(2) with respect to returning amounts in excess of expenses as follows:

(1) For a mileage allowance (other than a FAVR allowance) paid only at a cents-per-mile rate, the requirement to return excess amounts is treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of the allowance that relates to miles of travel not substantiated by the employee, even though the arrangement does not require the employee to return the portion of the allowance that relates to the miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance mileage allowance of $109.00 based on an anticipated 200 business miles at 54.5 cents per mile (at a time when the business standard mileage rate is 50.5 cents per mile), and the employee substantiates 120 business miles. The requirement to return excess amounts is treated as satisfied if the employee is required to return the portion of the allowance that relates to the 80 unsubstantiated business miles ($43.60) even though the employee is not required to return the portion of the allowance ($4.80) that exceeds the amount of the employee's expenses deemed substantiated under section 9.01 of this revenue procedure ($60.60) for the 120 substantiated business miles. However, the $4.80 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 9.05.

(2) For a mileage allowance (other than a FAVR allowance) paid other than only

at a cents-per-mile rate, the requirement to return excess amounts is treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of the allowance that exceeds the product of the standard mileage rate and the number of miles of travel substantiated by the employee. For example, assume a payor provides an employee an advance mileage allowance of $400 per month plus 20 cents per mile based on an anticipated 2000 miles for a total of $800 (at a time when the business standard mileage rate is 50.5 cents per mile), and the employee substantiates 1000 business miles. The requirement to return excess amounts is treated as satisfied if the employee is required to return $295, the portion of the allowance that exceeds the product of the standard mileage rate and the miles substantiated ($505).

(3) For a FAVR allowance, the requirement to return excess amounts is treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)), (a) the portion (if any) of the periodic variable payment received that relates to miles in excess of the business miles substantiated by the employee, and (b) the portion (if any) of a periodic fixed payment that relates to a period during which the employee was not covered by the FAVR allowance.

.04 An employee is not required to include in gross income the portion of a mileage allowance received from a payor that is less than or equal to the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02. *See* § 1.274–5T(f)(2)(i). Assuming that the remaining requirements for an accountable plan provided in § 1.62–2 are satisfied, that portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W–2, and is exempt from withholding and payment of employment taxes. *See* § 1.62–2(c)(2) and (c)(4).

.05 An employee is required to include in gross income the portion of a mileage allowance received from a payor that exceeds the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02 of this revenue procedure. *See* § 1.274–5T(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W–2, and is subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.06 If an employee's substantiated expenses are less than the employee's actual expenses, the following rules apply:

(1) Except as otherwise provided in section 9.06(2) of this revenue procedure with respect to leased automobiles, if the amount of the expenses deemed substantiated under the rules provided in section 9.01 of this revenue procedure is less than the amount of the employee's business transportation expenses, the employee may claim an itemized deduction for the amount by which the business transportation expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business transportation expenses (not just the excess over the business standard mileage rate), includes on Form 2106, *Employee Business Expenses*, the deemed substantiated portion of the mileage allowance received from the payor, and includes in gross income the portion (if any) of the mileage allowance received from the payor that exceeds the amount deemed substantiated. *See* § 1.274–5T(f)(2)(iii). However, for purposes of claiming this itemized deduction, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the applicable standard mileage rate multiplied by the number of business miles substantiated by the employee minus the amount deemed substantiated under section 9.01 of this revenue procedure. The itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

(2) An employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(1) of this revenue procedure (relating to an allowance other than a FAVR allowance) may not claim a deduction based on actual expenses under section 9.06(1) unless the employee does so consistently beginning with the first business use of the automobile after December 31, 1997. An employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(2) of this revenue procedure (relating to a FAVR allowance) may not claim a deduction based on actual expenses.

.07 An employee may deduct an amount computed pursuant to section 5.01 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.08 A self-employed individual may deduct an amount computed pursuant to section 5.01 of this revenue procedure in determining adjusted gross income under § 62(a)(1).

.09 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. *See* § 1.62–2(k) and Rev. Rul. 2006–56. Thus, the payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(3), (c)(5), and (h)(2), and section 10.03 of this revenue procedure.

SECTION 10. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES

.01 The portion of a mileage allowance (other than a FAVR allowance), if any, that relates to the miles of business travel substantiated and that exceeds the amount deemed substantiated for those miles under section 9.01(1) of this revenue procedure is treated as paid under a nonaccountable plan and is subject to withholding and payment of employment taxes. *See* § 1.62–2(h)(2)(i)(B).

(1) In the case of a mileage allowance paid as a reimbursement, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the business miles substantiated. *See* § 1.62–2(h)(2)(i)(B)(2).

(2) In the case of a mileage allowance paid as an advance, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of em-

ployment taxes no later than the first payroll period following the payroll period in which the business miles with respect to which the advance was paid are substantiated. *See* § 1.62–2(h)(2)(i)(B)(3). If some or all of the business miles with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those miles within a reasonable period of time, the portion of the allowance that relates to those miles is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. *See* § 1.62–2(h)(2)(i)(A).

(3) In the case of a mileage allowance that is not computed on the basis of a fixed amount per mile of travel (for example, a mileage allowance that combines periodic fixed and variable rate payments, but that does not satisfy the requirements of section 8 of this revenue procedure), the payor must compute periodically (no less frequently than quarterly) the amount, if any, that exceeds the amount deemed substantiated under section 9.01(1) of this revenue procedure by comparing the total mileage allowance paid for the period to the standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee for the period. Any excess is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. *See* § 1.62–2(h)(2)(i)(B)(4).

(4) For example, assume an employer pays its employees a mileage allowance under an arrangement that otherwise meets the requirements of an accountable plan at a rate of 54.5 cents per mile (when the business standard mileage rate is 50.5 cents per mile). The employer does not require the return of the portion of the allowance that exceeds the business standard mileage rate for the business miles substantiated (4.0 cents). In June, the employer advances an employee $272.50 for 500 miles to be traveled during the month. In July, the employee substantiates to the employer 400 business miles traveled in June and returns $54.50 to the employer for the 100 business miles not traveled. The amount deemed substantiated for the 400 miles traveled is $202.00 and the employee is not required to return $16.00. No later than the first payroll period following the payroll period in which the 400 business miles traveled are substantiated, the employer must withhold and pay employment taxes on $16.00.

.02 The portion of a FAVR allowance, if any, that exceeds the amount deemed substantiated for those miles under section 9.01(2) of this revenue procedure is subject to withholding and payment of employment taxes. *See* § 1.62–2(h)(2)(i)(B).

(1) Any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return within a reasonable period, or any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return within a reasonable period, is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. *See* § 1.62–2(h)(2)(i)(A).

(2) Any optional high mileage payment is subject to withholding and payment of employment taxes when paid.

.03 If a mileage allowance arrangement has no mechanism or process to determine when an allowance exceeds the amount that may be deemed substantiated and the arrangement routinely pays allowances in excess of the amount that may be deemed substantiated without requiring actual substantiation of all the expenses or repayment of the excess amount, the failure of the arrangement to treat the excess allowances as wages for employment tax purposes causes all payments made under the arrangement to be treated as made under a nonaccountable plan. *See* Rev. Rul. 2006–56.

SECTION 11. EFFECTIVE DATE

This revenue procedure is effective for (1) deductible transportation expenses paid or incurred on or after January 1, 2008, and (2) mileage allowances or reimbursements paid to an employee or to a charitable volunteer (a) on or after January 1, 2008, and (b) with respect to transportation expenses paid or incurred by the employee or charitable volunteer on or after January 1, 2008.

SECTION 12. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2006–49 is superseded.

DRAFTING INFORMATION

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

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Modifications of Commercial Mortgage Loans Held by a Real Estate Mortgage Investment Conduit (REMIC)

REG–127770–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would expand the list of permitted loan modifications to include certain modifications of commercial mortgages. Changes to the regulations are necessary to better accommodate evolving commercial mortgage industry practices. These changes will affect lenders, borrowers, servicers, and sponsors of securitizations of mortgages in REMICs.

DATES: Written or electronic comments and requests for a public hearing must be received by February 7, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–127770–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–127770–07), 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–127770–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Diana Imholtz or Susan Thompson Baker, (202) 622–3930; concerning submissions of comments and requests for a public hearing, Kelly D. Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by January 8, 2008.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §1.860G–2(b)(7). This information is required in order to show that modifications to mortgages permitted by the proposed regulation will not cause the modified mortgage to cease to be a qualified mortgage. The collection of information is voluntary to obtain a benefit. The likely respondents are businesses or other for-profit institutions.

Estimated total annual reporting burden: 3000 hours.

Estimated average annual burden hours per respondent: 8.

Estimated annual frequency of responses: 1.

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

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

Background

This document contains proposed amendments to 26 CFR part 1 under section 860G of the Internal Revenue Code (Code). The REMIC provisions under sections 860A through 860G provide for a pass-through vehicle that issues multiple classes of interests in pools of residential and commercial mortgage loans. All income from the mortgage loans in the REMIC is taxed to the holders of the regular and residual interests in the REMIC. Among the requirements for qualification are that the mortgage loans held by the REMIC must consist of "qualified mortgages" that are principally secured by an interest in real property. All loans must be acquired on the startup day of the REMIC or within three months thereafter, except that the REMIC may exchange a defective loan for a "qualified replacement mortgage" for up to two years.

Section 1.860G–2(b)(1) of the Income tax regulations (the regulations) provides that, subject to certain exceptions described in §1.860G–2(b)(3), if an obligation is significantly modified, then the modified obligation is treated as one that was newly issued in exchange for the unmodified obligation that it replaced. If such a significant modification occurs after the obligation has been contributed to the REMIC and the modified obligation is not a qualified replacement

mortgage, the modified obligation will not be a qualified mortgage and the deemed disposition of the unmodified obligation will be a prohibited transaction under section 860F(a)(2). Section 1.860G–2(b)(2) defines a "significant modification" as any change in the terms of an obligation that would be treated as an exchange of obligations under section 1001 and the related regulations. The treatment of specific loan modifications as deemed exchanges is addressed in §1.1001–3. Section 1.1001–3 defines a loan modification and provides that a modification that is significant will be treated as a deemed exchange of the original loan for a new loan.

Section 1.860G–2(b)(3) of the regulations sets forth four types of loan modifications that are expressly permitted without regard to the section 1001 modification rules. The four permitted modifications are: (i) changes in the terms of the obligation occasioned by default or a reasonably foreseeable default; (ii) assumption of the obligation; (iii) waiver of a due-on-sale clause or a due on encumbrance clause; and (iv) conversion of an interest rate by a mortgagor pursuant to the terms of a convertible mortgage.

The present REMIC regulations were adopted in 1992 at a time when the mortgage-backed securities market involved primarily residential mortgage loans. Since that time, the securitization of commercial mortgage loans has become more common. The four types of modifications that are expressly permitted without regard to the section 1001 modification rules cover the most common changes affecting residential mortgage loans, but may not cover the range of likely changes in commercial mortgage loans.

In Notice 2007–17, 2007–12 I.R.B. 748, the IRS and Treasury Department solicited input on whether the present REMIC regulations should be amended to permit additional types of modifications incurred in connection with the commercial mortgage loans. In response to Notice 2007–17, the IRS and Treasury Department received three comments. See §601.601(d)(2)(ii)(*b*).

The first comment set forth a proposal to add six new types of permissible modifications: (1) a modification that releases, adds, substitutes or otherwise alters any portion of the collateral for, a guarantee of, or other form of credit enhancement for the obligation, whether recourse or nonrecourse (other than an alteration that causes the obligation not to be principally secured by an interest in real property); (2) a change in the obligation from recourse (or substantially all recourse) to nonrecourse (or substantially all nonrecourse), or vice versa; (3) a change in the date on which the obligation may be prepaid or defeased in whole or in part, or addition of a defeasance provision; (4) substitution of a new obligor or addition or deletion of a co-obligor on the obligation; (5) imposition or waiver of a prepayment penalty or other fee; and (6) a change of the principal payment schedule of a loan following a voluntary or involuntary prepayment of principal. The second comment set forth a proposal to add two new types of permissible modifications relating to changes in collateral and defeasance that are substantially similar to proposals (1) and (3) of the first comment. In addition, the second comment set forth a proposal to revise the existing exception for assumptions of the obligation to include any substitution of a guarantor for a guarantee on, or other form of credit enhancement for, an obligation. The first and second comments also set forth examples of the most common changes to commercial loans requested by commercial borrowers to assist the IRS and Treasury Department in understanding the particular business need served by each proposed modification.

Finally, the third comment requested that the IRS and Treasury Department consider a prior proposal advocating a new standard to measure materiality for modifications to loans held by a REMIC. Rather than adding specific types of loan modifications to the list of permitted modifications, the prior proposal recommended that the REMIC regulations be revised to provide that any change in the terms of a qualified mortgage will not cause it to cease to be a qualified mortgage so long as the change does not increase the principal amount or extend the maturity of the mortgage.

IRS and Treasury Department personnel, including personnel from Large & Mid-Size Business (LMSB) and LMSB Division Counsel, reviewed all comments and met with certain of the submitting parties to explore the proposals and the analysis supporting those proposals. After consideration of all comments received, the IRS and Treasury Department believe that it is appropriate at this time to propose amendments to the REMIC regulations to permit certain additional types of modifications to commercial mortgages.

Explanation of Provisions

1. *General*

The proposed regulations are intended to address the concerns raised by the commercial real estate industry that the existing REMIC regulations do not adequately accommodate legitimate business practices existing in the commercial mortgage securitization market. Submitting parties have indicated that the real property that secures a commercial mortgage loan is typically an active, income-generating, business property of the commercial loan borrower. Thus, in contrast to residential mortgage loans, there is a greater need to make ongoing changes to the terms of a commercial mortgage loan. For example, a borrower may request a release of a parcel of land from the lien of the mortgage to either sell or develop the land. Although the mortgage continues to be principally secured by an interest in real property following the release, such a change under the existing REMIC regulations might cause the mortgage to cease to be a qualified mortgage.

The legislative history indicates that REMICs "should be flexible enough to accommodate most legitimate business concerns while preserving the desired certainty of income tax treatment." S. Rep. No. 99–313, 99th Cong., 2d Sess., at 792. The legislative history also indicates that a REMIC, to preserve its tax status, must consist of a substantially fixed pool of real estate mortgages and related assets and have "no powers to vary the composition of its mortgage assets." S. Rep. No. 99–313, 99th Cong., 2d Sess., at 791–792. Accordingly, the proposed regulations are intended to strike a balance between accommodating the legitimate business concerns of the commercial real estate industry with the requirement that a REMIC remain a substantially fixed pool of mortgages and not be engaged in an active lending business.

In weighing the business needs of the industry against Congressional intent that a REMIC consist of a fixed pool of quali-

fied mortgages that are principally secured by real property and whose income can be accurately calculated as of the startup day, the IRS and Treasury Department applied four core concepts to each of the proposed modifications. First, to minimize changes to REMIC cash flows after the startup day, the IRS and Treasury Department analyzed whether a particular modification would be likely to produce any significant gain or loss to the REMIC. Second, the IRS and Treasury Department considered whether a mortgage loan, if permitted to be modified as requested by submitting parties, would remain principally secured by real property after the modification. Third, the IRS and Treasury Department examined the ability of the IRS to review and administer compliance with the requirements of a particular modification. Finally, the IRS and Treasury Department considered the business needs indicated by the industry for a borrower requesting a particular modification to the terms of the loan and whether that business need was adequately addressed by the current regulations.

2. *Proposed Modifications*

In applying the four core concepts, the IRS and Treasury Department determined that proposals relating to changes in collateral, guarantees and credit enhancement of an obligation and changes to the recourse nature of an obligation should be added to the list of permitted exceptions under section 860G to the section 1001 modification rules. These changes would be permitted so long as the obligation continues to be principally secured by an interest in real property. The proposed regulations also would clarify that a release of a lien on real property collateral securing a mortgage does not disqualify a mortgage so long as the mortgage continues to be principally secured by an interest in real property after giving effect to any releases, substitutions, additions or other alterations to the collateral.

Section 1.860G–2(a)(1) of the current regulations provides that an obligation is principally secured by an interest in real property if the fair market value of the real property that secures the obligation equals at least 80 percent of the adjusted issue price of the obligation. The current regulations require the 80-percent test to be satisfied either at the time the obligation was originated or at the time the sponsor contributes the obligation to the REMIC. To ensure that a modified mortgage loan continues to be principally secured by an interest in real property, the proposed regulations require the 80-percent test to be satisfied at the time the mortgage loan is modified as determined by an appraisal performed by an independent appraiser.

To support their proposals, commentators provided examples of loan modification requests that arise with some frequency in commercial mortgage loan securitizations. The majority of those examples involved requests to change the security or credit enhancement of an obligation. Accordingly, the IRS and Treasury Department expect that, by permitting changes to collateral and changes to the recourse nature of an obligation without regard to the section 1001 modification rules, the proposed regulations will resolve many of the industry's business concerns arising from borrower requests to modify commercial mortgage loans.

3. *Other Modifications*

In balancing the competing interests noted in the preceding discussion, however, the IRS and Treasury Department determined that the remainder of the changes requested by commentators to accommodate business needs of the industry could not be adopted in the proposed regulations. First, commentators set forth a proposal to permit changes to the date on which a commercial mortgage loan may be defeased and to permit the addition of a defeasance provision where the original terms of the mortgage loan do not otherwise provide. By defeasing a commercial mortgage loan, the borrower replaces the underlying real property collateral securing the mortgage with government securities whose payments match the mortgage's payments. Section 1.860G–2(a)(8) of the current regulations permits defeasance of a mortgage loan, under certain conditions, including the condition that the defeasance not occur within 2 years of the startup date of the REMIC. These conditions are intended to ensure that the defeasance transaction is undertaken as part of a customary commercial transaction and not as part of an arrangement to collateralize a REMIC with obligations that are not real estate mortgages.

Commentators indicated that while defeasance is currently the preferred means by which a borrower can obtain an early release from liability on a commercial mortgage, the original terms of commercial loan documents do not always satisfy the current defeasance exception. Submitting parties maintain that expanding the borrower's ability to defease does not violate the policy against replacing real property securing a commercial mortgage with other collateral so long as the defeasance does not occur within two years of the startup date. The IRS and Treasury Department believe, however, that the current defeasance exception already adequately accommodates the legitimate business need of providing borrowers with the ability to defease a mortgage loan if certain conditions are met. Expanding the defeasance exception is not warranted given Congress' intent that REMICs consist of a substantially fixed pool of real estate mortgages and related assets.

Second, commentators set forth a proposal to expand the existing exception for assumptions of the obligation such that any changes to the obligor on a commercial mortgage loan, including the addition or deletion of a co-obligor, would be permitted. In general, a change to the obligor on a nonrecourse debt instrument is not a significant modification for purposes of the section 1001 modification rules. The submitting parties indicated that the vast majority of commercial mortgage loans are nonrecourse. As a result, permitting a borrower to make changes to the obligor on a commercial mortgage would not generally cause the mortgage to cease to be a qualified mortgage. For this reason, the IRS and Treasury Department do not believe that expanding the existing exception for assumptions of the obligation is necessary to address a business need of the industry that was not already addressed by the current regulations.

Third, the commentators set forth a proposal to allow for the imposition or waiver of a prepayment penalty. The imposition or waiver of a prepayment penalty generally results in a change in yield on an obligation and can further result in a significant modification under §1.1001–3(e)(2) of the regulations if the annual yield of the modified obligation varies from the unmodified obligation by more than the greater of 25 basis points

or 5 percent of the yield of the unmodified instrument. Commentators indicated that although there is an administrative burden imposed on the servicer because the yield change computations are complicated and are performed frequently due to borrower requests, the change in yield resulting from an imposition or waiver of a prepayment penalty does not generally cause a significant modification and does not cause the mortgage to cease to be a qualified mortgage. Accordingly, the IRS and Treasury Department do not believe that adoption of this proposal is necessary to address a business need of the industry that was not already addressed by the current regulations.

Fourth, commentators set forth a proposal to permit changes in the principal payment schedule following a partial prepayment of a mortgage. Commentators indicated that loan documents do not always provide for a reamortization or other adjustment of a principal payment schedule after a partial principal payment on a loan. In general, a material deferral of scheduled principal payments is a significant modification under the section 1001 modification rules. Section 1.1001–3(e)(3)(ii) of the regulations, however, provides a safe harbor period that begins on the original due date of the first deferred payment and extends for a period equal to the lesser of 5 years or 50 percent of the original term of the obligation. In addition, a *pro rata* prepayment of all of the remaining payments on an obligation does not result in a modification of the portion of the obligation that remains outstanding.

In light of the safe harbor and the rule for *pro rata* prepayments, it is not clear to the IRS and Treasury Department whether permitting changes to the timing of principal payments is necessary. In addition, it is not clear whether a change in the principal payment schedule of a commercial mortgage loan could result in a change in yield more than the greater of 25 basis points or 5 percent of the yield of the unmodified loan.

Finally, one commentator advocated a new standard to measure materiality for modifications to loans held by a REMIC that departs from the standards set forth under section 1001. The IRS and Treasury Department continue to believe that the section 1001 standard should generally govern modifications of mortgage loans held by a REMIC. The IRS and Treasury Department further believe that adding to the list of exceptions expressly permitted without regard to the section 1001 modifications strikes the appropriate balance between accommodating the business needs of the industry with the requirement that a REMIC remain a substantially fixed pool of mortgages.

4. *Interaction with Section 1001*

The additional types of modifications permitted by the proposed regulations will exempt the modified obligation from deemed exchange treatment for purposes of §1.860G–2(b)(1) of the regulations only. For example, a commercial mortgage loan that is modified from nonrecourse to recourse and continues to be principally secured by an interest in real property will continue to be a qualified mortgage and will not be subject to the prohibited transaction tax under section 860F(a)(2). Such a modification, however, is significant under §1.1001–3 and will be treated as a deemed exchange of the original mortgage loan for a new mortgage loan for purposes of section 1001. Accordingly, any resulting gain or loss under section 1001 must be included in the computation of the REMIC's taxable income.

Effective Date

These regulations are proposed to apply to modifications made to the terms of an obligation on or after publication of this document in the Federal Register as a Treasury decision.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation.

It is hereby certified that the collection of information requirement in this regulation will not have a significant economic impact on a substantial number of small business entities. This certification is based on the fact that the REMICs affected by this regulation will not be classified as small business entities. According to the Small Business Administration definition of a "small business," 13 C.F.R. 121.201, a REMIC is classified under Sector 52 (Finance and Insurance), Subsector 525 (Funds, Trusts and Other Financial Vehicles) under the category "Other Financial Vehicle", NAICS code 525990, and is only considered a small business entity if it accumulates less than 6.5 million dollars in annual receipts. REMICs affected by this regulation generally hold pools of commercial mortgage loans with an average loan size of 18.1 million dollars, and have greater than 6.5 million dollars in annual receipts. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for 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 these proposed regulations is Diana Imholtz of the Office of Associate Chief Counsel (Financial Institutions and Products). Other personnel from the IRS and Treasury Department participated, however, in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.860A–0 also issued under 26 U.S.C. 860G(e).

Section 1.860A–1 also issued under 26 U.S.C. 860G(e).

Section 1.860G–2 also issued under 26 U.S.C. 860G(e). * * *

Par. 2. Section 1.860A–0 is amended by adding an entry for §1.860G–2(b)(7) to read as follows:

§1.860A–0 Outline of REMIC provisions.

* * * * *

§1.860G–2 Other rules.

* * * * *

(b) * * *

(7) Principally secured test; appraisal requirement.

* * * * *

Par. 3. Section 1.860A–1 is amended by adding paragraph (b)(6) to read as follows:

§1.860A–1 Effective dates and transition rules.

* * * * *

(b) * * *

(6) *Exceptions for certain modified obligations*. Paragraphs (b)(3)(v), (b)(3)(vi) and (b)(7) of §1.860G–2 apply to modifications made to the terms of an obligation on or after the date of publication of this document in the Federal register as a Treasury decision.* * * * *

Par. 4. Section 1.860G–2 is amended by:

1. Revising paragraphs (a)(8), (b)(3)(iii) and (b)(3)(iv).

2. Adding paragraphs (b)(3)(v), (b)(3)(vi) and (b)(7).

The additions and revisions read as follows:

§1.860G–2 Other rules.

(a) * * *

(8) *Release of interest in real property securing a qualified mortgage; defeasance*. If a REMIC releases its lien on real property that secures a qualified mortgage, that mortgage ceases to be a qualified mortgage on the date the lien is released unless —

(i) The REMIC releases its lien pursuant to a modification described in paragraph (b)(3)(v) of this section addressing changes to the collateral for, guarantees on, or other form of credit enhancement on a mortgage; or

(ii) The mortgage is defeased in the following manner —

(A) The mortgagor pledges substitute collateral that consists solely of government securities (as defined in section 2(a)(16) of the Investment Company Act of 1940 as amended (*15 U.S.C. 80a–1)*);

(B) The mortgage documents allow such a substitution;

(C) The lien is released to facilitate the disposition of the property or any other customary commercial transaction, and not as part of an arrangement to collateralize a REMIC offering with obligations that are not real estate mortgages; and

(D) The release is not within 2 years of the startup day.

* * * * *

(b) * * *

(3) * * *

(iii) Waiver of a due-on-sale clause or a due on encumbrance clause;

(iv) Conversion of an interest rate by a mortgagor pursuant to the terms of a convertible mortgage;

(v) A modification that releases, substitutes, adds or otherwise alters a substantial amount of the collateral for, a guarantee on, or other form of credit enhancement for a recourse or nonrecourse obligation, so long as the obligation continues to be principally secured by an interest in real property following such release, substitution, addition or other alteration; and

(vi) A change in the nature of the obligation from recourse (or substantially all recourse) to nonrecourse (or substantially all nonrecourse), so long as the obligation continues to be principally secured by an interest in real property following such a change.

* * * * *

(7) *Principally secured test; appraisal requirement*. For purposes of paragraph (b)(3)(v) and (vi) of this section, in determining whether an obligation continues to be principally secured by an interest in real property, the fair market value of the interest in real property securing the obligation, determined as of the date of the modification, must be equal to at least 80 percent of the adjusted issue price of the modified obligation, determined as of the date of the modification. For purposes of this test, the fair market value of the interest in real property securing the obligation must be determined by an appraisal performed by an independent appraiser.

* * * * *

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 8, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 9, 2007, 72 F.R. 63523)

Wind Energy Partnerships

Announcement 2007–112

This announcement revises Revenue Procedure 2007–65, 2007–45 I.R.B. 967, by adding the following language to Section 3: "The requirements set forth in this revenue procedure that must be satisfied in order to qualify for the Safe Harbor, however, are not intended to provide substantive rules and are not to be used as audit guidelines," and replacing "will not challenge" with "will respect" in Section 6.

The principal authors of this announcement are Vishal R. Amin and Richard T. Probst of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this announcement, contact Vishal R. Amin or Richard T. Probst at (202) 622–3060 (not a toll-free call).

Disqualified Corporate Interest Expense Disallowed Under Section 163(j) and Related Information

Announcement 2007–114

This announcement alerts the public to the fact that a new proposed form, Form 8926, *Disqualified Corporate Interest Expense Disallowed Under Section 163(j) and Related Information*, is being posted on the IRS website. The proposed form requires corporate taxpayers that either paid or accrued any disqualified interest for the taxable year or carried forward disallowed disqualified interest from prior taxable years under section 163(j) of the Internal Revenue Code to provide certain information relating to the determinations and computations under section 163(j).

Section 163(j) imposes a limitation on deductions for interest paid or accrued by corporations to related persons where the interest is exempt or partially exempt from taxation. Section 163(j) also applies to a corporation that pays or accrues interest to an unrelated party if the interest is not subject to a gross basis tax and the guarantor is a related person who is either a foreign person or a tax-exempt organization as well as to a taxable REIT subsidiary of a REIT that pays or accrues interest to the REIT.

Section 424 of the American Jobs Creation Act of 2004, Public Law 108–357, 118 Stat. 1418 (October 22, 2004), mandated that the Secretary of the Treasury or a delegate conduct a study of the effectiveness of provisions of the Internal Revenue Code of 1986 applicable to earnings stripping.

The Treasury Department has conducted a study of earnings stripping as directed by Congress and has issued a report regarding its findings and recommendations on this issue. The study recommends that the relevant tax forms be modified to require more information about earnings stripping. Therefore, proposed Form 8926 has been created to obtain information relating to the application of section 163(j).

Proposed Form 8926 solicits information relating to the determination and computation of a corporate taxpayer's section 163(j) limitation, including the determination of the taxpayer's debt-to-equity ratio, net interest expense, adjusted taxable income, excess interest expense, total disqualified interest for the tax year and the amount of interest deduction disallowed under section 163(j), as well as certain information with respect to the related persons receiving disqualified interest. The proposed form will be posted on the IRS website at *www.irs.gov/taxpros/topic/index.html* under Draft Tax Forms.

The principal author of this announcement is Sheila Ramaswamy of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this announcement, contact Sheila Ramaswamy at (202) 622–3870 (not a toll-free call).

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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