Internal Revenue
bulletin

Bulletin No. 2008-14
April 7, 2008

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. 2008–20, page 716.

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 April 2008.

T.D. 9378, page 720.

Final regulations under section 6325 of the Code outline specific procedures for obtaining a release of a federal tax lien or a discharge of a federal tax lien from property to which it has attached. The regulations incorporate changes to the Code that were made by the IRS Restructuring and Reform Act of 1998, which afford a means for a person whose property is encumbered by a federal tax lien, but who does not owe the tax giving rise to the lien, to have his property discharged from the lien.

T.D. 9379, page 715.
REG–153589–06, page 730.

Temporary and proposed regulations under section 1221 of the Code provide the time and manner for making an election to treat the sale or exchange of musical compositions or copyrights in musical works created by the taxpayer as the sale or exchange of a capital asset.

T.D. 9381, page 694.

Final regulations under section 199 of the Code concern the amendments made by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) to section 199, which provides a deduction for income attributable to domestic production activities.

Notice 2008–40, page 725.

Amplification of Notice 2006–52; Deduction for Energy Efficient Commercial Buildings. This notice sets forth additional guidance relating to the deduction for energy efficient commercial buildings under section 179D of the Code and is intended to be used with Notice 2006–52. Several aspects of the deduction for energy efficient commercial buildings were not addressed in Notice 2006–52. This notice addresses some of these items including the allocation of the section 179D deduction to designers of government owned buildings, certification requirements for the interim lighting rule, and the application of the interim lighting rule to unconditioned garage space. Notice 2006–52 clarified and amplified.

Announcement 2008–25, page 732.

This document withdraws a portion of proposed regulations (REG–107592–00, 2007–44 I.R.B. 908) under the consolidated return regulations. The withdrawn portion relates to the treatment of transactions involving the provision of insurance between members of a consolidated group.

EMPLOYEE PLANS

Announcement 2008–23, page 731.

Pre-approved defined contribution master and prototype and volume submitter plans; issuance of EGTRRA opinion and advisory letters. This announcement states that the Service will soon issue opinion and advisory letters for pre-approved, *i.e.*, master and prototype and volume submitter defined contribution plans that were timely filed with the Service to comply with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), and other changes in plan qualification requirements listed in Notice 2004–84, 2004–2 C.B. 1030.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

EXEMPT ORGANIZATIONS

Announcement 2008–28, page 733.

A list is provided of organizations now classified as private foundations.

ADMINISTRATIVE

T.D. 9380, page 718.

Final regulations under section 6020 of the Code relate to returns prepared or signed by the Commissioner or other Internal Revenue Officers or employees. The regulations provide guidance for preparing a substitute for return under section 6020(b). Absent the existence of a return under section 6020(b), the addition to tax under section 6651(a)(2) does not apply to a nonfiler. The regulations affect any person who fails to file a required return.

Announcement 2008–25, page 732.

This document withdraws a portion of proposed regulations (REG–107592–00, 2007–44 I.R.B. 908) under the consolidated return regulations. The withdrawn portion relates to the treatment of transactions involving the provision of insurance between members of a consolidated group.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2008. See Rev. Rul. 2008-20, page 716.

Section 199.—Income Attributable to Domestic Production Activities

26 CFR 1.199–3: Domestic production gross receipts.

T.D. 9381

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

TIPRA Amendments to Section 199

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning the amendments made by the Tax Increase Prevention and Reconciliation Act of 2005 to section 199 of the Internal Revenue Code. The final regulations also contain a rule concerning the use of losses incurred by members of an expanded affiliated group. Section 199 provides a deduction for income attributable to domestic production activities. The final regulations affect taxpayers engaged in certain domestic production activities.

DATES: *Effective Date:* These regulations are effective on February 15, 2008.

Applicability Date: For dates of applicability, see §1.199–8(i)(5) and (6).

FOR FURTHER INFORMATION CONTACT: Concerning §§1.199–2(e)(2) and 1.199–8(i)(5), Paul Handleman or David McDonnell, (202) 622–3040; concerning §§1.199–3(i)(7) and (8), and 1.199–5, William Kostak, (202) 622–3060; and concerning §§1.199–7(b)(4) and 1.199–8(i)(6), Ken Cohen, (202) 622–7790 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document provides rules relating to the deduction for income attributable to domestic production activities under section 199 of the Internal Revenue Code (Code). Section 199 was added to the Code by section 102 of the American Jobs Creation Act of 2004 (Public Law 108–357, 118 Stat. 1418), and amended by section 403(a) of the Gulf Opportunity Zone Act of 2005 (Public Law 109–135, 119 Stat. 25), section 514 of the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109–222, 120 Stat. 345) (TIPRA), and section 401 of the Tax Relief and Health Care Act of 2006 (Public Law 109–432, 120 Stat. 2922). On June 1, 2006, the IRS and Treasury Department published final regulations under section 199 (T.D. 9263, 2006–1 C.B. 1063 [71 FR 31268]). On October 19, 2006, the IRS and Treasury Department published final and temporary regulations on the TIPRA amendments to section 199 (T.D. 9293, 2006–2 C.B. 957 [71 FR 61662]) and cross-referencing proposed regulations (REG–127819–06, 2006–2 C.B. 1013 [71 FR 61692]). No public hearing was requested or held on the proposed regulations. One comment responding to the proposed regulations was received. After consideration of the comment, the proposed regulations are adopted as amended by this Treasury decision and the corresponding temporary regulations are removed.

General Overview

Section 199(a)(1) allows a deduction equal to 9 percent (3 percent in the case of taxable years beginning in 2005 or 2006, and 6 percent in the case of taxable years beginning in 2007, 2008, or 2009) of the lesser of (A) the qualified production activities income (QPAI) of the taxpayer for the taxable year, or (B) taxable income (determined without regard to section 199) for the taxable year (or, in the case of an individual, adjusted gross income (AGI)).

Section 199(b)(1) limits the deduction for a taxable year to 50 percent of the W–2 wages paid by the taxpayer during the calendar year that ends in such taxable year. For this purpose, section 199(b)(2)(A) defines the term *W–2 wages* to mean, with respect to any person for any taxable year of such person, the sum of the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Section 514(a) of TIPRA added new section 199(b)(2)(B), which provides that the term *W–2 wages* does not include any amount which is not properly allocable to domestic production gross receipts (DPGR) for purposes of section 199(c)(1). Section 199(b)(2)(C) provides that the term *W–2 wages* does not include any amount that is not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for the return.

Pass-thru Entities

Section 199(d)(1)(A) provides that, in the case of a partnership or S corporation, (i) section 199 shall be applied at the partner or shareholder level, (ii) each partner or shareholder shall take into account such person's allocable share of each item described in section 199(c)(1)(A) or (B) (determined without regard to whether the items described in section 199(c)(1)(A) exceed the items described in section 199(c)(1)(B)), and (iii) each partner or shareholder shall be treated for purposes of section 199(b) as having W–2 wages for the taxable year in an amount equal to such person's allocable share of the W–2 wages of the partnership or S corporation for the taxable year (as determined under regulations prescribed by the Secretary).

Section 199(d)(1)(B) provides that, in the case of a trust or estate, (i) the items referred to in section 199(d)(1)(A)(ii) (as determined therein) and the W–2 wages

of the trust or estate for the taxable year shall be apportioned between the beneficiaries and the fiduciary (and among the beneficiaries) under regulations prescribed by the Secretary, and (ii) for purposes of section 199(d)(2), AGI of the trust or estate shall be determined as provided in section 67(e) with the adjustments described in such section.

Section 199(d)(1)(C) provides that the Secretary may prescribe rules requiring or restricting the allocation of items and wages under section 199(d)(1) and may prescribe such reporting requirements as the Secretary determines appropriate.

Expanded Affiliated Groups

Section 199(d)(4)(A) provides that all members of an expanded affiliated group (EAG) are treated as a single corporation for purposes of section 199. Section 199(d)(4)(B) provides that an EAG is an affiliated group as defined in section 1504(a), determined by substituting "more than 50 percent" for "at least 80 percent" each place it appears and without regard to section 1504(b)(2) and (4).

Authority to Prescribe Regulations

Section 199(d)(9) authorizes the Secretary to prescribe such regulations as are necessary to carry out the purposes of section 199, including regulations that prevent more than one taxpayer from being allowed a deduction under section 199 with respect to any activity described in section 199(c)(4)(A)(i).

Summary of Comments

For taxable years beginning after May 17, 2006, §1.199–2T(e)(2)(i) provides that the term *W–2 wages* includes only amounts described in §1.199–2(e)(1) (paragraph (e)(1) wages) that are properly allocable to DPGR (as defined in §1.199–3) for purposes of section 199(c)(1). A taxpayer may determine the amount of paragraph (e)(1) wages that is properly allocable to DPGR using any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances.

Section 1.199–2T(e)(2)(ii) and (iii) provide safe harbors for determining the amount of paragraph (e)(1) wages that is properly allocable to DPGR. Under the wage expense safe harbor in §1.199–2T(e)(2)(ii)(A) for taxpayers using either the section 861 method of cost allocation under §1.199–4(d) or the simplified deduction method under §1.199–4(e), a taxpayer may determine the amount of paragraph (e)(1) wages that is properly allocable to DPGR by multiplying the amount of paragraph (e)(1) wages by the ratio of the taxpayer's wage expense included in calculating QPAI for the taxable year to the taxpayer's total wage expense used in calculating the taxpayer's taxable income (or AGI, if applicable) for the taxable year. For purposes of determining the amount of wage expense included in cost of goods sold (CGS) for this safe harbor, §1.199–2T(e)(2)(ii)(B) provides that a taxpayer may determine its wage expense included in CGS using any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances.

Under the wage expense safe harbor in §1.199–2T(e)(2)(ii)(A), a taxpayer uses its wage expense, not W–2 wages, to determine the amount of W–2 wages that are properly allocable to DPGR. Section 1.199–2T(e)(2)(ii)(A) defines the term *wage expense* as wages (that is, compensation paid by the employer in the active conduct of a trade or business to its employees) that are properly taken into account under the taxpayer's method of accounting.

The commentator suggested that, in certain circumstances, it should not be necessary for W–2 wages to be paid by a taxpayer in order for those wages to be properly allocable to DPGR. Specifically, the commentator suggested that W–2 wages should be treated as properly allocable to DPGR if the wages are paid to employees that are performing services in connection with an activity attributable to DPGR. Thus, in the case of partnership-shared services, if the employees of one partnership perform services that give rise to DPGR for another partnership and both partnerships have common ownership, then some or all of the W–2 wages should be treated as properly allocable to DPGR. The commentator further suggested that W–2 wages should be properly allocable to DPGR as long as the owner of the pass-thru entity includes in its taxable income DPGR (as a distributive share of another pass-thru entity's DPGR) and deducts from its taxable income wages paid to employees (those employed by the pass-thru entity) whose services created that DPGR.

As an alternative, the commentator suggested that owners of certain pass-thru entities be permitted to treat non-DPGR as DPGR for purposes of determining whether W–2 wages are properly allocable to DPGR. The commentator suggested that the activity attribution rules for qualifying in-kind partnerships in §1.199–3T(i)(7)(i), EAG partnerships in §1.199–3T(i)(8)(ii), and EAGs in §1.199–7(a)(3) be extended to pass-thru entities with respect to gross receipts attributable to services performed by employees of a pass-thru entity if such gross receipts are taken into account as an item of income on a tax return in which the DPGR attributable to those services also is reported. The commentator believes the result of such a rule would be to recharacterize non-DPGR as DPGR if the activities giving rise to the employee wages contribute to generating DPGR that is reported on the same tax return as the wage deduction. Therefore, the pass-thru entity with the employees would be treated as engaged in a qualifying production activity to the extent of the W–2 wages and the W–2 wages would be treated as properly allocable to DPGR.

The interplay between the TIPRA amendment to section 199(b)(2) and the rules for qualifying in-kind partnerships under §1.199–3T(i)(7), EAG partnerships under §1.199–3T(i)(8), and EAGs under §1.199–7 may reduce or eliminate the section 199 deduction for EAGs and partners in qualifying in-kind partnerships if one entity uses employees of another entity to perform activities giving rise to DPGR. In addition, even though §1.199–3(f) provides rules for contract manufacturing and certain government contracts, the TIPRA amendment to section 199(b)(2) may reduce or eliminate the section 199 deduction for taxpayers entering into such contracts because the contract manufacturer's W–2 wages are not attributed to the taxpayer.

The commentator's suggestions would treat pass-thru entities more favorably than non-consolidated EAGs. In general, §1.199–7(a) and (b) provides that each member of an EAG calculates its own taxable income or loss, QPAI, and W–2 wages, which are then aggregated in determining the EAG's section 199 deduction.

After the TIPRA amendment to section 199(b)(2), to qualify as W–2 wages within the meaning of §1.199–2T(e)(2), paragraph (e)(1) wages must be properly allocable to DPGR. Because each member of an EAG separately calculates its own items before they are aggregated by the EAG, the member having the paragraph (e)(1) wages must itself have DPGR to which the wages are properly allocable in order to qualify those wages as W–2 wages. Paragraph (e)(1) wages that are not properly allocable to DPGR of the member having the paragraph (e)(1) wages do not qualify as W–2 wages, even if the paragraph (e)(1) wages were paid in connection with another member's DPGR activities. *Example 5* in §1.199–2T(e)(2)(iv) illustrates this point.

Section 514(b) of TIPRA amended section 199(d)(1)(A)(iii) regarding a partner's or shareholder's share of W–2 wages from a partnership or S corporation for taxable years beginning after May 17, 2006. After TIPRA, the section 199(d)(1)(A)(iii) rule for determining a partner's or shareholder's share of W–2 wages from a pass-thru entity no longer includes the second prong of the former two-prong standard, by which a partner's or shareholder's share of W–2 wages from the partnership or S corporation was limited to the lesser of that person's allocable share of W–2 wages from the entity or a specified percentage of the person's QPAI, computed by taking into account only the items of the entity allocated to that person for the taxable year of the entity. Before TIPRA, if the employees of a partnership performed services that gave rise to DPGR for another entity, but the partnership had no DPGR, then under the section 199(d)(1)(A)(iii) wage limitation, a partner could not take into account any W–2 wages from the partnership. After TIPRA, if the partner uses the section 861 method of cost allocation under §1.199–4(d), the partner cannot take into account any W–2 wages from the partnership because the W–2 wages do not generate DPGR in the partnership. Thus, in the case of partnership-shared services where the partner uses the section 861 method, the TIPRA amendment to section 199(b)(2) retains the result that the partner cannot take into account any W–2 wages from the partnership in applying the wage limitation under section 199(b)(1).

Moreover, the TIPRA amendment modified the W–2 wage limitation to narrow the availability of the section 199 deduction. The commentator's suggestions would allow more taxpayers to claim the section 199 deduction and increase the amount of the deduction for some taxpayers, which conflicts with the changes made by TIPRA. Accordingly, the final regulations do not adopt the commentator's suggestions.

In finalizing §1.199–5, certain clarifying changes have been made and conforming clarifications have been made to §1.199–9.

As described in the preamble to the final and temporary regulations on the TIPRA amendments to section 199, published on October 19, 2006 (T.D. 9293, 71 FR 61662), the combination of the aggregation rules for determining the taxable income of an EAG in §1.199–7(b)(1) of the June 1, 2006 final regulations (T.D. 9263, 71 FR 31268) and the rules of section 172 for net operating loss deductions could cause the unintended result of the same loss being used twice in determining the taxable income limitation under section 199(a)(1)(B). To eliminate this unintended result, §1.199–7T(b)(4) was promulgated to prevent a loss that was used in the year it was sustained in determining any EAG's taxable income for purposes of the taxable income limitation under section 199(a)(1)(B) from being used again as either a carryover or carryback to any taxable year in determining the taxable income limitation under section 199(a)(1)(B). No comments were received on the provisions of §1.199–7T(b)(4) and those provisions are finalized without change.

Effective/Applicability Dates

Section 199 applies to taxable years beginning after December 31, 2004. Sections 1.199–2(e)(2), 1.199–3(i)(7) and (8), and 1.199–5 are applicable for taxable years beginning on or after October 19, 2006 (the effective date of the temporary regulations). A taxpayer may apply §§1.199–2(e)(2), 1.199–3(i)(7) and (8), and 1.199–5 to taxable years beginning after May 17, 2006, and before October 19, 2006, regardless of whether the taxpayer otherwise relied upon Notice 2005–14, 2005–1 C.B. 498 (see §601.601(d)(2)(ii)(*b*)), the provisions of REG–105847–05, 2005–2 C.B. 987, or §§1.199–1 through 1.199–8. Section 1.199–7(b)(4) is applicable for taxable years beginning on or after February 15, 2008.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Paul Handleman and Lauren Ross Taylor, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.199–0 is amended by adding new entries for §§1.199–2(e)(2), 1.199–3(i)(7), 1.199–3(i)(8), 1.199–5, and 1.199–7(b)(4) to read as follows:

§1.199–0 Table of contents.

* * * * *

§1.199–2 Wage limitation.

* * * * *

(e) * * *

(2) Limitation on W–2 wages for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.

(i) In general.

(ii) Wage expense safe harbor.

(A) In general.

(B) Wage expense included in cost of goods sold.

(iii) Small business simplified overall method safe harbor.

(iv) Examples.

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§1.199–3 Domestic production gross receipts.

* * * * *

(i) * * *

(7) Qualifying in-kind partnership for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.

(i) In general.

(ii) Definition of qualifying in-kind partnership.

(iii) Other rules.

(iv) Example.

(8) Partnerships owned by members of a single expanded affiliated group for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.

(i) In general.

(ii) Attribution of activities.

(A) In general.

(B) Attribution between EAG partnerships.

(C) Exceptions to attribution.

(iii) Other rules.

(iv) Examples.

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§1.199–5 Application of section 199 to pass-thru entities for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.

(a) In general.

(b) Partnerships.

(1) In general.

(i) Determination at partner level.

(ii) Determination at entity level.

(2) Disallowed losses or deductions.

(3) Partner's share of paragraph (e)(1) wages.

(4) Transition rule for definition of W–2 wages and for W–2 wage limitation.

(5) Partnerships electing out of subchapter K.

(6) Examples.

(c) S corporations.

(1) In general.

(i) Determination at shareholder level.

(ii) Determination at entity level.

(2) Disallowed losses and deductions.

(3) Shareholder's share of paragraph (e)(1) wages.

(4) Transition rule for definition of W–2 wages and for W–2 wage limitation.

(d) Grantor trusts.

(e) Non-grantor trusts and estates.

(1) Allocation of costs.

(2) Allocation among trust or estate and beneficiaries.

(i) In general.

(ii) Treatment of items from a trust or estate reporting qualified production activities income.

(3) Transition rule for definition of W–2 wages and for W–2 wage limitation.

(4) Example.

(f) Gain or loss from the disposition of an interest in a pass-thru entity.

(g) No attribution of qualified activities.

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§1.199–7 Expanded affiliated groups.

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(b) * * *

(4) Losses used to reduce taxable income of expanded affiliated group.

(i) In general.

(ii) Examples.

* * * * *

§1.199–8 Other rules.

* * * * *

(i) * * *

(5) Tax Increase Prevention and Reconciliation Act of 2005.

(6) Losses used to reduce taxable income of expanded affiliated group.

* * * * *

§1.199–1 [Amended]

Par. 3. Section 1.199–1 is amended by removing the language "§1.199–9(d)" in paragraphs (d)(3)(i) and (ii) and adding the language "§1.199–5(d) or §1.199–9(d)" in its place.

Par. 4. Section 1.199–2 is amended by revising paragraph (e)(2) to read as follows:

§1.199–2 Wage limitation.

* * * * *

(e) * * *

(2) *Limitation on W–2 wages for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005*—(i) *In general.* The term *W–2 wages* includes only amounts described in paragraph (e)(1) of this section (paragraph (e)(1) wages) that are properly allocable to domestic production gross receipts (DPGR) (as defined in §1.199–3) for purposes of section 199(c)(1). A taxpayer may determine the amount of paragraph (e)(1) wages that is properly allocable to DPGR using any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances.

(ii) *Wage expense safe harbor*—(A) *In general.* A taxpayer using either the section 861 method of cost allocation under §1.199–4(d) or the simplified deduction method under §1.199–4(e) may determine the amount of paragraph (e)(1) wages that is properly allocable to DPGR for a taxable year by multiplying the amount of paragraph (e)(1) wages for the taxable year by the ratio of the taxpayer's wage expense included in calculating qualified production activities income (QPAI) (as defined in §1.199–1(c)) for the taxable year to the taxpayer's total wage expense used in calculating the taxpayer's taxable income (or adjusted gross income, if applicable) for the taxable year, without regard to any wage expense disallowed by section 465, 469, 704(d), or 1366(d). A taxpayer that uses the section 861 method of cost allocation under §1.199–4(d) or the simplified deduction method under §1.199–4(e) to determine QPAI must use the same expense allocation and apportionment methods that it uses to determine QPAI to allocate and apportion wage expense for purposes of this safe harbor. For purposes of

this paragraph (e)(2)(ii), the term *wage expense* means wages (that is, compensation paid by the employer in the active conduct of a trade or business to its employees) that are properly taken into account under the taxpayer's method of accounting.

(B) *Wage expense included in cost of goods sold.* For purposes of paragraph (e)(2)(ii)(A) of this section, a taxpayer may determine its wage expense included in cost of goods sold (CGS) using any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances, such as using the amount of direct labor included in CGS or using section 263A labor costs (as defined in §1.263A–1(h)(4)(ii)) included in CGS.

(iii) *Small business simplified overall method safe harbor.* A taxpayer that uses the small business simplified overall method under §1.199–4(f) may use the small business simplified overall method safe harbor for determining the amount of paragraph (e)(1) wages that is properly allocable to DPGR. Under this safe harbor, the amount of paragraph (e)(1) wages that is properly allocable to DPGR is equal to the same proportion of paragraph (e)(1) wages that the amount of DPGR bears to the taxpayer's total gross receipts.

(iv) *Examples.* The following examples illustrate the application of this paragraph (e)(2). See §1.199–5(e)(4) for an example of the application of paragraph (e)(2)(ii) of this section to a trust or estate. The examples read as follows:

Example 1. Section 861 method and no EAG. (i) *Facts.* X, a United States corporation that is not a member of an expanded affiliated group (EAG) (as defined in §1.199–7) or an affiliated group as defined in the regulations under section 861, engages in activities that generate both DPGR and non-DPGR. X's taxable year ends on April 30, 2011. For X's taxable year ending April 30, 2011, X has $3,000 of paragraph (e)(1) wages reported on 2010 Forms W–2. All of X's production activities that generate DPGR are within Standard Industrial Classification (SIC) Industry Group AAA (SIC AAA). All of X's production activities that generate non-DPGR are within SIC Industry Group BBB (SIC BBB). X is able to specifically identify CGS allocable to DPGR and to non-DPGR. X incurs $900 of research and experimentation expenses (R&E) that are deductible under section 174, $300 of which are performed with respect to SIC AAA and $600 of which are performed with respect to SIC BBB. None of the R&E is legally mandated R&E as described in §1.861–17(a)(4) and none of the R&E is included in CGS. X incurs section 162 selling expenses that are not includible in CGS and are definitely related to all of X's gross income. For X's taxable year ending April 30, 2011, the adjusted basis of X's assets is $50,000, $40,000 of which generate gross income attributable to DPGR and $10,000 of which generate gross income attributable to non-DPGR. For X's taxable year ending April 30, 2011, the total square footage of X's headquarters is 8,000 square feet, of which 2,000 square feet is set aside for domestic production activities. For its taxable year ending April 30, 2011, X's taxable income is $1,380 based on the following Federal income tax items:

DPGR (all from sales of products within SIC AAA)	$3,000
Non-DPGR (all from sales of products within SIC BBB)	3,000
CGS allocable to DPGR (includes $200 of wage expense)	(600)
CGS allocable to non-DPGR (includes $600 of wage expense)	(1,800)
Section 162 selling expenses (includes $600 of wage expense)	(840)
Section 174 R&E-SIC AAA (includes $100 of wage expense)	(300)
Section 174 R&E-SIC BBB (includes $200 of wage expense)	(600)
Interest expense (not included in CGS)	(300)
Headquarters overhead expense (includes $100 of wage expense)	(180)
X's taxable income	1,380

(ii) *X's QPAI.* X allocates and apportions its deductions to gross income attributable to DPGR under the section 861 method in §1.199–4(d). In this case, the section 162 selling expenses and overhead expense are definitely related to all of X's gross income. Based on the facts and circumstances of this specific case, apportionment of the section 162 selling expenses between DPGR and non-DPGR on the basis of X's gross receipts is appropriate. In addition, based on the facts and circumstances of this specific case, apportionment of the headquarters overhead expense between DPGR and non-DPGR on the basis of the square footage of X's headquarters is appropriate. For purposes of apportioning R&E, X elects to use the sales method as described in §1.861–17(c). X elects to apportion interest expense under the tax book value method of §1.861–9T(g). X has $2,400 of gross income attributable to DPGR (DPGR of $3,000 - CGS of $600 allocated based on X's books and records). X's QPAI for its taxable year ending April 30, 2011, is $1,395, as shown in the following table:

DPGR (all from sales of products within SIC AAA)	$3,000
CGS allocable to DPGR	(600)
Section 162 selling expenses ($840 x ($3,000 DPGR/$6,000 total gross receipts))	(420)
Section 174 R&E-SIC AAA	(300)
Interest expense (not included in CGS)	
($300 x ($40,000 (X's DPGR assets)/$50,000 (X's total assets)))	(240)
Headquarters overhead expense ($180 x (2,000 square feet attributable to	
DPGR activity/total 8,000 square feet))	(45)
X's QPAI	1,395

(iii) *W–2 wages.* X chooses to use the wage expense safe harbor under paragraph (e)(2)(ii) of this section to determine its W–2 wages, as shown in the following steps:

(A) *Step one.* X determines that $625 of wage expense were taken into account in determining its QPAI in paragraph (ii) of this *Example 1*, as shown in the following table:

CGS wage expense	$200
Section 162 selling expenses wage expense ($600 x ($3,000 DPGR/$6,000 total gross receipts))	300
Section 174 R&E-SIC AAA wage expense	100
Headquarters overhead wage expense ($100 x (2,000 square feet attributable to DPGR activity/8,000 total square feet))	25
Total wage expense taken into account	625

(B) *Step two*. X determines that $1,042 of the $3,000 in paragraph (e)(1) wages are properly allocable to DPGR, and are therefore W–2 wages, as shown in the following calculation:

Step one wage expense / X's total wage expense for taxable year ending April 30, 2011	x	X's paragraph (e)(1) wages		
$625 / $1,800	x	$3,000	=	$1,042

(iv) *Section 199 deduction determination*. X's tentative deduction under §1.199–1(a) (section 199 deduction) is $124 (.09 x (lesser of QPAI of $1,395 or taxable income of $1,380)) subject to the wage limitation under section 199(b)(1) (W–2 wage limitation) of $521 (50% x $1,042). Accordingly, X's section 199 deduction for its taxable year ending April 30, 2011, is $124.

Example 2. *Section 861 method and EAG*. (i) *Facts*. The facts are the same as in *Example 1* except that X owns stock in Y, a United States corporation, equal to 75% of the total voting power of the stock of Y and 80% of the total value of the stock of Y. X and Y are not members of an affiliated group as defined in section 1504(a). Accordingly, the rules of §1.861–14T do not apply to X's and Y's selling expenses, R&E, and charitable contributions. X and Y are, however, members of an affiliated group for purposes of allocating and apportioning interest expense (see §1.861–11T(d)(6)) and are also members of an EAG. Y's taxable year ends April 30, 2011. For Y's taxable year ending April 30, 2011, Y has $2,000 of paragraph (e)(1) wages reported on 2010 Forms W–2. For Y's taxable year ending April 30, 2011, the adjusted basis of Y's assets is $50,000, $20,000 of which generate gross income attributable to DPGR and $30,000 of which generate gross income attributable to non-DPGR. All of Y's activities that generate DPGR are within SIC Industry Group AAA (SIC AAA). All of Y's activities that generate non-DPGR are within SIC Industry Group BBB (SIC BBB). None of X's and Y's sales are to each other. Y is not able to specifically identify CGS allocable to DPGR and non-DPGR. In this case, because CGS is definitely related under the facts and circumstances to all of Y's gross receipts, apportionment of CGS between DPGR and non-DPGR based on gross receipts is appropriate. For Y's taxable year ending April 30, 2011, the total square footage of Y's headquarters is 8,000 square feet, of which 2,000 square feet is set aside for domestic production activities. Y incurs section 162 selling expenses that are not includible in CGS and are definitely related to all of Y's gross income. For Y's taxable year ending April 30, 2011, Y's taxable income is $1,710 based on the following Federal income tax items:

DPGR (all from sales of products within SIC AAA)	$3,000
Non-DPGR (all from sales of products within SIC BBB)	3,000
CGS allocated to DPGR (includes $300 of wage expense)	(1,200)
CGS allocated to non-DPGR (includes $300 of wage expense)	(1,200)
Section 162 selling expenses (includes $300 of wage expense)	(840)
Section 174 R&E-SIC AAA (includes $20 of wage expense)	(100)
Section 174 R&E-SIC BBB (includes $60 of wage expense)	(200)
Interest expense (not included in CGS and not subject to §1.861–10T)	(500)
Charitable contributions	(50)
Headquarters overhead expense (includes $40 of wage expense)	(200)
Y's taxable income	1,710

(ii) *QPAI*. (A) *X's QPAI*. Determination of X's QPAI is the same as in *Example 1* except that interest is apportioned to gross income attributable to DPGR based on the combined adjusted bases of X's and Y's assets. See §1.861–11T(c). Accordingly, X's QPAI for its taxable year ending April 30, 2011, is $1,455, as shown in the following table:

DPGR (all from sales of products within SIC AAA)	$3,000
CGS allocated to DPGR	(600)
Section 162 selling expenses ($840 x ($3,000 DPGR/$6,000 total gross receipts))	(420)
Section 174 R&E-SIC AAA	(300)
Interest expense (not included in CGS and not subject to §1.861–10T) ($300 x ($60,000 (tax book value of X's and Y's DPGR assets)/$100,000 (tax book value of X's and Y's total assets)))	(180)
Headquarters overhead expense ($180 x (2,000 square feet attributable to DPGR activity/total 8,000 square feet))	(45)
X's QPAI	1,455

(B) *Y's QPAI*. Y makes the same elections under the section 861 method as does X. Y has $1,800 of gross income attributable to DPGR (DPGR of $3,000 - CGS of $1,200 allocated based on Y's gross receipts). Y's QPAI for its taxable year ending April 30, 2011, is $905, as shown in the following table:

DPGR (all from sales of products within SIC AAA)	$3,000
CGS allocated to DPGR	(1,200)
Section 162 selling expenses ($840 x ($3,000 DPGR/$6,000 total gross receipts))	(420)
Section 174 R&E-SIC AAA	(100)
Interest expense (not included in CGS and not subject to §1.861–10T) ($500 x ($60,000 (tax book value of X's and Y's DPGR assets)/$100,000 (tax book value of X's and Y's total assets)))	(300)
Charitable contributions (not included in CGS) ($50 x ($1,800 gross income attributable to DPGR/$3,600 total gross income))	(25)
Headquarters overhead expense ($200 x (2,000 square feet attributable to DPGR activity/total 8,000 square feet))	(50)
Y's QPAI	905

(iii) *W–2 wages.* (A) *X's W–2 wages.* X's W–2 wages are $1,042, the same as in *Example 1*.

(B) *Y's W–2 wages.* Y chooses to use the wage expense safe harbor under paragraph (e)(2)(ii) of this section to determine its W–2 wages, as shown in the following steps:

(*1*) *Step one.* Y determines that $480 of wage expense were taken into account in determining its QPAI in paragraph (ii)(B) of this *Example 2*, as shown in the following table:

CGS wage expense	$300
Section 162 selling expenses wage expense ($300 x ($3,000 DPGR/$6,000 total gross receipts))	150
Section 174 R&E-SIC AAA wage expense	20
Headquarters overhead wage expense ($40 x (2,000 square feet attributable to DPGR activity/ 8,000 total square feet))	10
Total wage expense taken into account	480

(*2*) *Step two.* Y determines that $941 of the $2,000 paragraph (e)(1) wages are properly allocable to DPGR, and are therefore W–2 wages, as shown in the following calculation:

$$\frac{\text{Step one wage expense}}{\text{Y's total wage expense for taxable year ending April 30, 2011}} \times \text{Y's paragraph (e)(1) wages}$$

$$\frac{\$480}{\$1,020} \times \$2,000 = \$941$$

(iv) *Section 199 deduction determination.* The section 199 deduction of the X and Y EAG is determined by aggregating the separately determined taxable income, QPAI, and W–2 wages of X and Y. See §1.199–7(b). Accordingly, the X and Y EAG's tentative section 199 deduction is $212 (.09 x (lesser of combined QPAI of X and Y of $2,360 (X's QPAI of $1,455 plus Y's QPAI of $905) or combined taxable incomes of X and Y of $3,090 (X's taxable income of $1,380 plus Y's taxable income of $1,710)) subject to the combined W–2 wage limitation of X and Y of $992 (50% x ($1,042 (X's W–2 wages) + $941 (Y's W–2 wages)))). Accordingly, the X and Y EAG's section 199 deduction is $212. The $212 is allocated to X and Y in proportion to their QPAI. See §1.199–7(c).

Example 3. Simplified deduction method. (i) *Facts.* Z, a corporation that is not a member of an EAG, engages in activities that generate both DPGR and non-DPGR. Z is able to specifically identify CGS allocable to DPGR and to non-DPGR. Z's taxable year ends on April 30, 2011. For Z's taxable year ending April 30, 2011, Z has $3,000 of paragraph (e)(1) wages reported on 2010 Forms W–2, and Z's taxable income is $1,380 based on the following Federal income tax items:

DPGR	$3,000
Non-DPGR	3,000
CGS allocable to DPGR (includes $200 of wage expense)	(600)
CGS allocable to non-DPGR (includes $600 of wage expense)	(1,800)
Expenses, losses, or deductions (deductions) (includes $1,000 of wage expense)	(2,220)
Z's taxable income	1,380

(ii) *Z's QPAI.* Z uses the simplified deduction method under §1.199–4(e) to apportion deductions between DPGR and non-DPGR. Z's QPAI for its taxable year ending April 30, 2011, is $1,290, as shown in the following table:

DPGR	$3,000
CGS allocable to DPGR	(600)
Deductions apportioned to DPGR ($2,220 x ($3,000 DPGR/$6,000 total gross receipts))	(1,110)
Z's QPAI	1,290

(iii) *W–2 wages.* Z chooses to use the wage expense safe harbor under paragraph (e)(2)(ii) of this section to determine its W–2 wages, as shown in the following steps:

(A) *Step one.* Z determines that $700 of wage expense were taken into account in determining its

QPAI in paragraph (ii) of this *Example 3*, as shown in the following table:

Wage expense included in CGS allocable to DPGR	$200
Wage expense included in deductions ($1,000 in wage expense x ($3,000 DPGR/$6,000 total gross receipts))	500
Wage expense allocable to DPGR	700

(B) *Step two*. Z determines that $1,167 of the $3,000 paragraph (e)(1) wages are properly allocable to DPGR, and are therefore W–2 wages, as shown in the following calculation:

Step one wage expense Z's total wage expense for taxable year ending April 30, 2011	x	Z's paragraph (e)(1) wages		
$700 $1,800	x	$3,000	=	$1,167

(iv) *Section 199 deduction determination*. Z's tentative section 199 deduction is $116 (.09 x (lesser of QPAI of $1,290 or taxable income of $1,380)) subject to the W–2 wage limitation of $584 (50% x $1,167). Accordingly, Z's section 199 deduction for its taxable year ending April 30, 2011, is $116.

Example 4. Small business simplified overall method. (i) *Facts*. Z, a corporation that is not a member of an EAG, engages in activities that generate both DPGR and non-DPGR. Z's taxable year ends on April 30, 2011. For Z's taxable year ending April 30, 2011, Z has $3,000 of paragraph (e)(1) wages reported on 2010 Forms W–2, and Z's taxable income is $1,380 based on the following Federal income tax items:

DPGR	$3,000
Non-DPGR	3,000
CGS and deductions	(4,620)
Z's taxable income	1,380

(ii) *Z's QPAI*. Z uses the small business simplified overall method under §1.199–4(f) to apportion CGS and deductions between DPGR and non-DPGR. Z's QPAI for its taxable year ending April 30, 2011, is $690, as shown in the following table:

DPGR	$3,000
CGS and deductions apportioned to DPGR ($4,620 x ($3,000 DPGR/$6,000 total gross receipts))	(2,310)
Z's QPAI	690

(iii) *W–2 wages*. Z's W–2 wages under paragraph (e)(2)(iii) of this section are $1,500, as shown in the following calculation:

$3,000 in paragraph (e)(1) wages x ($3,000 DPGR/$6,000 total gross receipts)	$1,500

(iv) *Section 199 deduction determination*. Z's tentative section 199 deduction is $62 (.09 x (lesser of QPAI of $690 or taxable income of $1,380)) subject to the W–2 wage limitation of $750 (50% x $1,500). Accordingly, Z's section 199 deduction for its taxable year ending April 30, 2011, is $62.

Example 5. Corporation uses employees of non-consolidated EAG member. (i) *Facts*. Corporations S and B are the only members of a single EAG but are not members of a consolidated group. S and B are both calendar year taxpayers. All the activities described in this *Example 5* take place during the same taxable year and they are the only activities of S and B. S and B each use the section 861 method described in §1.199–4(d) for allocating and apportioning their deductions. B is a manufacturer but has only three employees of its own. S employs the remainder of the personnel who perform the manufacturing activities for B. S's only receipts are from supplying employees to B. In 2010, B manufactures qualifying production property (QPP) (as defined in §1.199–3(j)(1)), using its three employees and S's employees, and sells the QPP for $10,000,000. B's total CGS and other deductions are $6,000,000, including $1,000,000 paid to S for the use of S's employees and $100,000 paid to its own employees. B reports the $100,000 paid to its employees on the 2010 Forms W–2 issued to its employees. S pays its employees $800,000 that is reported on the 2010 Forms W–2 issued to the employees.

(ii) *B's W–2 wages*. In determining its W–2 wages, B utilizes the wage expense safe harbor described in paragraph (e)(2)(ii) of this section. The entire $100,000 paid by B to its employees is included in B's wage expense included in calculating its QPAI and is the only wage expense used in calculating B's taxable income. Thus, under the wage expense safe harbor described in paragraph (e)(2)(ii) of this section, B's W–2 wages are $100,000 ($100,000 (paragraph (e)(1) wages) x ($100,000 (wage expense used in calculating B's QPAI)/$100,000 (wage expense used in calculating B's taxable income))).

(iii) *S's W–2 wages*. In determining its W–2 wages, S utilizes the wage expense safe harbor described in paragraph (e)(2)(ii) of this section. Because S's $1,000,000 in receipts from B do not qualify as DPGR and are S's only gross receipts, none of the $800,000 paid by S to its employees is included in S's wage expense included in calculating its QPAI. However, the entire $800,000 is included in calculating S's taxable income. Thus, under the wage expense safe harbor described in paragraph (e)(2)(ii)(A) of this section, S's W–2 wages are $0 ($800,000 (paragraph (e)(1) wages) x ($0 (wage expense used in calculating S's QPAI)/$800,000 (wage expense used in calculating S's taxable income))).

(iv) *Determination of EAG's section 199 deduction*. The section 199 deduction of the S and B EAG is determined by aggregating the separately determined taxable income or loss, QPAI, and W–2 wages

of S and B. See §1.199–7(b). B's taxable income and QPAI are each $4,000,000 ($10,000,000 DPGR - $6,000,000 CGS and other deductions). S's taxable income is $200,000 ($1,000,000 gross receipts - $800,000 total deductions). S's QPAI is $0 ($0 DPGR - $0 CGS and other deductions). B's W–2 wages (as calculated in paragraph (ii) of this *Example 5*) are $100,000 and S's W–2 wages (as calculated in paragraph (iii) of this *Example 5*) are $0. The EAG's tentative section 199 deduction is $360,000 (.09 x (lesser of combined QPAI of $4,000,000 (B's QPAI of $4,000,000 + S's QPAI of $0) or combined taxable income of $4,200,000 (B's taxable income of $4,000,000 + S's taxable income of $200,000))) subject to the W–2 wage limitation of $50,000 (50% x ($100,000 (B's W–2 wages) + $0 (S's W–2 wages))). Accordingly, the S and B EAG's section 199 deduction for 2010 is $50,000. The $50,000 is allocated to S and B in proportion to their QPAI. See §1.199–7(c). Because S has no QPAI, the entire $50,000 is allocated to B.

Example 6. Corporation using employees of consolidated EAG member. The facts are the same as in *Example 5* except that B and S are members of the same consolidated group. Ordinarily, as demonstrated in *Example 5*, S's $1,000,000 of receipts would not be DPGR and its $800,000 paid to its employees would not be W–2 wages (because the $800,000 would not be properly allocable to DPGR). However, because S and B are members of the same consolidated group, §1.1502–13(c)(1)(i) provides that the separate entity attributes of S's intercompany items or B's corresponding items, or both, may be redetermined in order to produce the same effect as if S and B were divisions of a single corporation. If S and B were divisions of a single corporation, S and B would have QPAI and taxable income of $4,200,000 ($10,000,000 DPGR received from the sale of the QPP - $5,800,000 CGS and other deductions) and, under the wage expense safe harbor described in paragraph (e)(2)(ii) of this section, would have $900,000 of W–2 wages ($900,000 (combined paragraph (e)(1) wages of S and B) x ($900,000 (wage expense used in calculating QPAI)/$900,000 (wage expense used in calculating taxable income))). The single corporation would have a tentative section 199 deduction equal to 9% of $4,200,000, or $378,000, subject to the W–2 wage limitation of 50% of $900,000, or $450,000. Thus, the single corporation would have a section 199 deduction of $378,000. To obtain this same result for the consolidated group, S's $1,000,000 of receipts from the intercompany transaction are redetermined as DPGR. Thus, S's $800,000 paid to its employees are costs properly allocable to DPGR and S's W–2 wages are $800,000. Accordingly, the consolidated group has QPAI and taxable income of $4,200,000 ($11,000,000 DPGR (from the sale of the QPP and the redetermined intercompany transaction) - $6,800,000 CGS and other deductions) and W–2 wages of $900,000. The consolidated group's section 199 deduction is $378,000, the same as the single corporation. However, for purposes of allocating the section 199 deduction between S and B, the redetermination of S's income as DPGR under §1.1502–13(c)(1)(i) is not taken into account. See §1.199–7(d)(5). Accordingly, the consolidated group's entire section 199 deduction of $378,000 is allocated to B.

* * * * *

§1.199–2T [Removed]

Par. 5. Section 1.199–2T is removed.

Par. 6. Section 1.199–3 is amended by:

1. Revising the first sentence of paragraph (f)(1).

2. Adding the language "paragraph (i)(8) of this section and" before the language "§1.199–9(j)" in paragraph (g)(4)(ii)(B).

3. Adding the language "paragraph (i)(7) of this section and" before the language "§1.199–9(i)" in paragraph (g)(4)(ii)(D).

4. Revising paragraphs (i)(7) and (8).

5. Removing the language "§1.199–9(e)" in the last sentence of paragraph (m)(6)(iv)(B) and adding the language "§§1.199–5(e) and 1.199–9(e)" in its place.

6. Revising the second and third sentences in paragraph (p).

The revisions read as follows:

§1.199–3 Domestic production gross receipts.

* * * * *

(f) * * * (1) *In general.* With the exception of the rules applicable to an expanded affiliated group (EAG) under §1.199–7, qualifying in-kind partnerships under paragraph (i)(7) of this section and §1.199–9(i), EAG partnerships under paragraph (i)(8) of this section and §1.199–9(j), and government contracts under paragraph (f)(2) of this section, only one taxpayer may claim the deduction under §1.199–1(a) with respect to any qualifying activity under paragraphs (e)(1), (k)(1), and (l)(1) of this section performed in connection with the same QPP, or the production of a qualified film or utilities. * * *

* * * * *

(i) * * *

(7) *Qualifying in-kind partnership for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005*—(i) *In general.* If a partnership is a qualifying in-kind partnership described in paragraph (i)(7)(ii) of this section, then each partner is treated as having MPGE or produced the property MPGE or produced by the partnership that is distributed to that partner. If a partner of a qualifying in-kind partnership derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of the property that was MPGE or produced by the qualifying in-kind partnership and distributed to that partner, then, provided such partner is a partner of the qualifying in-kind partnership at the time the partner disposes of the property, the partner is treated as conducting the MPGE or production activities previously conducted by the qualifying in-kind partnership with respect to that property. With respect to a lease, rental, or license, the partner is treated as having disposed of the property on the date or dates on which it takes into account its gross receipts derived from the lease, rental, or license under its method of accounting. With respect to a sale, exchange, or other disposition, the partner is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes, even if no gain or loss is taken into account.

(ii) *Definition of qualifying in-kind partnership.* For purposes of this paragraph (i)(7), a *qualifying in-kind partnership* is a partnership engaged solely in—

(A) The extraction, refining, or processing of oil, natural gas (as described in paragraph (l)(2) of this section), petrochemicals, or products derived from oil, natural gas, or petrochemicals in whole or in significant part within the United States;

(B) The production or generation of electricity in the United States; or

(C) An activity or industry designated by the Secretary by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter).

(iii) *Other rules.* Except as provided in this paragraph (i)(7), a qualifying in-kind partnership is treated the same as other partnerships for purposes of section 199. Accordingly, a qualifying in-kind partnership is subject to the rules of this section regarding the application of section 199 to pass-thru entities, including application of the section 199(d)(1)(A)(iii) rule for determining a partner's share of the amounts described in §1.199–2(e)(1) (paragraph (e)(1) wages) from the partnership under §1.199–5(b)(3). In determining whether a qualifying in-kind partnership or its partners MPGE QPP in whole or in significant part within the United States, see paragraphs (g)(2) and (3) of this section.

(iv) *Example*. The following example illustrates the application of this paragraph (i)(7). Assume that PRS and X are calendar year taxpayers. The example reads as follows:

Example. X, Y, and Z are partners in PRS, a qualifying in-kind partnership described in paragraph (i)(7)(ii) of this section. X, Y, and Z are corporations. In 2007, PRS distributes oil to X that PRS derived from its oil extraction. PRS incurred $600 of CGS extracting the oil distributed to X, and X's adjusted basis in the distributed oil is $600. X incurs $200 of CGS in refining the oil within the United States. In 2007, X, while it is a partner in PRS, sells the oil to a customer for $1,500. X is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes. Under paragraph (i)(7)(i) of this section, X is treated as having extracted the oil. The extraction and refining of the oil each qualify as an MPGE activity under paragraph (e)(1) of this section. Therefore, X's $1,500 of gross receipts qualify as DPGR. X subtracts from the $1,500 of DPGR the $600 of CGS incurred by PRS and the $200 of refining costs it incurred. Thus, X's QPAI is $700 for 2007.

(8) *Partnerships owned by members of a single expanded affiliated group for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005*—(i) *In general*. For purposes of this section, if all of the interests in the capital and profits of a partnership are owned by members of a single EAG at all times during the taxable year of the partnership (EAG partnership), then the EAG partnership and all members of that EAG are treated as a single taxpayer for purposes of section 199(c)(4) during that taxable year.

(ii) *Attribution of activities*—(A) *In general*. If a member of an EAG (disposing member) derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of property that was MPGE or produced by an EAG partnership, all the partners of which are members of the same EAG to which the disposing member belongs at the time that the disposing member disposes of such property, then the disposing member is treated as conducting the MPGE or production activities previously conducted by the EAG partnership with respect to that property. The previous sentence applies only for those taxable years in which the disposing member is a member of the EAG of which all the partners of the EAG partnership are members for the entire taxable year of the EAG partnership. With respect to a lease, rental, or license, the disposing member is treated as having disposed of the property on the date or dates on which it takes into account its gross receipts from the lease, rental, or license under its method of accounting. With respect to a sale, exchange, or other disposition, the disposing member is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes, even if no gain or loss is taken into account. Likewise, if an EAG partnership derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of property that was MPGE or produced by a member (or members) of the same EAG (the producing member) to which all the partners of the EAG partnership belong at the time that the EAG partnership disposes of such property, then the EAG partnership is treated as conducting the MPGE or production activities previously conducted by the producing member with respect to that property. The previous sentence applies only for those taxable years in which the producing member is a member of the EAG of which all the partners of the EAG partnership are members for the entire taxable year of the EAG partnership. With respect to a lease, rental, or license, the EAG partnership is treated as having disposed of the property on the date or dates on which it takes into account its gross receipts derived from the lease, rental, or license under its method of accounting. With respect to a sale, exchange, or other disposition, the EAG partnership is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes, even if no gain or loss is taken into account. See paragraph (i)(8)(iv) *Example 3* of this section.

(B) *Attribution between EAG partnerships*. If an EAG partnership (disposing partnership) derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of property that was MPGE or produced by another EAG partnership (producing partnership), then the disposing partnership is treated as conducting the MPGE or production activities previously conducted by the producing partnership with respect to that property, provided that each of these partnerships (the producing partnership and the disposing partnership) is owned for its entire taxable year in which the disposing partnership disposes of such property by members of the same EAG. With respect to a lease, rental, or license, the disposing partnership is treated as having disposed of the property on the date or dates on which it takes into account its gross receipts from the lease, rental, or license under its method of accounting. With respect to a sale, exchange, or other disposition, the disposing partnership is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes, even if no gain or loss is taken into account.

(C) *Exceptions to attribution*. Attribution of activities does not apply for purposes of the construction of real property under paragraph (m)(1) of this section and the performance of engineering and architectural services under paragraphs (n)(2) and (3) of this section, respectively.

(iii) *Other rules*. Except as provided in this paragraph (i)(8), an EAG partnership is treated the same as other partnerships for purposes of section 199. Accordingly, an EAG partnership is subject to the rules of this section regarding the application of section 199 to pass-thru entities, including the section 199(d)(1)(A)(iii) rule under §1.199–5(b)(3). In determining whether a member of an EAG or an EAG partnership MPGE QPP in whole or in significant part within the United States or produced a qualified film or produced utilities within the United States, see paragraphs (g)(2) and (3) of this section and *Example 5* of paragraph (i)(8)(iv) of this section.

(iv) *Examples*. The following examples illustrate the rules of this paragraph (i)(8). Assume that PRS, X, Y, and Z all are calendar year taxpayers. The examples read as follows:

Example 1. Contribution. X and Y are the only partners in PRS, a partnership, for PRS's entire 2007 taxable year. X and Y are both members of a single EAG for the entire 2007 year. In 2007, X MPGE QPP within the United States and contributes the QPP to PRS. In 2007, PRS sells the QPP for $1,000. Under this paragraph (i)(8), PRS is treated as having MPGE the QPP within the United States, and PRS's $1,000 gross receipts constitute DPGR. PRS, X, and Y must apply the rules of this section regarding the application of section 199 to pass-thru entities with respect to the activity of PRS, including the section 199(d)(1)(A)(iii) rule for determining a partner's share of the paragraph (e)(1) wages from the partnership under §1.199–5(b)(3).

Example 2. Sale. X, Y, and Z are the only members of a single EAG for the entire 2007 year. X and Y each own 50% of the capital and profits interests in PRS, a partnership, for PRS's entire 2007 taxable year. In 2007, PRS MPGE QPP within the United

States and then sells the QPP to X for $6,000, its fair market value at the time of the sale. PRS's gross receipts of $6,000 qualify as DPGR. In 2007, X sells the QPP to customers for $10,000, incurring selling expenses of $2,000. Under paragraph (i)(8)(ii)(A) of this section, X is treated as having MPGE the QPP within the United States, and X's $10,000 of gross receipts qualify as DPGR. PRS, X and Y must apply the rules of this section regarding the application of section 199 to pass-thru entities with respect to the activity of PRS, including application of the section 199(d)(1)(A)(iii) rule for determining a partner's share of the paragraph (e)(1) wages from the partnership under §1.199–5(b)(3). The results would be the same if PRS sold the QPP to Z rather than to X. However, if PRS did sell the QPP to Z, and Z was not a member of the EAG for PRS's entire taxable year, the activities previously conducted by PRS with respect to the QPP would not be attributed to Z, and none of Z's $10,000 of gross receipts would qualify as DPGR.

Example 3. Lease. X, Y, and Z are the only members of a single EAG for the entire 2007 year. X and Y each own 50% of the capital and profits interests in PRS, a partnership, for PRS's entire 2007 taxable year. In 2007, PRS MPGE QPP within the United States and then sells the QPP to X for $6,000, its fair market value at the time of the sale. PRS's gross receipts of $6,000 qualify as DPGR. In 2007, X rents the QPP it acquired from PRS to customers unrelated to X. X takes the gross receipts attributable to the rental of the QPP into account under its method of accounting in 2007 and 2008. On July 1, 2008, X ceases to be a member of the same EAG to which Y, the other partner in PRS, belongs. For 2007, X is treated as having MPGE the QPP within the United States under paragraph (i)(8)(ii)(A) of this section, and its gross receipts derived from the rental of the QPP qualify as DPGR. For 2008, however, because X and Y, partners in PRS, are no longer members of the same EAG for the entire year, the gross rental receipts X takes into account in 2008 do not qualify as DPGR.

Example 4. Distribution. X and Y are the only partners in PRS, a partnership, for PRS's entire 2007 taxable year. X and Y are both members of a single EAG for the entire 2007 year. In 2007, PRS MPGE QPP within the United States, incurring $600 of CGS, and then distributes the QPP to X. X's adjusted basis in the QPP is $600. X incurs $200 of CGS to further MPGE the QPP within the United States. In 2007, X sells the QPP for $1,500 to an unrelated customer. X is treated as having disposed of the QPP on the date it ceases to own the QPP for Federal income tax purposes. Under paragraph (i)(8)(ii)(A) of this section, X is treated as having MPGE the QPP within the United States, and X's $1,500 of gross receipts qualify as DPGR.

Example 5. Multiple sales. (i) *Facts.* X and Y are the only partners in PRS, a partnership, for PRS's entire 2007 taxable year. X and Y are both non-consolidated members of a single EAG for the entire 2007 year. PRS produces in bulk form in the United States the active ingredient for a drug. Assume that PRS's own MPGE activity with respect to the active ingredient is not substantial in nature, taking into account all of the facts and circumstances, and PRS's direct labor and overhead to MPGE the active ingredient within the United States are $15 and account for 15% of PRS's $100 CGS of the active ingredient. In 2007, PRS sells the active ingredient in bulk form to X. X uses the active ingredient to produce the finished dosage form drug. Assume that X's own MPGE activity with respect to the finished dosage form drug is not substantial in nature, taking into account all of the facts and circumstances, and X's direct labor and overhead to MPGE the finished dosage form drug within the United States are $12 and account for 10% of X's $120 CGS of the drug. In 2007, X sells the finished dosage form drug to Y and Y sells the finished dosage form drug to customers. Assume that Y's own MPGE activity with respect to the finished dosage form drug is not substantial in nature, taking into account all of the facts and circumstances, and Y incurs $2 of direct labor and overhead and Y's CGS in selling the finished dosage form drug to customers is $130.

(ii) *Analysis.* PRS's gross receipts from the sale of the active ingredient to X are non-DPGR because PRS's MPGE activity is not substantial in nature and PRS does not satisfy the safe harbor described in paragraph (g)(3) of this section because PRS's direct labor and overhead account for less than 20% of PRS's CGS of the active ingredient. X's gross receipts from the sale of the finished dosage form drug to Y are DPGR because X is considered to have MPGE the finished dosage form drug in significant part in the United States pursuant to the safe harbor described in paragraph (g)(3) of this section because the $27 ($15 + $12) of direct labor and overhead incurred by PRS and X equals or exceeds 20% of X's total CGS ($120) of the finished dosage form drug at the time X disposes of the finished dosage form drug to Y. Similarly, Y's gross receipts from the sale of the finished dosage form drug to customers are DPGR because Y is considered to have MPGE the finished dosage form drug in significant part in the United States pursuant to the safe harbor described in paragraph (g)(3) of this section because the $29 ($15 + $12 + $2) of direct labor and overhead incurred by PRS, X, and Y equals or exceeds 20% of Y's total CGS ($130) of the finished dosage form drug at the time Y disposes of the finished dosage form drug to Y's customers.

* * * * *

(p) * * * Thus, partners, including partners in partnerships described in paragraphs (i)(7) and (8) of this section and §1.199–9(i) and (j), may not treat guaranteed payments as DPGR. See §§1.199–5(b)(6) *Example 5* and 1.199–9(b)(6) *Example 5*.

§1.199–3T [Removed]

Par. 7. Section 1.199–3T is removed.

Par. 8. Section 1.199–4 is amended by:

1. Revising paragraph (d)(5).

2. Removing the language "§1.199–9(d)" in paragraph (e)(1) and adding the language "§1.199–5(d) or §1.199–9(d)" in its place.

3. Revising paragraph (f)(5).

The revisions read as follows:

§1.199–4 Costs allocable to domestic production gross receipts.

* * * * *

(d) * * *

(5) *Treatment of items from a pass-thru entity reporting qualified production activities income.* If, pursuant to §1.199–5(e)(2) or §1.199–9(e)(2), or to the authority granted in §1.199–5(b)(1)(ii) or (c)(1)(ii), or §1.199–9(b)(1)(ii) or (c)(1)(ii), a taxpayer must combine QPAI and W–2 wages from a partnership, S corporation, trust (to the extent not described in §1.199–5(d) or §1.199–9(d)) or estate with the taxpayer's total QPAI and W–2 wages from other sources, then for purposes of apportioning the taxpayer's interest expense under this paragraph (d), the taxpayer's interest in such partnership (and, where relevant in apportioning the taxpayer's interest expense, the partnership's assets), the taxpayer's shares in such S corporation, or the taxpayer's interest in such trust shall be disregarded.

* * * * *

(f) * * *

(5) *Trusts and estates.* Trusts and estates under §§1.199–5(e) and 1.199–9(e) may not use the small business simplified overall method.

* * * * *

Par. 9. Section 1.199–5 is added to read as follows:

§1.199–5 Application of section 199 to pass-thru entities for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.

(a) *In general.* The provisions of this section apply solely for purposes of section 199 of the Internal Revenue Code (Code).

(b) *Partnerships*—(1) *In general*—(i) *Determination at partner level.* The deduction with respect to the qualified production activities of the partnership allowable under §1.199–1(a) (section 199 deduction) is determined at the partner level. As a result, each partner must compute its deduction separately. The section 199 deduction has no effect on the adjusted basis of the partner's interest in the partnership. Except as provided by publication pursuant to paragraph (b)(1)(ii) of

this section, for purposes of this section, each partner is allocated, in accordance with sections 702 and 704, its share of partnership items (including items of income, gain, loss, and deduction), cost of goods sold (CGS) allocated to such items of income, and gross receipts that are included in such items of income, even if the partner's share of CGS and other deductions and losses exceeds domestic production gross receipts (DPGR) (as defined in §1.199–3(a)). A partnership may specially allocate items of income, gain, loss, or deduction to its partners, subject to the rules of section 704(b) and the supporting regulations. Guaranteed payments under section 707(c) are not considered allocations of partnership income for purposes of this section. Guaranteed payments under section 707(c) are deductions by the partnership that must be taken into account under the rules of §1.199–4. See §1.199–3(p) and paragraph (b)(6) *Example 5* of this section. Except as provided in paragraph (b)(1)(ii) of this section, to determine its section 199 deduction for the taxable year, a partner aggregates its distributive share of such items, to the extent they are not otherwise disallowed by the Code, with those items it incurs outside the partnership (whether directly or indirectly) for purposes of allocating and apportioning deductions to DPGR and computing its qualified production activities income (QPAI) (as defined in §1.199–1(c)).

(ii) *Determination at entity level.* The Secretary may, by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), permit a partnership to calculate a partner's share of QPAI and W–2 wages as defined in §1.199–2(e)(2) (W–2 wages) at the entity level, instead of allocating to the partner, in accordance with sections 702 and 704, the partner's share of partnership items (including items of income, gain, loss, and deduction) and amounts described in §1.199–2(e)(1) (paragraph (e)(1) wages). If a partnership does calculate QPAI at the entity level—

(A) Each partner is allocated its share of QPAI (subject to the limitations of paragraph (b)(2) of this section) and W–2 wages from the partnership, which are combined with the partner's QPAI and W–2 wages from other sources, if any;

(B) For purposes of computing the partner's QPAI under §§1.199–1 through 1.199–8, a partner does not take into account the items from the partnership (for example, a partner does not take into account items from the partnership in determining whether a threshold or *de minimis* rule applies or in allocating and apportioning deductions) in calculating its QPAI from other sources;

(C) A partner generally does not recompute its share of QPAI from the partnership using another method; however, the partner might have to adjust its share of QPAI from the partnership to take into account certain disallowed losses or deductions, or the allowance of suspended losses or deductions; and

(D) A partner's distributive share of QPAI from a partnership may be less than zero.

(2) *Disallowed losses or deductions.* Except as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), losses or deductions of a partnership are taken into account in computing the partner's QPAI for a taxable year only if, and to the extent that, the partner's distributive share of those losses or deductions from all of the partnership's activities is not disallowed by section 465, 469, or 704(d), or any other provision of the Code. If only a portion of the partner's distributive share of the losses or deductions from a partnership is allowed for a taxable year, a proportionate share of those allowed losses or deductions that are allocated to the partnership's qualified production activities, determined in a manner consistent with sections 465, 469, and 704(d), and any other applicable provision of the Code, is taken into account in computing QPAI for that taxable year. To the extent that any of the disallowed losses or deductions are allowed in a later taxable year under section 465, 469, or 704(d), or any other provision of the Code, the partner takes into account a proportionate share of those allowed losses or deductions that are allocated to the partnership's qualified production activities in computing the partner's QPAI for that later taxable year. Losses or deductions of the partnership that are disallowed for taxable years beginning on or before December 31, 2004, however, are not taken into account in a later taxable year for purposes of computing the partner's QPAI for that later taxable year, whether or not the losses or deductions are allowed for other purposes.

(3) *Partner's share of paragraph (e)(1) wages.* Under section 199(d)(1)(A)(iii), a partner's share of paragraph (e)(1) wages of a partnership for purposes of determining the partner's wage limitation under section 199(b)(1) (W–2 wage limitation) equals the partner's allocable share of those wages. Except as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), the partnership must allocate the amount of paragraph (e)(1) wages among the partners in the same manner it allocates wage expense among those partners. The partner must add its share of the paragraph (e)(1) wages from the partnership to the partner's paragraph (e)(1) wages from other sources, if any. The partner (other than a partner that itself is a partnership or S corporation) then must calculate its W–2 wages by determining the amount of the partner's total paragraph (e)(1) wages properly allocable to DPGR. If the partner is a partnership or S corporation, the partner must allocate its paragraph (e)(1) wages (including the paragraph (e)(1) wages from a lower-tier partnership) among its partners or shareholders in the same manner it allocates wage expense among those partners or shareholders. See §1.199–2(e)(2) for the computation of W–2 wages and for the proper allocation of any such wages to DPGR.

(4) *Transition rule for definition of W–2 wages and for W–2 wage limitation.* If a partnership and any partner in that partnership have different taxable years, only one of which begins after May 17, 2006, the definition of W–2 wages of the partnership and the section 199(d)(1)(A)(iii) rule for determining a partner's share of wages from that partnership is determined under the law applicable to partnerships based on the beginning date of the partnership's taxable year. Thus, for example, for the taxable year of a partnership beginning on or before May 17, 2006, a partner's share of W–2 wages from the partnership is determined under section 199(d)(1)(A)(iii) as in effect for taxable years beginning on or before May 17, 2006, even if the taxable year of that partner in which those wages are taken into account begins after May 17, 2006.

(5) *Partnerships electing out of subchapter K.* For purposes of §§1.199–1

through 1.199–8, the rules of this paragraph (b) apply to all partnerships, including those partnerships electing under section 761(a) to be excluded, in whole or in part, from the application of subchapter K of chapter 1 of the Code.

(6) *Examples*. The following examples illustrate the application of this paragraph (b). Assume that each partner has sufficient adjusted gross income or taxable income so that the section 199 deduction is not limited under section 199(a)(1)(B). Assume also that the partnership and each of its partners (whether individual or corporate) are calendar year taxpayers. The examples read as follows:

Example 1. Section 861 method with interest expense. (i) *Partnership Federal income tax items.* X and Y, unrelated United States corporations, are each 50% partners in PRS, a partnership that engages in production activities that generate both DPGR and non-DPGR. X and Y share all items of income, gain, loss, deduction, and credit equally. Both X and Y are engaged in a trade or business. PRS is not able to identify from its books and records CGS allocable to DPGR and non-DPGR. In this case, because CGS is definitely related under the facts and circumstances to all of PRS's gross receipts, apportionment of CGS between DPGR and non-DPGR based on gross receipts is appropriate. For 2010, the adjusted basis of PRS's business assets is $5,000, $4,000 of which generate gross income attributable to DPGR and $1,000 of which generate gross income attributable to non-DPGR. For 2010, PRS has the following Federal income tax items:

DPGR	$3,000
Non-DPGR	3,000
CGS	3,240
Section 162 selling expenses	1,200
Interest expense (not included in CGS)	300

(ii) *Allocation of PRS's Federal income tax items.* X and Y each receive the following distributive share of PRS's Federal income tax items, as determined under the principles of §1.704–1(b)(1)(vii):

Gross income attributable to DPGR ($1,500 (DPGR) - $810 (allocable CGS))	$690
Gross income attributable to non-DPGR ($1,500 (non-DPGR) - $810 (allocable CGS))	690
Section 162 selling expenses	600
Interest expense (not included in CGS)	150

(iii) *Determination of QPAI.* (A) *X's QPAI.* Because the section 199 deduction is determined at the partner level, X determines its QPAI by aggregating its distributive share of PRS's Federal income tax items with all other such items from all other, non-PRS-related activities. For 2010, X does not have any other such items. For 2010, the adjusted basis of X's non-PRS assets, all of which are investment assets, is $10,000. X's only gross receipts for 2010 are those attributable to the allocation of gross income from PRS. X allocates and apportions its deductible items to gross income attributable to DPGR under the section 861 method of §1.199–4(d). In this case, the section 162 selling expenses are not included in CGS and are definitely related to all of PRS's gross income. Based on the facts and circumstances of this specific case, apportionment of those expenses between DPGR and non-DPGR on the basis of PRS's gross receipts is appropriate. X elects to apportion its distributive share of interest expense under the tax book value method of §1.861–9T(g). X's QPAI for 2010 is $366, as shown in the following table:

DPGR	$1,500
CGS allocable to DPGR	(810)
Section 162 selling expenses ($600 x ($1,500 DPGR/$3,000 total gross receipts))	(300)
Interest expense (not included in CGS) ($150 x ($2,000 (X's share of PRS's DPGR assets)/ $12,500 (X's non-PRS assets ($10,000) + X's share of PRS assets ($2,500))))	(24)
X's QPAI	366

(B) *Y's QPAI.* (*1*) For 2010, in addition to the activities of PRS, Y engages in production activities that generate both DPGR and non-DPGR. Y is able to identify from its books and records CGS allocable to DPGR and to non-DPGR. For 2010, the adjusted basis of Y's non-PRS assets attributable to its production activities that generate DPGR is $8,000 and to other production activities that generate non-DPGR is $2,000. Y has no other assets. Y has the following Federal income tax items relating to its non-PRS activities:

Gross income attributable to DPGR ($1,500 (DPGR) - $900 (allocable CGS))	$600
Gross income attributable to non-DPGR ($3,000 (other gross receipts) - $1,620 (allocable CGS))	1,380
Section 162 selling expenses	540
Interest expense (not included in CGS)	90

(*2*) Y determines its QPAI in the same general manner as X. However, because Y has other trade or business activities outside of PRS, Y must aggregate its distributive share of PRS's Federal income tax items with its own such items. Y allocates and apportions its deductible items to gross income attributable to DPGR under the section 861 method of §1.199–4(d). In this case, Y's distributive share of PRS's section 162 selling expenses, as well as those selling expenses from Y's non-PRS activities, are definitely related to all of its gross income. Based on the facts and circumstances of this specific case, apportionment of those expenses between DPGR and non-DPGR on the basis of Y's gross receipts (including Y's share of PRS's gross receipts) is appropriate. Y elects to apportion its distributive share of interest expense under the tax book value method of §1.861–9T(g). Y has $1,290 of gross income attributable to DPGR ($3,000 DPGR ($1,500 from PRS and $1,500 from non-PRS activities) - $1,710 CGS ($810 from PRS and $900 from non-PRS activities)). Y's QPAI for 2010 is $642, as shown in the following table:

DPGR ($1,500 from PRS and $1,500 from non-PRS activities)	$3,000
CGS allocable to DPGR ($810 from PRS and $900 from non-PRS activities)	(1,710)
Section 162 selling expenses ($1,140 ($600 from PRS and $540 from non-PRS activities) x $3,000 ($1,500 PRS DPGR + $1,500 non-PRS DPGR)/$7,500 ($3,000 PRS total gross receipts + $4,500 non-PRS total gross receipts))	(456)
Interest expense (not included in CGS) ($240 ($150 from PRS and $90 from non-PRS activities) x $10,000 (Y's non-PRS DPGR assets ($8,000) + Y's share of PRS DPGR assets ($2,000))/$12,500 (Y's non-PRS assets ($10,000) + Y's share of PRS assets ($2,500)))	(192)
Y's QPAI	642

(iv) *Determination of section 199 deduction.* X's tentative section 199 deduction is $33 (.09 x $366, that is, QPAI determined at the partner level) subject to the W–2 wage limitation (50% of W–2 wages). Y's tentative section 199 deduction is $58 (.09 x $642) subject to the W–2 wage limitation.

Example 2. Section 861 method with R&E expense. (i) *Partnership Federal income tax items.* X and Y, unrelated United States corporations each of which is engaged in a trade or business, are partners in PRS, a partnership that engages in production activities that generate both DPGR and non-DPGR. Neither X nor Y is a member of an affiliated group. X and Y share all items of income, gain, loss, deduction, and credit equally. All of PRS's domestic production activities that generate DPGR are within Standard Industrial Classification (SIC) Industry Group AAA (SIC AAA). All of PRS's production activities that generate non-DPGR are within SIC Industry Group BBB (SIC BBB). PRS is not able to identify from its books and records CGS allocable to DPGR and to non-DPGR. In this case, because CGS is definitely related under the facts and circumstances to all of PRS's gross receipts, apportionment of CGS between DPGR and non-DPGR based on gross receipts is appropriate. PRS incurs $900 of research and experimentation expenses (R&E) that are deductible under section 174, $300 of which are performed with respect to SIC AAA and $600 of which are performed with respect to SIC BBB. None of the R&E is legally mandated R&E as described in §1.861–17(a)(4) and none is included in CGS. For 2010, PRS has the following Federal income tax items:

DPGR (all from sales of products within SIC AAA)	$3,000
Non-DPGR (all from sales of products within SIC BBB)	3,000
CGS	2,400
Section 162 selling expenses	840
Section 174 R&E-SIC AAA	300
Section 174 R&E-SIC BBB	600

(ii) *Allocation of PRS's Federal income tax items.* X and Y each receive the following distributive share of PRS's Federal income tax items, as determined under the principles of §1.704–1(b)(1)(vii):

Gross income attributable to DPGR ($1,500 (DPGR) - $600 (CGS))	$900
Gross income attributable to non-DPGR ($1,500 (other gross receipts) - $600 (CGS))	900
Section 162 selling expenses	420
Section 174 R&E-SIC AAA	150
Section 174 R&E-SIC BBB	300

(iii) *Determination of QPAI.* (A) *X's QPAI.* Because the section 199 deduction is determined at the partner level, X determines its QPAI by aggregating its distributive share of PRS's Federal income tax items with all other such items from all other, non-PRS-related activities. For 2010, X does not have any other such tax items. X's only gross receipts for 2010 are those attributable to the allocation of gross income from PRS. As stated, all of PRS's domestic production activities that generate DPGR are within SIC AAA. X allocates and apportions its deductible items to gross income attributable to DPGR under the section 861 method of §1.199–4(d). In this case, the section 162 selling expenses are definitely related to all of PRS's gross income. Based on the facts and circumstances of this specific case, apportionment of those expenses between DPGR and non-DPGR on the basis of PRS's gross receipts is appropriate. For purposes of apportioning R&E, X elects to use the sales method as described in §1.861–17(c). Because X has no direct sales of products, and because all of PRS's SIC AAA sales attributable to X's share of PRS's gross income generate DPGR, all of X's share of PRS's section 174 R&E attributable to SIC AAA is taken into account for purposes of determining X's QPAI. Thus, X's total QPAI for 2010 is $540, as shown in the following table:

DPGR (all from sales of products within SIC AAA)	$1,500
CGS	(600)
Section 162 selling expenses ($420 x ($1,500 DPGR/$3,000 total gross receipts))	(210)
Section 174 R&E-SIC AAA	(150)
X's QPAI	540

(B) *Y's QPAI.* (*1*) For 2010, in addition to the activities of PRS, Y engages in domestic production activities that generate both DPGR and non-DPGR. With respect to those non-PRS activities, Y is not able to identify from its books and records CGS allocable to DPGR and to non-DPGR. In this case, because non-PRS CGS is definitely related under the facts and circumstances to all of Y's non-PRS gross receipts, apportionment of non-PRS CGS between DPGR and non-DPGR based on Y's non-PRS gross receipts is appropriate. For 2010, Y has the following non-PRS Federal income tax items:

DPGR (from sales of products within SIC AAA)	$1,500
DPGR (from sales of products within SIC BBB)	1,500
Non-DPGR (from sales of products within SIC BBB)	3,000
CGS (allocated to DPGR within SIC AAA)	750
CGS (allocated to DPGR within SIC BBB)	750
CGS (allocated to non-DPGR within SIC BBB)	1,500
Section 162 selling expenses	540
Section 174 R&E-SIC AAA	300
Section 174 R&E-SIC BBB	450

(*2*) Because Y has DPGR as a result of activities outside PRS, Y must aggregate its distributive share of PRS's Federal income tax items with such items from all its other, non-PRS-related activities. Y allocates and apportions its deductible items to gross income attributable to DPGR under the section 861 method of §1.199–4(d). In this case, the section 162 selling expenses are definitely related to all of Y's gross income. Based on the facts and circumstances of the specific case, apportionment of such expenses between DPGR and non-DPGR on the basis of Y's gross receipts (including Y's share of PRS's gross receipts) is appropriate. For purposes of apportioning R&E, Y elects to use the sales method as described in §1.861–17(c).

(*3*) With respect to sales that generate DPGR, Y has gross income of $2,400 ($4,500 DPGR ($1,500 from PRS and $3,000 from non-PRS activities) - $2,100 CGS ($600 from sales of products by PRS and $1,500 from non-PRS activities)). Because all of the sales in SIC AAA generate DPGR, all of Y's share of PRS's section 174 R&E attributable to SIC AAA and the section 174 R&E attributable to SIC AAA that Y incurs in its non-PRS activities are taken into account for purposes of determining Y's QPAI. Because only a portion of the sales within SIC BBB generate DPGR, only a portion of the section 174 R&E attributable to SIC BBB is taken into account in determining Y's QPAI. Thus, Y's QPAI for 2010 is $1,282, as shown in the following table:

DPGR ($4,500 DPGR ($1,500 from PRS and $3,000 from non-PRS activities))	$4,500
CGS ($600 from sales of products by PRS and $1,500 from non-PRS activities)	(2,100)
Section 162 selling expenses ($960 ($420 from PRS + $540 from non-PRS activities) x ($4,500 DPGR/$9,000 total gross receipts))	(480)
Section 174 R&E-SIC AAA ($150 from PRS and $300 from non-PRS activities)	(450)
Section 174 R&E-SIC BBB ($750 ($300 from PRS + $450 from non-PRS activities) x ($1,500 DPGR/$6,000 total gross receipts allocated to SIC BBB ($1,500 from PRS + $4,500 from non-PRS activities))	(188)
Y's QPAI	1,282

(iv) *Determination of section 199 deduction.* X's tentative section 199 deduction is $49 (.09 x $540, that is, QPAI determined at the partner level) subject to the W–2 wage limitation (50% of W–2 wages). Y's tentative section 199 deduction is $115 (.09 x $1,282) subject to the W–2 wage limitation.

Example 3. Partnership with special allocations. (i) *In general.* X and Y are unrelated corporate partners in PRS and each is engaged in a trade or business. PRS is a partnership that engages in a domestic production activity and other activities. In general, X and Y share all partnership items of income, gain, loss, deduction, and credit equally, except that 80% of the wage expense of PRS and 20% of PRS's other expenses are specially allocated to X. Under all the facts and circumstances, these special allocations have substantial economic effect under section 704(b). In the 2010 taxable year, PRS's only wage expense is $2,000 for marketing, which is not included in CGS. PRS has $8,000 of gross receipts ($6,000 of which is DPGR), $4,000 of CGS ($3,500 of which is allocable to DPGR), and $3,000 of deductions (comprised of $2,000 of wage expense for marketing and $1,000 of other expenses). X qualifies for and uses the simplified deduction method under §1.199–4(e). Y does not qualify to use that method and, therefore, must use the section 861 method under §1.199–4(d). In the 2010 taxable year, X has gross receipts attributable to non-partnership trade or business activities of $1,000 and wage expense of $200. None of X's non-PRS gross receipts is DPGR. For purposes of this *Example 3*, with regard to both X and PRS, paragraph (e)(1) wages equal wage expense for the 2010 taxable year.

(ii) *Allocation and apportionment of costs.* Under the partnership agreement, X's distributive share of the Federal income tax items of PRS is $1,250 of gross income attributable to DPGR ($3,000 DPGR - $1,750 allocable CGS), $750 of gross income attributable to non-DPGR ($1,000 non-DPGR - $250 allocable CGS), and $1,800 of deductions (comprised of X's special allocations of $1,600 of wage expense ($2,000 x 80%) for marketing and $200 of other expenses ($1,000 x 20%)). Under the simplified deduction method, X apportions $1,200 of other deductions to DPGR ($2,000 ($1,800 from the partnership and $200 from non-partnership activities) x ($3,000 DPGR/$5,000 total gross receipts)). Accordingly, X's QPAI is $50 ($3,000 DPGR - $1,750 CGS - $1,200 of deductions). X has $1,800 of paragraph (e)(1) wages ($1,600 (X's 80% share) from PRS + $200 (X's own non-PRS paragraph (e)(1) wages)). To calculate its W–2 wages, X must determine how much of this $1,800 is properly allocable under §1.199–2(e)(2) to X's total DPGR (including X's share of DPGR from PRS). Thus, X's tentative section 199 deduction for the 2010 taxable year is $5 (.09 x $50), subject to the W–2 wage limitation (50% of X's W–2 wages).

Example 4. Partnership with no paragraph (e)(1) wages. (i) *Facts.* A and B, both individuals, are partners in PRS. PRS is a partnership that engages in manufacturing activities that generate both DPGR and non-DPGR. A and B share all items of income, gain, loss, deduction, and credit equally. For the 2010 taxable year, PRS has total gross receipts of $2,000 ($1,000 of which is DPGR), CGS of $400 and deductions of $800. PRS has no paragraph (e)(1) wages. Each partner's distributive share of PRS's Federal income tax items is $500 DPGR, $500 non-DPGR, $200 CGS, and $400 of deductions. A has trade or business activities outside of PRS (non-PRS activities). With respect to those activities, A has total gross receipts of $1,000 ($500 of which is DPGR), CGS of $400 (including $50 of paragraph (e)(1) wages), and deductions of $200 for the 2010 taxable year. B has no trade or business activities outside of PRS. A and B each use the small business simplified overall method under §1.199–4(f).

(ii) *A's QPAI.* A's total CGS and deductions apportioned to DPGR equal $600 (($1,200 ($200 PRS CGS + $400 non-PRS CGS + $400 PRS deductions + $200 non-PRS trade or business deductions)) x ($1,000 total DPGR ($500 from PRS + $500 from non-PRS activities)/$2,000 total gross receipts ($1,000 from PRS + $1,000 from non-PRS activities))). Accordingly, A's QPAI is $400 ($1,000 DPGR ($500 from PRS + $500 from non-PRS activities) - $600 CGS and deductions).

(iii) *A's W–2 wages and section 199 deduction.* A has $50 of paragraph (e)(1) wages ($0 from PRS + $50 from A's non-PRS activities). To calculate A's W–2 wages, A determines, under a reasonable method satisfactory to the Secretary, that $40 of this $50 is properly allocable under §1.199–2(e)(2) to A's DPGR from PRS and non-PRS activities. A's tentative section 199 deduction is $36 (.09 x $400), subject to the W–2 wage limitation of $20 (50% of W–2 wages of $40). Thus, A's section 199 deduction is $20.

(iv) *B's QPAI and section 199 deduction.* B's CGS and deductions apportioned to DPGR equal $300 (($200 PRS CGS + $400 PRS deductions) x ($500 DPGR from PRS /$1,000 total gross receipts

from PRS)). Accordingly, B's QPAI is $200 ($500 DPGR - $300 CGS and deductions). B's tentative section 199 deduction is $18 (.09 x $200), subject to the W–2 wage limitation. In this case, however, the limitation is $0, because B has no paragraph (e)(1) wages. Thus, B's section 199 deduction is $0.

Example 5. Guaranteed payment. (i) *Facts.* The facts are the same as in *Example 4*, except that in 2010 PRS also makes a guaranteed payment of $200 to A for services rendered by A (see section 707(c)), and PRS incurs $200 of wage expense for employees' salary, which is included within the $400 of CGS (in this case the wage expense of $200 equals PRS's paragraph (e)(1) wages). The guaranteed payment is taxable to A as ordinary income and is properly deducted by PRS under section 162. Pursuant to §1.199–3(p), A may not treat any part of this payment as DPGR. Accordingly, PRS has total gross receipts of $2,000 ($1,000 of which is DPGR), CGS of $400 (including $200 of wage expense) and deductions of $1,000 (including the $200 guaranteed payment) for the 2010 taxable year. Each partner's distributive share of the items of the partnership is $500 DPGR, $500 non-DPGR, $200 CGS (including $100 of wage expense), and $500 of deductions.

(ii) *A's QPAI and W–2 wages.* A's total CGS and deductions apportioned to DPGR equal $591 ($1,300 ($200 PRS CGS + $400 non-PRS CGS + $500 PRS deductions + $200 non-PRS trade or business deductions) x ($1,000 total DPGR ($500 from PRS + $500 from non-PRS activities)/$2,200 total gross receipts ($1,000 from PRS + $200 guaranteed payment + $1,000 from non-PRS activities))). Accordingly, A's QPAI is $409 ($1,000 DPGR - $591 CGS and other deductions). A's total paragraph (e)(1) wages are $150 ($100 from PRS + $50 from non-PRS activities). To calculate its W–2 wages, A must determine how much of this $150 is properly allocable under §1.199–2(e)(2) to A's total DPGR from PRS and non-PRS activities. A's tentative section 199 deduction is $37 (.09 x $409), subject to the W–2 wage limitation (50% of W–2 wages).

(iii) *B's QPAI and W–2 wages.* B's QPAI is $150 ($500 DPGR - $350 CGS and other deductions). B has $100 of paragraph (e)(1) wages (all from PRS). To calculate its W–2 wages, B must determine how much of this $100 is properly allocable under §1.199–2(e)(2) to B's total DPGR. B's tentative section 199 deduction is $14 (.09 x $150), subject to the W–2 wage limitation (50% of B's W–2 wages).

(c) *S corporations*—(1) *In general*—(i) *Determination at shareholder level.* The section 199 deduction with respect to the qualified production activities of an S corporation is determined at the shareholder level. As a result, each shareholder must compute its deduction separately. The section 199 deduction has no effect on the adjusted basis of a shareholder's stock in an S corporation. Except as provided by publication pursuant to paragraph (c)(1)(ii) of this section, for purposes of this section, each shareholder is allocated, in accordance with section 1366, its *pro rata* share of S corporation items (including items of income, gain, loss, and deduction), CGS allocated to such items of income, and gross receipts included in such items of income, even if the shareholder's share of CGS and other deductions and losses exceeds DPGR. Except as provided by publication under paragraph (c)(1)(ii) of this section, to determine its section 199 deduction for the taxable year, the shareholder aggregates its *pro rata* share of such items, to the extent they are not otherwise disallowed by the Code, with those items it incurs outside the S corporation (whether directly or indirectly) for purposes of allocating and apportioning deductions to DPGR and computing its QPAI.

(ii) *Determination at entity level.* The Secretary may, by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), permit an S corporation to calculate a shareholder's share of QPAI and W–2 wages at the entity level, instead of allocating to the shareholder, in accordance with section 1366, the shareholder's *pro rata* share of S corporation items (including items of income, gain, loss, and deduction) and paragraph (e)(1) wages. If an S corporation does calculate QPAI at the entity level—

(A) Each shareholder is allocated its share of QPAI (subject to the limitations of paragraph (c)(2) of this section) and W–2 wages from the S corporation, which are combined with the shareholder's QPAI and W–2 wages from other sources, if any;

(B) For purposes of computing the shareholder's QPAI under §§1.199–1 through 1.199–8, a shareholder does not take into account the items from the S corporation (for example, a shareholder does not take into account items from the S corporation in determining whether a threshold or *de minimis* rule applies or in allocating and apportioning deductions) in calculating its QPAI from other sources;

(C) A shareholder generally does not recompute its share of QPAI from the S corporation using another method; however, the shareholder might have to adjust its share of QPAI from the S corporation to take into account certain disallowed losses or deductions, or the allowance of suspended losses or deductions; and

(D) A shareholder's share of QPAI from an S corporation may be less than zero.

(2) *Disallowed losses or deductions.* Except as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), losses or deductions of the S corporation are taken into account in computing the shareholder's QPAI for a taxable year only if, and to the extent that, the shareholder's *pro rata* share of the losses or deductions from all of the S corporation's activities is not disallowed by section 465, 469, or 1366(d), or any other provision of the Code. If only a portion of the shareholder's share of the losses or deductions from an S corporation is allowed for a taxable year, a proportionate share of those allowed losses or deductions that are allocated to the S corporation's qualified production activities, determined in a manner consistent with sections 465, 469, and 1366(d), and any other applicable provision of the Code, is taken into account in computing QPAI for that taxable year. To the extent that any of the disallowed losses or deductions are allowed in a later taxable year under section 465, 469, or 1366(d), or any other provision of the Code, the shareholder takes into account a proportionate share of those allowed losses or deductions that are allocated to the S corporation's qualified production activities in computing the shareholder's QPAI for that later taxable year. Losses or deductions of the S corporation that are disallowed for taxable years beginning on or before December 31, 2004, however, are not taken into account in a later taxable year for purposes of computing the shareholder's QPAI for that later taxable year, whether or not the losses or deductions are allowed for other purposes.

(3) *Shareholder's share of paragraph (e)(1) wages.* Under section 199(d)(1)(A)(iii), an S corporation shareholder's share of the paragraph (e)(1) wages of the S corporation for purposes of determining the shareholder's W–2 wage limitation equals the shareholder's allocable share of those wages. Except as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), the S corporation must allocate the paragraph (e)(1) wages among the shareholders in the same manner it allocates wage expense among those shareholders. The shareholder then must add its share of the paragraph (e)(1) wages from the S corporation to the shareholder's paragraph (e)(1) wages from other sources, if any, and then must determine the por-

tion of those total paragraph (e)(1) wages allocable to DPGR to compute the shareholder's W–2 wages. See §1.199–2(e)(2) for the computation of W–2 wages and for the proper allocation of such wages to DPGR.

(4) *Transition rule for definition of W–2 wages and for W–2 wage limitation*. If an S corporation and any of its shareholders have different taxable years, only one of which begins after May 17, 2006, the definition of W–2 wages of the S corporation and the section 199(d)(1)(A)(iii) rule for determining a shareholder's share of wages from that S corporation is determined under the law applicable to S corporations based on the beginning date of the S corporation's taxable year. Thus, for example, for the short taxable year of an S corporation beginning after May 17, 2006, and ending in 2006, a shareholder's share of W–2 wages from the S corporation is determined under section 199(d)(1)(A)(iii) for taxable years beginning after May 17, 2006, even if that shareholder's taxable year began on or before May 17, 2006.

(d) *Grantor trusts*. To the extent that the grantor or another person is treated as owning all or part (the owned portion) of a trust under sections 671 through 679, such person (owner) computes its QPAI with respect to the owned portion of the trust as if that QPAI had been generated by activities performed directly by the owner. Similarly, for purposes of the W–2 wage limitation, the owner of the trust takes into account the owner's share of the paragraph (e)(1) wages of the trust that are attributable to the owned portion of the trust. The provisions of paragraph (e) of this section do not apply to the owned portion of a trust.

(e) *Non-grantor trusts and estates*—(1) *Allocation of costs*. The trust or estate calculates each beneficiary's share (as well as the trust's or estate's own share, if any) of QPAI and W–2 wages from the trust or estate at the trust or estate level. The beneficiary of a trust or estate may not recompute its share of QPAI or W–2 wages from the trust or estate by using another method to reallocate the trust's or estate's qualified production costs or paragraph (e)(1) wages, or otherwise. Except as provided in paragraph (d) of this section, the QPAI of a trust or estate must be computed by allocating expenses described in section 199(d)(5) in one of two ways, depending on the classification of those expenses under §1.652(b)–3. Specifically, directly attributable expenses within the meaning of §1.652(b)–3 are allocated pursuant to §1.652(b)–3, and expenses not directly attributable within the meaning of §1.652(b)–3 (other expenses) are allocated under the simplified deduction method of §1.199–4(e) (unless the trust or estate does not qualify to use the simplified deduction method, in which case it must use the section 861 method of §1.199–4(d) with respect to such other expenses). For this purpose, depletion and depreciation deductions described in section 642(e) and amortization deductions described in section 642(f) are treated as other expenses described in section 199(d)(5). Also for this purpose, the trust's or estate's share of other expenses from a lower-tier pass-thru entity is not directly attributable to any class of income (whether or not those other expenses are directly attributable to the aggregate pass-thru gross income as a class for purposes other than section 199). A trust or estate may not use the small business simplified overall method for computing its QPAI. See §1.199–4(f)(5).

(2) *Allocation among trust or estate and beneficiaries*—(i) *In general*. The QPAI of a trust or estate (which will be less than zero if the CGS and deductions allocated and apportioned to DPGR exceed the trust's or estate's DPGR) and W–2 wages of a trust or estate are allocated to each beneficiary and to the trust or estate based on the relative proportion of the trust's or estate's distributable net income (DNI), as defined by section 643(a), for the taxable year that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate. For this purpose, the trust or estate's DNI is determined with regard to the separate share rule of section 663(c), but without regard to section 199. To the extent that the trust or estate has no DNI for the taxable year, any QPAI and W–2 wages are allocated entirely to the trust or estate. A trust or estate is allowed the section 199 deduction in computing its taxable income to the extent that QPAI and W–2 wages are allocated to the trust or estate. A beneficiary of a trust or estate is allowed the section 199 deduction in computing its taxable income based on its share of QPAI and W–2 wages from the trust or estate, which are aggregated with the beneficiary's QPAI and W–2 wages from other sources, if any.

(ii) *Treatment of items from a trust or estate reporting qualified production activities income*. When, pursuant to this paragraph (e), a taxpayer must combine QPAI and W–2 wages from a trust or estate with the taxpayer's total QPAI and W–2 wages from other sources, the taxpayer, when applying §§1.199–1 through 1.199–8 to determine the taxpayer's total QPAI and W–2 wages from such other sources, does not take into account the items from such trust or estate. Thus, for example, a beneficiary of an estate that receives QPAI from the estate does not take into account the beneficiary's distributive share of the estate's gross receipts, gross income, or deductions when the beneficiary determines whether a threshold or *de minimis* rule applies or when the beneficiary allocates and apportions deductions in calculating its QPAI from other sources. Similarly, in determining the portion of the beneficiary's paragraph (e)(1) wages from other sources that is attributable to DPGR (thus, the W–2 wages from other sources), the beneficiary does not take into account DPGR and non-DPGR from the trust or estate.

(3) *Transition rule for definition of W–2 wages and for W–2 wage limitation*. The definition of W–2 wages of a trust or estate and the section 199(d)(1)(A)(iii) rule for determining the respective shares of wages from that trust or estate, and thus the beneficiary's share of W–2 wages from that trust or estate, is determined under the law applicable to pass-thru entities based on the beginning date of the taxable year of the trust or estate, regardless of the beginning date of the taxable year of the beneficiary.

(4) *Example*. The following example illustrates the application of this paragraph (e). Assume that the partnership, trust, and trust beneficiary all are calendar year taxpayers. The example reads as follows:

Example. (i) *Computation of DNI and inclusion and deduction amounts*. (A) *Trust's distributive share of partnership items*. Trust, a complex trust, is a partner in PRS, a partnership that engages in activities that generate DPGR and non-DPGR. In 2010, PRS distributes $10,000 cash to Trust. PRS properly allocates (in the same manner as wage expense) paragraph (e)(1) wages of $3,000 to Trust. Trust's distributive share of PRS items, which are properly included in Trust's DNI, is as follows:

Gross income attributable to DPGR ($15,000 DPGR - $5,000 CGS (including wage expense of $1,000))	$10,000
Gross income attributable to non-DPGR ($5,000 other gross receipts - $0 CGS)	5,000
Selling expenses attributable to DPGR (includes wage expense of $2,000)	3,000
Other expenses (includes wage expense of $1,000)	2,000

(B) *Trust's direct activities*. In addition to its cash distribution in 2010 from PRS, Trust directly has the following items which are properly included in Trust's DNI:

Dividends	$10,000
Tax-exempt interest	10,000
Rents from commercial real property operated by Trust as a business	10,000
Real estate taxes	1,000
Trustee commissions	3,000
State income and personal property taxes	5,000
Wage expense for rental business (direct paragraph (e)(1) wages)	2,000
Other business expenses	1,000

(C) *Allocation of deductions under §1.652(b)–3*. (*1*) *Directly attributable expenses*. In computing Trust's DNI for the taxable year, the distributive share of expenses of PRS are directly attributable under §1.652(b)–3(a) to the distributive share of income of PRS. Accordingly, the $5,000 of CGS, $3,000 of selling expenses, and $2,000 of other expenses are subtracted from the gross receipts from PRS ($20,000), resulting in net income from PRS of $10,000. With respect to the Trust's direct expenses, $1,000 of the trustee commissions, the $1,000 of real estate taxes, and the $2,000 of wage expense are directly attributable under §1.652(b)–3(a) to the rental income.

(*2*) *Non-directly attributable expenses*. Under §1.652(b)–3(b), the trustee must allocate a portion of the sum of the balance of the trustee commissions ($2,000), state income and personal property taxes ($5,000), and the other business expenses ($1,000) to the $10,000 of tax-exempt interest. The portion to be attributed to tax-exempt interest is $2,222 ($8,000 x ($10,000 tax exempt interest/$36,000 gross receipts net of direct expenses)), resulting in $7,778 ($10,000 - $2,222) of net tax-exempt interest. Pursuant to its authority recognized under §1.652(b)–3(b), the trustee allocates the entire amount of the remaining $5,778 of trustee commissions, state income and personal property taxes, and other business expenses to the $6,000 of net rental income, resulting in $222 ($6,000 - $5,778) of net rental income.

(D) *Amounts included in taxable income*. For 2010, Trust has DNI of $28,000 (net dividend income of $10,000 + net PRS income of $10,000 + net rental income of $222 + net tax-exempt income of $7,778). Pursuant to Trust's governing instrument, Trustee distributes 50%, or $14,000, of that DNI to B, an individual who is a discretionary beneficiary of Trust. Assume that there are no separate shares under Trust, and no distributions are made to any other beneficiary that year. Consequently, with respect to the $14,000 distribution B receives from Trust, B properly includes in B's gross income $5,000 of income from PRS, $111 of rents, and $5,000 of dividends, and properly excludes from B's gross income $3,889 of tax-exempt interest. Trust includes $20,222 in its adjusted total income and deducts $10,111 under section 661(a) in computing its taxable income.

(ii) *Section 199 deduction*. (A) *Simplified deduction method*. For purposes of computing the section 199 deduction for the taxable year, assume Trust qualifies for the simplified deduction method under §1.199–4(e). The determination of Trust's QPAI under the simplified deduction method requires multiple steps to allocate costs. First, the Trust's expenses directly attributable to DPGR under §1.652(b)–3(a) are subtracted from the Trust's DPGR. In this step, the directly attributable $5,000 of CGS and selling expenses of $3,000 are subtracted from the $15,000 of DPGR from PRS. Second, the Trust's expenses directly attributable under §1.652(b)–3(a) to non-DPGR from a trade or business are subtracted from the Trust's trade or business non-DPGR. In this step, $4,000 of Trust expenses directly allocable to the real property rental activity ($1,000 of real estate taxes, $1,000 of Trustee commissions, and $2,000 of wages) are subtracted from the $10,000 of rental income. Third, Trust must identify the portion of its other expenses that is attributable to Trust's trade or business activities, if any, because expenses not attributable to trade or business activities are not taken into account in computing QPAI. In this step, in this example, the portion of the trustee commissions not directly attributable to the rental operation ($2,000) is directly attributable to non-trade or business activities. In addition, the state income and personal property taxes are not directly attributable under §1.652(b)–3(a) to either trade or business or non-trade or business activities, so the portion of those taxes not attributable to either the PRS interests or the rental operation is not a trade or business expense and, thus, is not taken into account in computing QPAI. The portion of the state income and personal property taxes that is treated as an other trade or business expense is $3,000 ($5,000 x $30,000 total trade or business gross receipts/$50,000 total gross receipts). Fourth, Trust then allocates its other trade or business expenses (not directly attributable under §1.652(b)–3(a)) between DPGR and non-DPGR on the basis of its total gross receipts from the conduct of a trade or business ($20,000 from PRS + $10,000 rental income). Thus, Trust combines its non-directly attributable (other) business expenses ($2,000 from PRS + $4,000 ($1,000 of other business expenses + $3,000 of income and property taxes allocated to a trade or business) from its own activities) and then apportions this total ($6,000) between DPGR and other receipts on the basis of Trust's total trade or business gross receipts ($6,000 of such expenses x $15,000 DPGR/$30,000 total trade or business gross receipts = $3,000). Thus, for purposes of computing Trust's and B's section 199 deduction, Trust's QPAI is $4,000 ($7,000 ($15,000 DPGR - $5,000 CGS - $3,000 selling expenses) - $3,000). Because the distribution of Trust's DNI to B equals one-half of Trust's DNI, Trust and B each has QPAI from PRS for purposes of the section 199 deduction of $2,000. B has $1,000 of QPAI from non-Trust activities that is added to the $2,000 QPAI from Trust for a total of $3,000 of QPAI.

(B) *W–2 wages*. For the 2010 taxable year, Trust chooses to use the wage expense safe harbor under §1.199–2(e)(2)(ii) to determine its W–2 wages. For its taxable year ending December 31, 2010, Trust has $5,000 ($3,000 from PRS + $2,000 of Trust) of paragraph (e)(1) wages reported on 2010 Forms W–2. Trust's W–2 wages are $2,917, as shown in the following table:

Wage expense included in CGS directly attributable to DPGR	$1,000
Wage expense included in selling expense directly attributable to DPGR	2,000
Wage expense included in non-directly attributable deductions ($1,000 in wage expense x ($15,000 DPGR/$30,000 total trade or business gross receipts))	500
Wage expense allocable to DPGR	3,500
W–2 wages (($3,500 of wage expense allocable to DPGR/$6,000 of total wage expense) x $5,000 in paragraph (e)(1) wages)	$2,917

(C) *Section 199 deduction computation*. (*1*) *B's computation*. B is eligible to use the small business simplified overall method. Assume that B has sufficient adjusted gross income so that the section 199 deduction is not limited under section 199(a)(1)(B). Because the $14,000 Trust distribution to B equals one-half of Trust's DNI, B has W–2 wages from Trust of $1,459 (50% x $2,917). B has W–2 wages of $100 from trade or business activities outside of Trust and attributable to DPGR (computed without regard to B's interest in Trust pursuant to §1.199–2(e)) for a total of $1,559 of W–2 wages. B has $1,000 of QPAI from non-Trust activities that is added to the $2,000 QPAI from Trust for a total of $3,000 of QPAI. B's tentative deduction is $270 (.09 x $3,000), limited under the W–2 wage limitation to $780 (50% x $1,559 W–2 wages). Accordingly, B's section 199 deduction for 2010 is $270.

(*2*) *Trust's computation*. Trust has sufficient adjusted gross income so that the section 199 deduction is not limited under section 199(a)(1)(B). Because the $14,000 Trust distribution to B equals one-half of Trust's DNI, Trust has W–2 wages of $1,459 (50% x $2,917). Trust's tentative deduction is $180 (.09 x $2,000 QPAI), limited under the W–2 wage limitation to $730 (50% x $1,459 W–2 wages). Accordingly, Trust's section 199 deduction for 2010 is $180.

(f) *Gain or loss from the disposition of an interest in a pass-thru entity*. DPGR generally does not include gain or loss recognized on the sale, exchange, or other disposition of an interest in a pass-thru entity. However, with respect to a partnership, if section 751(a) or (b) applies, then gain or loss attributable to assets of the partnership giving rise to ordinary income under section 751(a) or (b), the sale, exchange, or other disposition of which would give rise to DPGR, is taken into account in computing the partner's section 199 deduction. Accordingly, to the extent that cash or property received by a partner in a sale or exchange of all or part of its partnership interest is attributable to unrealized receivables or inventory items within the meaning of section 751(c) or (d), respectively, and the sale or exchange of the unrealized receivable or inventory items would give rise to DPGR if sold, exchanged, or otherwise disposed of by the partnership, the cash or property received by the partner is taken into account by the partner in determining its DPGR for the taxable year. Likewise, to the extent that a distribution of property to a partner is treated under section 751(b) as a sale or exchange of property between the partnership and the distributee partner, and any property deemed sold or exchanged would give rise to DPGR if sold, exchanged, or otherwise disposed of by the partnership, the deemed sale or exchange of the property must be taken into account in determining the partnership's and distributee partner's DPGR to the extent not taken into account under the qualifying in-kind partnership rules. See §§1.751–1(b) and 1.199–3(i)(7).

(g) *No attribution of qualified activities*. Except as provided in §1.199–3(i)(7) regarding qualifying in-kind partnerships and §1.199–3(i)(8) regarding EAG partnerships, an owner of a pass-thru entity is not treated as conducting the qualified production activities of the pass-thru entity, and vice versa. This rule applies to all partnerships, including partnerships that have elected out of subchapter K under section 761(a). Accordingly, if a partnership manufactures QPP within the United States, or produces a qualified film or produces utilities in the United States, and distributes or leases, rents, licenses, sells, exchanges, or otherwise disposes of such property to a partner who then, without performing its own qualifying activity, leases, rents, licenses, sells, exchanges, or otherwise disposes of such property, then the partner's gross receipts from this latter lease, rental, license, sale, exchange, or other disposition are treated as non-DPGR. In addition, if a partner manufactures QPP within the United States, or produces a qualified film or produces utilities in the United States, and contributes or leases, rents, licenses, sells, exchanges, or otherwise disposes of such property to a partnership which then, without performing its own qualifying activity, leases, rents, licenses, sells, exchanges, or otherwise disposes of such property, then the partnership's gross receipts from this latter disposition are treated as non-DPGR.

§1.199–5T [Removed]

Par. 10. Section 1.199–5T is removed.

Par. 11. Section 1.199–7 is amended by revising paragraph (b)(4) to read as follows:

§1.199–7 Expanded affiliated groups.

* * * * *

(b) * * *

(4) *Losses used to reduce taxable income of expanded affiliated group*—(i) *In general*. The amount of an NOL sustained by any member of an EAG that is used in the year sustained in determining an EAG's taxable income limitation under section 199(a)(1)(B) is not treated as an NOL carryover or NOL carryback to any taxable year in determining the taxable income limitation under section 199(a)(1)(B). For purposes of this paragraph (b)(4), an NOL is considered to be used if it reduces an EAG's aggregate taxable income, regardless of whether the use of the NOL actually reduces the amount of the section 199 deduction that the EAG would otherwise derive. An NOL is not considered to be used to the extent that it reduces an EAG's aggregate taxable income to an amount less than zero. If more than one member of an EAG has an NOL used in the same taxable year to reduce the EAG's taxable income, the members' respective NOLs are deemed used in proportion to the amount of their NOLs.

(ii) *Examples*. The following examples illustrate the application of this paragraph (b)(4). For purposes of these examples, assume that all relevant parties have sufficient W–2 wages so that the section 199 deduction is not limited under section 199(b)(1). The examples read as follows:

Example 1. (i) *Facts*. Corporations A and B are the only two members of an EAG. A and B are both calendar year taxpayers, and they do not join in the filing of a consolidated Federal income tax return. Neither A nor B had taxable income or loss prior to 2010. In 2010, A has QPAI and taxable income of $1,000, and B has QPAI of $1,000 and an NOL of $1,500. In 2011, A has QPAI of $2,000 and taxable income of $1,000 and B has QPAI of $2,000 and taxable income

prior to the NOL deduction allowed under section 172 of $2,000.

(ii) *Section 199 deduction for 2010.* In determining the EAG's section 199 deduction for 2010, A's $1,000 of QPAI and B's $1,000 of QPAI are aggregated, as are A's $1,000 of taxable income and B's $1,500 NOL. Thus, for 2010, the EAG has QPAI of $2,000 and taxable income of ($500). The EAG's section 199 deduction for 2010 is 9% of the lesser of its QPAI or its taxable income. Because the EAG has a taxable loss in 2010, the EAG's section 199 deduction is $0.

(iii) *Section 199 deduction for 2011.* In determining the EAG's section 199 deduction for 2011, A's $2,000 of QPAI and B's $2,000 of QPAI are aggregated, giving the EAG QPAI of $4,000. Also, $1,000 of B's NOL from 2010 was used in 2010 to reduce the EAG's taxable income to $0. The remaining $500 of B's 2010 NOL is not considered to have been used in 2010 because it reduced the EAG's taxable income below $0. Accordingly, for purposes of determining the EAG's taxable income limitation under section 199(a)(1)(B) in 2011, B is deemed to have only a $500 NOL carryover from 2010 to offset a portion of its 2011 taxable income. Thus, B's taxable income in 2011 is $1,500 which is aggregated with A's $1,000 of taxable income. The EAG's taxable income limitation in 2011 is $2,500. The EAG's section 199 deduction is 9% of the lesser of its QPAI of $4,000 or its taxable income of $2,500. Thus, the EAG's section 199 deduction in 2011 is 9% of $2,500, or $225. The results would be the same if neither A nor B had QPAI in 2010.

Example 2. The facts are the same as in *Example 1* except that in 2010 B was not a member of the same EAG as A, but instead was a member of an EAG with Corporation X, which had QPAI and taxable income of $1,000 in 2010, and had neither taxable income nor loss in any other year. There were no other members of the EAG in 2010 besides B and X, and B and X did not file a consolidated Federal income tax return. As $1,000 of B's NOL was used in 2010 to reduce the B and X EAG's taxable income to $0, B is considered to have only a $500 NOL carryover from 2010 to offset a portion of its 2011 taxable income for purposes of the taxable income limitation under section 199(a)(1)(B), just as in *Example 1.* Accordingly, the results for the A and B EAG in 2011 are the same as in *Example 1.*

Example 3. The facts are the same as in *Example 1* except that B is not a member of any EAG in 2011. Because $1,000 of B's NOL was used in 2010 to reduce the EAG's taxable income to $0, B is considered to have only a $500 NOL carryover from 2010 to offset a portion of its 2011 taxable income for purposes of the taxable income limitation under section 199(a)(1)(B), just as in *Example 1.* Thus, for purposes of determining B's taxable income limitation in 2011, B is considered to have taxable income of $1,500, and B has a section 199 deduction of 9% of $1,500, or $135.

Example 4. Corporations A, B, and C are the only members of an EAG. A, B, and C are all calendar year taxpayers, and they do not join in the filing of a consolidated Federal income tax return. None of the EAG members (A, B, or C) had taxable income or loss prior to 2010. In 2010, A has QPAI of $2,000 and taxable income of $1,000, B has QPAI of $1,000 and an NOL of $1,000, and C has QPAI of $1,000 and an NOL of $3,000. In 2011, prior to the NOL deduction allowed under section 172, A and B each has taxable income of $200 and C has taxable income of $5,000. In determining the EAG's section 199 deduction for 2010, A's QPAI of $2,000, B's QPAI of $1,000, and C's QPAI of $1,000 are aggregated, as are A's taxable income of $1,000, B's NOL of $1,000, and C's NOL of $3,000. Thus, for 2010, the EAG has QPAI of $4,000 and taxable income of ($3,000). In determining the EAG's taxable income limitation under section 199(a)(1)(B) in 2011, $1,000 of B's and C's aggregate NOLs in 2010 of $4,000 are considered to have been used in 2010 to reduce the EAG's taxable income to $0, in proportion to their NOLs. Thus, $250 of B's NOL from 2010 ($1,000 x $1,000/$4,000) and $750 of C's NOL from 2010 ($1,000 x $3,000/$4,000) are deemed to have been used in 2010. The remaining $750 of B's NOL and the remaining $2,250 of C's NOL are not deemed to have been used because so doing would have reduced the EAG's taxable income in 2010 below $0. Accordingly, for purposes of determining the EAG's taxable income limitation in 2011, B is deemed to have a $750 NOL carryover from 2010 and C is deemed to have a $2,250 NOL carryover from 2010. Thus, for purposes of determining the EAG's taxable income limitation, B's taxable income in 2011 is $0 and C's taxable income in 2011 is $2,750, which are aggregated with A's $200 taxable income. B's unused NOL carryover from 2010 cannot be used to reduce either A's or C's 2011 taxable income. Thus, the EAG's taxable income limitation in 2011 is $2,950, A's taxable income of $200 plus B's taxable income of $0 plus C's taxable income of $2,750.

* * * * *

§1.199–7T [Removed]

Par. 12. Section 1.199–7T is removed.

Par. 13. Section 1.199–8 is amended by:

1. Removing the language "§1.199–9(j)" in paragraph (e)(1)(i) and adding the language "§§1.199–3(i)(8) and 1.199–9(j)" in its place.

2. Removing the language "§1.199–9(i)" in paragraph (e)(1)(i) and adding the language "§§1.199–3(i)(7) and 1.199–9(i)" in its place.

3. Removing the language "§1.199–9(i)" in paragraph (e)(1)(ii)(B) and adding the language "§1.199–3(i)(7) or §1.199–9(i)" in its place.

4. Revising the last two sentences in paragraph (h).

5. Revising paragraphs (i)(5) and (i)(6).

The revisions read as follows:

§1.199–8 Other rules.

* * * * *

(h) *Disallowed losses or deductions.* * * * For taxpayers that are partners in partnerships, see §§1.199–5(b)(2) and 1.199–9(b)(2). For taxpayers that are shareholders in S corporations, see §§1.199–5(c)(2) and 1.199(c)(2).

(i) * * *

(5) *Tax Increase Prevention and Reconciliation Act of 2005.* Sections 1.199–2(e)(2), 1.199–3(i)(7) and (8), and 1.199–5 are applicable for taxable years beginning on or after October 19, 2006. A taxpayer may apply §§1.199–2(e)(2), 1.199–3(i)(7) and (8), and 1.199–5 to taxable years beginning after May 17, 2006, and before October 19, 2006, regardless of whether the taxpayer otherwise relied upon Notice 2005–14, 2005–1 C.B. 498 (see §601.601(d)(2)(ii)(*b*) of this chapter), the provisions of REG–105847–05, 2005–2 C.B. 987, or §§1.199–1 through 1.199–8.

(6) *Losses used to reduce taxable income of expanded affiliated group.* Section 1.199–7(b)(4) is applicable for taxable years beginning on or after February 15, 2008. For taxable years beginning on or after October 19, 2006, and before February 15, 2008, see §1.199–7T(b)(4) (see 26 CFR part 1 revised as of April 1, 2007).

* * * * *

§1.199–8T [Removed]

Par. 14. Section 1.199–8T is removed.

Par. 15. Section 1.199–9 is amended by:

1. Revising paragraph (b)(1)(ii)(B).

2. Removing the language "paragraph (b) of this section shall" from paragraph (b)(5) and adding the language "this paragraph (b)" in its place.

3. Revising paragraph (c)(1)(ii)(B).

4. Revising paragraph (e)(2)(i).

5. Removing the language "directly allocable costs" in the sixth sentence of *Example 4* in paragraph (j)(5) and adding the language "CGS" in its place.

6. Adding the language "finished dosage form" before the word "drug" each time it appears in the seventh, eighth, and ninth sentences in paragraph (j)(5) *Example 5* (i) and in the second and third sentences in paragraph (j)(5) *Example 5* (ii).

The revisions read as follows:

§1.199–9 Application of section 199 to pass-thru entities for taxable years beginning on or before May 17, 2006, the enactment date of the Tax Increase

Prevention and Reconciliation Act of 2006.

* * * * *

(b) * * *

(1) * * *

(ii) * * *

(B) For purposes of computing the partner's QPAI under §§1.199–1 through 1.199–9, a partner does not take into account the items from the partnership (for example, a partner does not take into account items from the partnership in determining whether a threshold or *de minimis* rule applies or in allocating and apportioning deductions) in calculating its QPAI from other sources;

* * * * *

(c) * * *

(1) * * *

(ii) * * *

(B) For purposes of computing the shareholder's QPAI under §§1.199–1 through 1.199–9, a shareholder does not take into account the items from the S corporation (for example, a shareholder does not take into account items from the S corporation in determining whether a threshold or *de minimis* rule applies or in allocating and apportioning deductions) in calculating its QPAI from other sources;

* * * * *

(e) * * *

(2) * * * (i) *In general*. The QPAI of a trust or estate (which will be less than zero if the CGS and deductions allocated and apportioned to DPGR exceed the trust's or estate's DPGR) and W–2 wages of a trust or estate are allocated to each beneficiary and to the trust or estate based on the relative proportion of the trust's or estate's distributable net income (DNI), as defined by section 643(a), for the taxable year that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate. For this purpose, the trust or estate's DNI is determined with regard to the separate share rule of section 663(c), but without regard to section 199. To the extent that the trust or estate has no DNI for the taxable year, any QPAI and W–2 wages are allocated entirely to the trust or estate. A trust or estate is allowed the section 199 deduction in computing its taxable income to the extent that QPAI and W–2 wages are allocated to the trust or estate. A beneficiary of a trust or estate is allowed the section 199 deduction in computing its taxable income based on its share of QPAI and W–2 wages from the trust or estate, which (subject to the wage limitation as described in paragraph (e)(3) of this section) are aggregated with the beneficiary's QPAI and W–2 wages from other sources, if any.

* * * * *

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

Approved February 1, 2008.

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

(Filed by the Office of the Federal Register on February 14, 2008, 8:45 a.m., and published in the issue of the Federal Register for February 15, 2008, 73 F.R. 8798)

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of April 2008. See Rev. Rul. 2008-20, page 716.

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 April 2008. See Rev. Rul. 2008-20, page 716.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2008. See Rev. Rul. 2008-20, page 716.

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 April 2008. See Rev. Rul. 2008-20, page 716.

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 April 2008. See Rev. Rul. 2008-20, page 716.

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 April 2008. See Rev. Rul. 2008-20, page 716.

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 April 2008. See Rev. Rul. 2008-20, page 716.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of April 2008. See Rev. Rul. 2008-20, page 716.

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 April 2008. See Rev. Rul. 2008-20, page 716.

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 April 2008. See Rev. Rul. 2008-20, page 716.

Section 1221.—Capital Asset Defined

26 CFR 1.1221–3T: Time and manner for electing capital asset treatment for certain self-created musical works (temporary).

T.D. 9379

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Time and Manner for Electing Capital Asset Treatment for Certain Self-Created Musical Works

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulation.

SUMMARY: This document contains a temporary regulation that provides the time and manner for making an election to treat the sale or exchange of musical compositions or copyrights in musical works created by the taxpayer (or received by the taxpayer from the works' creator in a transferred basis transaction) as the sale or exchange of a capital asset. The regulation reflects changes to the law made by the Tax Increase Prevention and Reconciliation Act of 2005 and the Tax Relief and Health Care Act of 2006. The regulation affects taxpayers making the election under section 1221(b)(3) of the Internal Revenue Code (Code) to treat gain or loss from such a sale or exchange as capital gain or loss. The text of this temporary regulation also serves as the text of the proposed regulation (REG–153589–06) set forth in this issue of the Bulletin.

DATES: *Effective Date:* This regulation is effective on February 8, 2008.

Applicability Dates: For dates of applicability, see §1.1221–3T(d).

FOR FURTHER INFORMATION CONTACT: Jamie Kim, (202) 622–4950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 1221(a) of the Internal Revenue Code (Code) generally provides that capital assets include all property held by a taxpayer with certain specified exclusions. Section 1221(a)(1) excludes from the definition of a capital asset inventory property or property held by a taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. Section 1221(a)(3) excludes from the definition of a capital asset copyrights, literary, musical, or artistic compositions, letters or memoranda, or similar property held by a taxpayer whose personal efforts created the property (or held by a taxpayer whose basis in the property is determined by reference to the basis of such property in the hands of the taxpayer whose personal efforts created the property).

Section 1221(b)(3) of the Code, added by section 204 of the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109–222, 120 Stat. 345) and amended by section 412 of the Tax Relief and Health Care Act of 2006 (Public Law 109–432, 120 Stat. 2922), provides that, at the election of a taxpayer, the section 1221(a)(1) and (a)(3) exclusions from capital asset status do not apply to musical compositions or copyrights in musical works sold or exchanged by a taxpayer described in section 1221(a)(3). Thus, if a taxpayer who owns a musical composition or copyright in a musical work created by the taxpayer (or transferred to the taxpayer by the work's creator in a section 1221(a)(3)(C) transferred basis transaction) elects the application of this provision, gain or loss from the sale or exchange of the musical composition or copyright is treated as capital gain or loss.

Explanation of Provisions

This temporary regulation provides rules regarding the time and manner for making an election under section 1221(b)(3) to treat gain or loss from the sale or exchange of certain musical compositions or copyrights in musical works as gain or loss from the sale or exchange of a capital asset.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation. For application of the Regulatory Flexibility Act (5 U.S.C. Chapter 6) please refer to the cross reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. 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.

Drafting Information

The principal author of these regulations is Jamie Kim of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1221–3T is added to read as follows:

§1.1221–3T Time and manner for electing capital asset treatment for certain self-created musical works (temporary).

(a) *Description.* Section 1221(b)(3) allows an electing taxpayer to treat the sale or exchange of a musical composition or copyright in a musical work created by the taxpayer's personal efforts (or having a basis determined by reference to the basis of such property in the hands of a taxpayer whose personal efforts created such property) as the sale or exchange of a capital asset. As a consequence, gain or loss from the sale or exchange is treated as capital gain or loss. An election may be made for

sales and exchanges in taxable years beginning after May 17, 2006.

(b) *Time and manner for making the election*. An election described in this section is made separately for each musical composition (or copyright in a musical work) sold or exchanged during the taxable year. An election must be made on or before the due date (including extensions) of the income tax return for the taxable year of the sale or exchange. An election is to be made on Schedule D, "*Capital Gains and Losses*," of the appropriate income tax form (for example, Form 1040, "*U.S. Individual Income Tax Return*;" Form 1065, "*U.S. Return of Partnership Income*;" Form 1120, "*U.S. Corporation Income Tax Return*") by treating the sale or exchange as the sale or exchange of a capital asset, in accordance with the form and its instructions.

(c) *Revocability of election*. An election described in this section is revocable with the consent of the Commissioner. To seek consent to revoke an election, a taxpayer must submit a request for a letter ruling under the appropriate revenue procedure. See, for example, Rev. Proc. 2007–1, 2007–1 C.B. 1 (updated annually). Alternatively, an automatic extension of 6 months from the due date of the taxpayer's income tax return (excluding extensions) is granted to revoke an election, provided the taxpayer timely filed the taxpayer's income tax return and, within this 6-month extension period, the taxpayer files an amended income tax return that treats the sale or exchange as the sale or exchange of property that is not a capital asset. See §601.601(d)(2)(ii)(*b*) of this Chapter.

(d) *Effective/applicability date*. (1) The rules of this section apply to sales and exchanges in taxable years beginning after May 17, 2006.

(2) *Expiration date*. This section expires on February 8, 2011.

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

Approved January 28, 2008.

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

(Filed by the Office of the Federal Register on February 7, 2008, 8:45 a.m., and published in the issue of the Federal Register for February 8, 2008, 73 F.R. 7464)

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 April 2008.

Rev. Rul. 2008–20

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

REV. RUL. 2008–20 TABLE 1

Applicable Federal Rates (AFR) for April 2008

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	1.85%	1.84%	1.84%	1.83%
110% AFR	2.03%	2.02%	2.01%	2.01%
120% AFR	2.22%	2.21%	2.20%	2.20%
130% AFR	2.40%	2.39%	2.38%	2.38%
Mid-term				
AFR	2.87%	2.85%	2.84%	2.83%
110% AFR	3.16%	3.14%	3.13%	3.12%
120% AFR	3.45%	3.42%	3.41%	3.40%
130% AFR	3.74%	3.71%	3.69%	3.68%
150% AFR	4.33%	4.28%	4.26%	4.24%
175% AFR	5.05%	4.99%	4.96%	4.94%
Long-term				
AFR	4.40%	4.35%	4.33%	4.31%
110% AFR	4.85%	4.79%	4.76%	4.74%
120% AFR	5.29%	5.22%	5.19%	5.16%
130% AFR	5.74%	5.66%	5.62%	5.59%

REV. RUL. 2008–20 TABLE 2

Adjusted AFR for April 2008

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	1.99%	1.98%	1.98%	1.97%
Mid-term adjusted AFR	3.28%	3.25%	3.24%	3.23%
Long-term adjusted AFR	4.55%	4.50%	4.47%	4.46%

REV. RUL. 2008–20 TABLE 3

Rates Under Section 382 for April 2008

Adjusted federal long-term rate for the current month	4.55%
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.)	4.55%

REV. RUL. 2008–20 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for April 2008

Appropriate percentage for the 70% present value low-income housing credit	7.84%
Appropriate percentage for the 30% present value low-income housing credit	3.36%

REV. RUL. 2008–20 TABLE 5

Rate Under Section 7520 for April 2008

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	3.4%

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 April 2008. See Rev. Rul. 2008-20, page 716.

Section 6020.—Returns Prepared for or Executed by Secretary

26 CFR 301.6020–1: Returns prepared or executed by the Commissioner or other Internal Revenue Officers.

T.D. 9380

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Substitute for Return

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to returns prepared or signed by the Commissioner or other Internal Revenue Officers or employees under section 6020 of the Internal Revenue Code. These final regulations provide guidance for preparing a substitute for return under section 6020(b). Absent the existence of a return under section 6020(b), the addition to tax under section 6651(a)(2) does not apply to a nonfiler. These final regulations affect any person who fails to file a required return.

DATES: *Effective Date:* These regulations are effective on February 20, 2008.

Applicability Date: For dates of applicability, see §301.6020–1(d).

FOR FURTHER INFORMATION CONTACT: Alicia E. Goldstein at (202) 622–3630 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations relating to substitutes for returns. These final regulations reflect amendments to 26 CFR part 301 under section 6020 of the Internal Revenue Code. Section 301.6020–1 of the Procedure and Administration Regulations provides for the preparation or execution of returns by authorized Internal Revenue Officers or employees. Section 1301(a) of the Taxpayer Bill of Rights Act of 1996, Public Law 104–168 (110 Stat. 1452), amended section 6651 to add subsection (g)(2), which provides that, for returns due after July 30, 1996 (determined without regard to extensions), a return made under section 6020(b) shall be treated as a return filed by the taxpayer for purposes of determining the amount of the additions to tax under section 6651(a)(2) and (a)(3). Absent the existence of a return under section 6020(b), the addition to tax under section 6651(a)(2) does not apply to a nonfiler.

In *Cabirac v. Commissioner*, 120 T.C. 163 (2003), *aff'd in an unpublished opinion*, No. 03–3157 (3rd Cir. Feb. 10, 2004), and *Spurlock v. Commissioner*, T.C. Memo. 2003–124, the Tax Court found that the Service did not establish that it had prepared and signed a return in accordance with section 6020(b). In *Spurlock*, the Tax Court held that a return for section 6020(b) purposes must be subscribed, contain sufficient information from which to compute the taxpayer's tax liability, and the return and any attachments must "purport to be a return." *Spurlock*, T.C.Memo. 2003–124 at 27. These decisions prompted the Service and the Treasury Department to revise its rules for the preparation or execution of returns by authorized Internal Revenue Officer or employees. Temporary regulations and a notice of proposed rulemaking (REG–131739–03, 2005–2 C.B. 494) were published in the **Federal Register** on July 18, 2005 [70 FR 41165].

The Service and the Treasury Department received written public comments responding to the proposed regulations. After consideration of the comments received, the proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations with one minor change as explained in more detail in the preamble.

Explanation of Provisions and Summary of Comments

The regulations provide that a document (or set of documents) signed by an authorized Internal Revenue Officer or employee is a return under section 6020(b) if the document (or set of documents) identifies the taxpayer by name and taxpayer identification number, contains sufficient information from which to compute the taxpayer's tax liability, and the document (or set of documents) purports to be a return under section 6020(b). A Form 13496, "*IRC Section 6020(b) Certification*," or any other form that an authorized Internal Revenue Officer or employee signs and uses to identify a document (or set of documents) containing the information set forth in this preamble as a section 6020(b) return, and the documents identified, constitute a valid section 6020(b) return.

Further, because the Service prepares and signs section 6020(b) returns both by hand and through automated means, these regulations provide that a name or title of an Internal Revenue Officer or employee appearing upon a return made in accordance with section 6020(b) is sufficient as a subscription by that officer or employee to adopt the document as a return for the taxpayer without regard to whether the name or title is handwritten, stamped, typed, printed or otherwise mechanically affixed to the document. The document or

set of documents and subscription may be in written or electronic form.

These final regulations do not alter the method for the preparation of returns under section 6020(a) as provided in T.D. 6498. Under section 6020(a), if the taxpayer consents to disclose necessary information, the Service may prepare a return on behalf of a taxpayer, and if the taxpayer signs the return, the Service will receive it as the taxpayer's return.

The proposed regulations generated numerous comments. For the most part, the comments were variations of ten different form letters. The commentators took issue with the regulation because the signature on the certification was not signed under oath, and therefore not signed under a penalty of perjury; because a "set of documents" could substitute for a return instead of the form that would have been used by the taxpayer, and because the Service was making the decision of who should file a tax return.

After considering these comments, the Service and the Treasury Department have concluded that they provide no basis for adopting changes in the final regulations. In particular, the argument that the Service should not be able to decide who should file a tax return is without merit. The requirement to file a tax return is not voluntary and is clearly set forth in sections 6011(a) and 6012(a).

There has been one minor change to the text of the temporary regulations. The temporary regulation provided that any return made in accordance with paragraph (b)(1) of this section and signed by the Commissioner or other authorized Internal Revenue Officer or employee shall be *prima facie* good and sufficient for all legal purposes. In 2005, new language was added to the Bankruptcy Code at 11 U.S.C. §523(a) that specifically provided that a section 6020(b) return is not a return for dischargeability purposes. Therefore, the portion of the temporary regulation that stated that the return was sufficient for all legal purposes is no longer correct. The language in the regulation has been changed to state that a section 6020(b) return is sufficient for all legal purposes "except insofar as any Federal statute expressly provides otherwise."

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Alicia Goldstein, Office of the Associate Chief Counsel (Procedure and Administration).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

§301.6020–1T **[Removed]**

Par. 2. Section 301.6020–1T is removed.

Par. 3. Section 301.6020–1 is added to read as follows:

§301.6020–1 Returns prepared or executed by the Commissioner or other Internal Revenue Officers.

(a) *Preparation of returns*—(1) *In general*. If any person required by the Internal Revenue Code or by the regulations to make a return fails to make such return, it may be prepared by the Commissioner or other authorized Internal Revenue Officer or employee provided such person consents to disclose all information necessary for the preparation of such return. The return upon being signed by the person required to make it shall be received by the Commissioner as the return of such person.

(2) *Responsibility of person for whom return is prepared*. A person for whom a return is prepared in accordance with paragraph (a)(1) of this section shall for all legal purposes remain responsible for the correctness of the return to the same extent as if the return had been prepared by him.

(b) *Execution of returns*—(1) *In general*. If any person required by the Internal Revenue Code or by the regulations to make a return (other than a declaration of estimated tax required under section 6654 or 6655) fails to make such return at the time prescribed therefore, or makes, willfully or otherwise, a false, fraudulent or frivolous return, the Commissioner or other authorized Internal Revenue Officer or employee shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise. The Commissioner or other authorized Internal Revenue Officer or employee may make the return by gathering information and making computations through electronic, automated or other means to make a determination of the taxpayer's tax liability.

(2) *Form of the return*. A document (or set of documents) signed by the Commissioner or other authorized Internal Revenue Officer or employee shall be a return for a person described in paragraph (b)(1) of this section if the document (or set of documents) identifies the taxpayer by name and taxpayer identification number, contains sufficient information from which to compute the taxpayer's tax liability, and purports to be a return. A Form 13496, "*IRC Section 6020(b) Certification*," or any other form that an authorized Internal Revenue Officer or employee signs and uses to identify a set of documents containing the information set forth in this paragraph as a section 6020(b) return, and the documents identified, constitute a return under section 6020(b). A return may be signed by the name or title of an Internal Revenue Officer or employee being handwritten, stamped, typed, printed or otherwise mechanically affixed

to the return, so long as that name or title was placed on the document to signify that the Internal Revenue Officer or employee adopted the document as a return for the taxpayer. The document and signature may be in written or electronic form.

(3) *Status of returns*. Any return made in accordance with paragraph (b)(1) of this section and signed by the Commissioner or other authorized Internal Revenue Officer or employee shall be good and sufficient for all legal purposes except insofar as any Federal statute expressly provides otherwise. Furthermore, the return shall be treated as the return filed by the taxpayer for purposes of determining the amount of the addition to tax under sections 6651(a)(2) and (3).

(4) *Deficiency procedures*. For deficiency procedures in the case of income, estate, and gift taxes, see §§6211 through 6216, inclusive, and §§301.6211–1 through 301.6215–1, inclusive.

(5) *Employment status procedures*. For pre-assessment procedures in employment taxes cases involving worker classification, see section 7436 (proceedings for determination of employment status).

(6) *Examples*. The application of this paragraph (b) is illustrated by the following examples:

Example 1. Individual A, a calendar-year taxpayer, fails to file his 2003 return. Employee X, an Internal Revenue Service employee, opens an examination related to A's 2003 taxable year. At the end of the examination, X completes a Form 13496, "*IRC Section 6020(b) Certification*," and attached to it the documents listed on the form. Those documents explain examination changes and provide sufficient information to compute A's tax liability. The Form 13496 provides that the Service employee identified on the form certifies that the attached pages constitute a return under section 6020(b). When X signs the certification package, the package constitutes a return under paragraph (b) of this section because the package identifies A by name, contains A's taxpayer identifying number (TIN), has sufficient information to compute A's tax liability, and contains a statement stating that it constitutes a return under section 6020(b). In addition, the Service will determine the amount of the additions to tax under section 6651(a)(2) by treating the section 6020(b) return as the return filed by the taxpayer. Likewise, the Service will determine the amount of any addition to tax under section 6651(a)(3), which arises only after notice and demand for payment, by treating the section 6020(b) return as the return filed by the taxpayer.

Example 2. Same facts as in *Example 1*, except that, after performing the examination, X does not compile any examination documents together as a related set of documents. X also does not sign and complete the Form 13496 nor associate the forms explaining examination changes with any other document. Because X did not sign any document stating that it constitutes a return under section 6020(b) and the documents otherwise do not purport to be a section 6020(b) return, the documents do not constitute a return under section 6020(b). Therefore, the Service cannot determine the section 6651(a)(2) addition to tax against nonfiler A for A's 2003 taxable year on the basis of those documents.

Example 3. Individual C, a calendar-year taxpayer, fails to file his 2003 return. The Service determines through its automated internal matching programs that C received reportable income and failed to file a return. The Service, again through its automated systems, generates a Letter 2566, "30 Day Proposed Assessment (SFR–01) 910 SC/CG." This letter contains C's name, TIN, and has sufficient information to compute C's tax liability. Contemporaneous with the creation of the Letter 2566, the Service, through its automated system, electronically creates and stores a certification stating that the electronic data contained as part of C's account constitutes a valid return under section 6020(b) as of that date. Further, the electronic data includes the signature of the Service employee authorized to sign the section 6020(b) return upon its creation. Although the signature is stored electronically, it can appear as a printed name when the Service requests a paper copy of the certification. The electronically created information, signature, and certification is a return under section 6020(b). The Service will treat that return as the return filed by the taxpayer in determining the amount of the section 6651(a)(2) addition to tax with respect to C's 2003 taxable year. Likewise, the Service will determine the amount of any addition to tax under section 6651(a)(3), which arises only after notice and demand for payment, by treating the section 6020(b) return as the return filed by the taxpayer.

Example 4. Corporation M, a quarterly taxpayer, fails to file a Form 941, "*Employer's QUARTERLY Federal Tax Return*," for the second quarter of 2004. Q, a Service employee authorized to sign returns under section 6020(b), prepares a Form 941 by hand, stating Corporation M's name, address, and TIN. Q completes the Form 941 by entering line item amounts, including the tax due, and then signs the document. The Form 941 that Q prepared and signed constitutes a section 6020(b) return because the Form 941 purports to be a return under section 6020(b), the form contains M's name and TIN, and it includes sufficient information to compute M's tax liability for the second quarter of 2004.

(c) *Cross references*—(1) For provisions that a return executed by the Commissioner or other authorized Internal Revenue Officer or employee will not start the running of the period of limitations on assessment and collection, see section 6501(b)(3) and §301.6501(b)–1(e).

(2) For determining the period of limitations on collection after assessment of a liability on a return executed by the Commissioner or other authorized Internal Revenue Officer or employee, see section 6502 and §301.6502–1.

(3) For additions to the tax and additional amounts for failure to file returns, see section 6651 and §301.6651–1, and section 6652 and §301.6652–1, respectively.

(4) For additions to the tax for failure to pay tax, see section 6651 and §301.6651–1.

(5) For criminal penalties for willful failure to make returns, see sections 7201, 7202 and 7203.

(6) For criminal penalties for willfully making false or fraudulent returns, see sections 7206 and 7207.

(7) For civil penalties for filing frivolous income tax returns, see section 6702.

(8) For authority to examine books and witnesses, see section 7602 and §301.7602–1.

(d) *Effective/Applicability date*. This section is applicable on February 20, 2008.

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

Approved February 5, 2008.

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

(Filed by the Office of the Federal Register on February 19, 2008, 8:45 a.m., and published in the issue of the Federal Register for February 20, 2008, 73 F.R. 9188)

Section 6325.—Release of Lien or Discharge of Property

26 CFR 301.6325–1: Release of lien or discharge of property.

T.D. 9378

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 301 and 401

Release of Lien or Discharge of Property

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations related to release of lien and discharge of property under sections 6325, 6503, and 7426 of the Internal Revenue Code (Code). These regulations update existing regulations and contain procedures for processing a request made by a property owner for discharge of a Federal tax lien from his property under section 6325(b)(4). The regulations also clarify the impact of these procedures on sections 6503(f)(2) and 7426(a)(4) and (b)(5). These regulations reflect the enactment of sections 6325(b)(4), 6503(f)(2), and 7426(a)(4) by the IRS Restructuring and Reform Act of 1998.

DATES: *Effective Date:* These regulations are effective January 31, 2008.

Applicability Date: These regulations apply to any release of lien or discharge of property that is requested after January 31, 2008.

FOR FURTHER INFORMATION CONTACT: Debra A. Kohn, (202) 622–7985 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations that amend the Procedure and Administration Regulations (26 CFR part 301) under sections 6325, 6503, and 7426 of the Code. The IRS Restructuring and Reform Act of 1998, Public Law 105–206 (112 Stat. 685) (RRA 1998), enacted sections 6325(b)(4), 6503(f)(2), 7426(a)(4), and 7426(a)(5) to provide a statutory mechanism for a person other than the person against whom the underlying tax was assessed, upon furnishing a deposit or bond, to obtain a discharge of the Federal tax lien from property owned by him, and for the IRS or the courts to determine the disposition of the deposit or bond amount. RRA 1998 thereby necessitated changes to the rules under sections 6325, 6503, and 7426.

On January 11, 2007, a notice of proposed rulemaking (REG–159444–04, 2007–9 I.R.B. 618) relating to release of lien or discharge of property was published in the **Federal Register** (72 FR 1301–03). No comments were received and no public hearing was requested or held. Accordingly, the proposed regulations are adopted as amended by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations but include one modification as explained in more detail below.

Explanation of Modification

The final regulations differ substantively in one respect from the version of the regulations set forth in the notice of proposed rulemaking. The proposed regulations interpret section 6325(b)(4)(D), which states that section 6325(b)(4)(A) is inapplicable "if the owner of the property is the person whose unsatisfied liability gave rise to the lien," as indicating that the procedures for obtaining a discharge of a Federal tax lien under section 6325(b)(4) are not available to a person who owns the subject property with the person whose tax liability gave rise to the lien (the taxpayer). Upon further consideration of this issue, it was decided that section 6235(b)(4)(D) should not be so interpreted, as that interpretation would unfairly leave some third-party property owners without a means to discharge Federal tax liens from their properties. Accordingly, the final regulations reflect an interpretation of section 6325(b)(4)(D) that makes the section 6325(b)(4) procedures available to a person who co-owns property with the taxpayer.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Debra A. Kohn of the Office of the Associate Chief Counsel (Procedure and Administration).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, 26 CFR parts 301 and 401 are amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6325–1 is amended as follows:

1. Paragraphs (a) and (b)(1)(i), (b)(2)(i), (b)(2)(ii), and (b)(3) are revised.

2. Paragraph (b)(2)(iii) is redesignated as paragraph (b)(6) and revised.

3. Paragraph (b)(4) is redesignated as paragraph (b)(5) and revised.

4. A new paragraph (b)(4) is added.

5. Paragraphs (c)(1) and (c)(2) are amended by removing the language "district director" and adding the language "appropriate official" in its place, wherever it appears.

6. The first sentence of paragraph (d)(1) is amended by removing the language "A district director" and adding the language "The appropriate official" in its place, by removing the word "Code" and adding the language "Internal Revenue Code" in its place, and by removing the language "the district director" and adding the language "the appropriate official" in its place. The third sentence is amended by removing the language "a district director" and adding the language "the appropriate official" in its place, and removing the language "the district director" and adding "the appropriate official" in its place.

7. Paragraph (d)(2)(i) is amended by removing the language "A district director" and adding the language "The appropriate official" in its place, by removing the word "Code" and adding the language "Internal Revenue Code" in its place, and by removing the language "the district director" and

adding the language "the appropriate official" in its place.

8. Paragraph (d)(2)(ii), *Examples 1* through *4*, are amended by removing the language "district director" and adding the language "appropriate official" in its place, wherever it appears.

9. Paragraphs (d)(3) and (d)(4) are amended by removing the language "district director" and adding the language "appropriate official" in its place, wherever it appears.

10. The first sentence of paragraph (e) is amended by removing the language "a district director" and adding the language "the appropriate official" in its place, and by removing the language "the district director" and adding the language "the appropriate official" in its place. The third and fourth sentences are amended by removing the language "district director" and adding the language "appropriate official" in its place.

11. Paragraphs (f)(1) and (f)(2)(i) are amended by removing the language "a district director" and adding the language "the appropriate official" in its place, paragraph (f)(2)(i)(b) is amended by removing the language "the district director" and adding the language "the appropriate official" in its place, and paragraph (f)(3) is amended by removing the word "Code" and adding the language "Internal Revenue Code" in its place.

12. Paragraphs (h) and (i) are added.

The revisions and additions read as follows:

§301.6325–1 Release of lien or discharge of property.

(a) *Release of lien*—(1) *Liability satisfied or unenforceable.* The appropriate official shall issue a certificate of release for a filed notice of Federal tax lien, no later than 30 days after the date on which he finds that the entire tax liability listed in such notice of Federal tax lien either has been fully satisfied (as defined in paragraph (a)(4) of this section) or has become legally unenforceable. In all cases, the liability for the payment of the tax continues until satisfaction of the tax in full or until the expiration of the statutory period for collection, including such extension of the period for collection as is agreed to.

(2) *Bond accepted.* The appropriate official shall issue a certificate of release of any tax lien if he is furnished and accepts a bond that is conditioned upon the payment of the amount assessed (together with all interest in respect thereof), within the time agreed upon in the bond, but not later than 6 months before the expiration of the statutory period for collection, including any agreed upon extensions. For provisions relating to bonds, see sections 7101 and 7102 and §§301.7101–1 and 301.7102–1.

(3) *Certificate of release for a lien which has become legally unenforceable.* The appropriate official shall have the authority to file a notice of Federal tax lien which also contains a certificate of release pertaining to those liens which become legally unenforceable. Such release will become effective as a release as of a date prescribed in the document containing the notice of Federal tax lien and certificate of release.

(4) *Satisfaction of tax liability.* For purposes of paragraph (a)(1) of this section, satisfaction of the tax liability occurs when—

(i) The appropriate official determines that the entire tax liability listed in a notice of Federal tax lien has been fully satisfied. Such determination will be made as soon as practicable after tender of payment; or

(ii) The taxpayer provides the appropriate official with proof of full payment (as defined in paragraph (a)(5) of this section) with respect to the entire tax liability listed in a notice of Federal tax lien together with the information and documents set forth in paragraph (a)(7) of this section. See paragraph (a)(6) of this section if more than one tax liability is listed in a notice of Federal tax lien.

(5) *Proof of full payment.* As used in paragraph (a)(4)(ii) of this section, the term *proof of full payment* means—

(i) An internal revenue cashier's receipt reflecting full payment of the tax liability in question;

(ii) A canceled check in an amount sufficient to satisfy the tax liability for which the release is being sought;

(iii) A record, made in accordance with procedures prescribed by the Commissioner, of proper payment of the tax liability by credit or debit card or by electronic funds transfer; or

(iv) Any other manner of proof acceptable to the appropriate official.

(6) *Notice of a Federal tax lien which lists multiple liabilities.* When a notice of Federal tax lien lists multiple tax liabilities, the appropriate official shall issue a certificate of release when all of the tax liabilities listed in the notice of Federal tax lien have been fully satisfied or have become legally unenforceable. In addition, if the taxpayer requests that a certificate of release be issued with respect to one or more tax liabilities listed in the notice of Federal tax lien and such liability has been fully satisfied or has become legally unenforceable, the appropriate official shall issue a certificate of release. For example, if a notice of Federal tax lien lists two separate liabilities and one of the liabilities is satisfied, the taxpayer may request the issuance of a certificate of release with respect to the satisfied tax liability and the appropriate official shall issue a release.

(7) *Taxpayer requests.* A request for a certificate of release with respect to a notice of Federal tax lien shall be submitted in writing to the appropriate official. The request shall contain the information required in the appropriate IRS Publication.

(b) *Discharge of specific property from the lien*—(1) *Property double the amount of the liability.* (i) The appropriate official may, in his discretion, issue a certificate of discharge of any part of the property subject to a Federal tax lien imposed under chapter 64 of the Internal Revenue Code if he determines that the fair market value of that part of the property remaining subject to the Federal tax lien is at least double the sum of the amount of the unsatisfied liability secured by the Federal tax lien and of the amount of all other liens upon the property which have priority over the Federal tax lien. In general, fair market value is that amount which one ready and willing but not compelled to buy would pay to another ready and willing but not compelled to sell the property.

* * * * *

(2) *Part payment; interest of United States valueless*—(i) *Part payment.* The appropriate official may, in his discretion, issue a certificate of discharge of any part of the property subject to a Federal tax lien imposed under chapter 64 of the Internal Revenue Code if there is paid over to him in partial satisfaction of the liability secured by the Federal tax lien an amount determined by him to be not less than the value of the interest of the United States in the property to be so discharged. In deter-

mining the amount to be paid, the appropriate official will take into consideration all the facts and circumstances of the case, including the expenses to which the government has been put in the matter. In no case shall the amount to be paid be less than the value of the interest of the United States in the property with respect to which the certificate of discharge is to be issued.

(ii) *Interest of the United States valueless*. The appropriate official may, in his discretion, issue a certificate of discharge of any part of the property subject to the Federal tax lien if he determines that the interest of the United States in the property to be so discharged has no value.

(3) *Discharge of property by substitution of proceeds of sale*. The appropriate official may, in his discretion, issue a certificate of discharge of any part of the property subject to a Federal tax lien imposed under chapter 64 of the Internal Revenue Code if such part of the property is sold and, pursuant to a written agreement with the appropriate official, the proceeds of the sale are held, as a fund subject to the Federal tax liens and claims of the United States, in the same manner and with the same priority as the Federal tax liens or claims had with respect to the discharged property. This paragraph does not apply unless the sale divests the taxpayer of all right, title, and interest in the property sought to be discharged. Any reasonable and necessary expenses incurred in connection with the sale of the property and the administration of the sale proceeds shall be paid by the applicant or from the proceeds of the sale before satisfaction of any Federal tax liens or claims of the United States.

(4) *Right of substitution of value*—(i) *Issuance of certificate of discharge to property owner who is not the taxpayer*. If an owner of property subject to a Federal tax lien imposed under chapter 64 of the Internal Revenue Code submits an application for a certificate of discharge pursuant to paragraph (b)(5) of this section, the appropriate official shall issue a certificate of discharge of such property after the owner either deposits with the appropriate official an amount equal to the value of the interest of the United States in the property, as determined by the appropriate official pursuant to paragraph (b)(6) of this section, or furnishes an acceptable bond in a like amount. This paragraph does not apply if the person seeking the discharge is the person whose unsatisfied liability gave rise to the Federal tax lien. Thus, if the property is owned by both the taxpayer and another person, the other person may obtain a certificate of discharge of the property under this paragraph, but the taxpayer may not.

(ii) *Refund of deposit and release of bond*. The appropriate official may, in his discretion, determine that either the entire unsatisfied tax liability listed on the notice of Federal tax lien can be satisfied from a source other than the property sought to be discharged, or the value of the interest of the United States is less than the prior determination of such value. The appropriate official shall refund the amount deposited with interest at the overpayment rate determined under section 6621 or release the bond furnished to the extent that he makes this determination.

(iii) *Refund request*. If a property owner desires an administrative refund of his deposit or release of the bond, the owner shall file a request in writing with the appropriate official. The request shall contain such information as the appropriate IRS Publication may require. The request must be filed within 120 days after the date the certificate of discharge is issued. A refund request made under this paragraph neither is required nor is effective to extend the period for filing an action in court under section 7426(a)(4).

(iv) *Internal Revenue Service's use of deposit if court action not filed*. If no action is filed under section 7426(a)(4) for refund of the deposit or release of the bond within the 120-day period specified therein, the appropriate official shall, within 60 days after the expiration of the 120-day period, apply the amount deposited or collect on such bond to the extent necessary to satisfy the liability listed on the notice of Federal tax lien, and shall refund, with interest at the overpayment rate determined under section 6621, any portion of the amount deposited that is not used to satisfy the liability. If the appropriate official has not completed the application of the deposit to the unsatisfied liability before the end of the 60-day period, the deposit will be deemed to have been applied to the unsatisfied liability as of the 60th day.

(5) *Application for certificate of discharge*. Any person desiring a certificate of discharge under this paragraph (b) shall submit an application in writing to the appropriate official. The application shall contain the information required by the appropriate IRS Publication. For purposes of this paragraph (b), any application for certificate of discharge made by a property owner who is not the taxpayer, and any amount submitted pursuant to the application, will be treated as an application for discharge and a deposit under section 6325(b)(4) unless the owner of the property submits a statement, in writing, that the application is being submitted under another paragraph of section 6325 and not under section 6325(b)(4), and the owner in writing waives the rights afforded under paragraph (b)(4), including the right to seek judicial review.

(6) *Valuation of interest of United States*. For purposes of paragraphs (b)(2) and (b)(4) of this section, in determining the value of the interest of the United States in the property, or any part thereof, with respect to which the certificate of discharge is to be issued, the appropriate official shall give consideration to the value of the property and the amount of all liens and encumbrances thereon having priority over the Federal tax lien. In determining the value of the property, the appropriate official may, in his discretion, give consideration to the forced sale value of the property in appropriate cases.

* * * * *

(h) As used in this section, the term *appropriate official* means either the official or office identified in the relevant IRS Publication or, if such official or office is not so identified, the Secretary or his delegate.

(i) *Effective/applicability date*. This section applies to any release of lien or discharge of property that is requested after January 31, 2008.

Par. 3. Section 301.6503(f)–1 is amended as follows:

1. The section heading is revised.

2. The undesignated paragraph is designated as paragraph (a), a paragraph heading is added, and a new sentence is added immediately prior to the *Example*.

3. In newly designated paragraph (a), the language "a district director" is removed and the language "the appropriate official" is added in its place, the language "the district director" is removed and the language "the appropriate official"

is added in its place, and in the *Example* the language "district director" is removed and the language "appropriate official" is added in its place, wherever it appears.

4. Paragraphs (b), (c), and (d) are added.

The revisions and additions read as follows:

§301.6503(f)–1 Suspension of running of period of limitation; wrongful seizure of property of third-party owner and discharge of lien for substitution of value.

(a) *Wrongful seizure.* * * * The following example illustrates the principles of this section:

* * * * *

(b) *Discharge of wrongful lien for substitution of value.* If a person other than the taxpayer submits a request in writing for a certificate of discharge for a filed Federal tax lien under section 6325(b)(4), the running of the period of limitations on collection after assessment under section 6502 for any liability listed in such notice of Federal tax lien shall be suspended for a period equal to the period beginning on the date the appropriate official receives a deposit or bond in the amount specified in §301.6325–1(b)(4)(i) and ending on the date that is 30 days after the earlier of—

(1) The date the appropriate official no longer holds, or is deemed to no longer hold, within the meaning of paragraph (b)(4)(iv) of this section, any amount as a deposit or bond by reason of taking such actions as prescribed in sections 6325(b)(4)(B) and (C); or

(2) The date the judgment secured under section 7426(b)(5) becomes final.

(c) As used in this section, the term *appropriate official* means either the official or office identified in the relevant IRS Publication or, if such official or office is not so identified, the Secretary or his delegate.

(d) *Effective/applicability date.* This section applies to any request for a certificate of discharge made after January 31, 2008.

Par. 4. In §301.7426–1, paragraphs (a)(4), (b)(5), and (d) are added.

§301.7426–1 Civil actions by persons other than taxpayers.

(a) * * *

(4) *Substitution of value.* A person who obtains a certificate of discharge under section 6325(b)(4) with respect to any property may, within 120 days after the day on which the certificate is issued, bring a civil action against the United States in a district court of the United States for a determination of whether the value of the interest of the United States (if any) in such property is less than the value determined by the appropriate official. A civil action under this provision shall be the exclusive judicial remedy for a person other than the taxpayer who obtains a certificate of discharge for a filed notice of Federal tax lien.

(b) * * *

(5) *Substitution of value.* If the court determines that the determination by the appropriate official of the value of the interest of the United States in the property exceeds the actual value of such interest, the court may grant a judgment ordering a refund of the amount deposited, or a release of the bond, to the extent that the aggregate of those amounts exceeds the value as determined by the court.

* * * * *

(d) Paragraphs (a)(4) and (b)(5) of this section apply to any request for a certificate of discharge made after January 31, 2008.

PART 401—[REMOVED]

Par. 5. Part 401 is removed.

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

Approved January 9, 2008.

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

(Filed by the Office of the Federal Register on January 30, 2008, 8:45 a.m., and published in the issue of the Federal Register for January 31, 2008, 73 F.R. 5741)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2008. See Rev. Rul. 2008-20, page 716.

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 April 2008. See Rev. Rul. 2008-20, page 716.

Part III. Administrative, Procedural, and Miscellaneous

Amplification of Notice 2006–52; Deduction for Energy Efficient Commercial Buildings

Notice 2008–40

SECTION 1. PURPOSE

This notice clarifies and amplifies Notice 2006–52, 2006–1 C.B. 1175. Notice 2006–52 provides a process that allows a taxpayer who owns a commercial building and installs property as part of the commercial building's interior lighting systems, heating, cooling, ventilation, and hot water systems, or building envelope to obtain a certification that the property satisfies the energy efficiency requirements of § 179D(c)(1) and (d) of the Internal Revenue Code. Notice 2006–52 also provides for a public list of software programs that may be used in calculating energy and power consumption for purposes of § 179D.

This notice sets forth additional guidance relating to the deduction for energy efficient commercial buildings under § 179D and is intended to be used with Notice 2006–52. Any reference in this notice to Standard 90.1–2001 should be treated as a reference to ANSI/ASHRAE/IESNA Standard 90.1–2001, Energy Standard for Buildings Except Low-Rise Residential Buildings, developed for the American National Standards Institute by the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America (as in effect on April 2, 2003, including addenda 90.1a–2003, 90.1b–2002, 90.1c–2002, 90.1d–2002, and 90.1k–2002 as in effect on that date).

SECTION 2. BACKGROUND

Section 1331 of the Energy Policy Act of 2005, Pub. L. No. 109–58, 119 Stat. 594 (2005), enacted § 179D of the Code, which provides a deduction with respect to energy efficient commercial buildings. Section 204 of the Tax Relief and Health Care Act of 2006, Pub. L. No. 109–432, 120 Stat. 2922 (2006), extends the § 179D deduction through December 31, 2008.

Section 179D(a) allows a deduction to a taxpayer for part or all of the cost of energy efficient commercial building property that the taxpayer places in service after December 31, 2005, and before January 1, 2009. Sections 179D(d)(1) and 179D(f) allow a deduction to a taxpayer for part or all of the cost of certain partially qualifying commercial building property that the taxpayer places in service after December 31, 2005, and before January 1, 2009. Partially qualifying commercial building property is property that would be energy efficient commercial building property but for the failure to achieve the 50-percent reduction in energy and power costs required under § 179D(c)(1)(D).

SECTION 3. SPECIAL RULE FOR GOVERNMENT-OWNED BUILDINGS

.01 *In General*. In the case of energy efficient commercial building property (or partially qualifying commercial building property for which a deduction is allowed under § 179D) that is installed on or in property owned by a Federal, State, or local government or a political subdivision thereof, the owner of the property may allocate the § 179D deduction to the person primarily responsible for designing the property (the designer). If the allocation of a § 179D deduction to a designer satisfies the requirements of this section, the deduction will be allowed only to that designer. The deduction will be allowed to the designer for the taxable year that includes the date on which the property is placed in service.

.02 *Designer of Government-Owned Buildings*. A designer is a person that creates the technical specifications for installation of energy efficient commercial building property (or partially qualifying commercial building property for which a deduction is allowed under § 179D). A designer may include, for example, an architect, engineer, contractor, environmental consultant or energy services provider who creates the technical specifications for a new building or an addition to an existing building that incorporates energy efficient commercial building property (or partially qualifying commercial building property for which a deduction is allowed under § 179D). A person that merely installs, repairs, or maintains the property is not a designer.

.03 *Allocation of the Deduction*. If more than one designer is responsible for creating the technical specifications for installation of energy efficient commercial building property (or partially qualifying commercial building property for which a deduction is allowed under § 179D) on or in a government-owned building, the owner of the building shall—

(1) determine which designer is primarily responsible and allocate the full deduction to that designer, or

(2) at the owner's discretion, allocate the deduction among several designers.

.04 *Form of Allocation*. An allocation of the § 179D deduction to the designer of a government-owned building must be in writing and will be treated as satisfying the requirements of this section with respect to energy efficient commercial building property (or partially qualifying commercial building property for which a deduction is allowed under § 179D) if the allocation contains all of the following:

(1) The name, address, and telephone number of an authorized representative of the owner of the government-owned building;

(2) The name, address, and telephone number of an authorized representative of the designer receiving the allocation of the § 179D deduction;

(3) The address of the government-owned building on or in which the property is installed;

(4) The cost of the property;

(5) The date the property is placed in service;

(6) The amount of the § 179D deduction allocated to the designer;

(7) The signatures of the authorized representatives of both the owner of the government-owned building and the designer or the designer's authorized representative; and

(8) A declaration, applicable to the allocation and any accompanying documents, signed by the authorized representative of the owner of the government-owned building, in the following form:

"Under penalties of perjury, I declare that I have examined this allocation, in-

cluding accompanying documents, and to the best of my knowledge and belief, the facts presented in support of this allocation are true, correct, and complete."

.05 *Obligations of Designer*. Before a designer may claim the § 179D deduction with respect to property installed on or in a government-owned building, the designer must obtain the written allocation described in section 3.04. A designer is not required to attach the allocation to the return on which the deduction is taken. However, § 1.6001–1(a) of the Income Tax Regulations requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any deduction claimed by the taxpayer. Accordingly, a designer claiming a deduction under § 179D should retain the allocation as part of the taxpayer's records for purposes of § 1.6001–1(a) of the Income Tax Regulations.

.06 *Tax Consequences to Designer of Government-Owned Buildings*. The maximum amount of the § 179D deduction to be allocated to the designer is the amount of the costs incurred by the owner of the government-owned building to place the energy efficient commercial building property in service. A partial deduction may be allocated and computed in accordance with the procedures set forth in sections 2 and 3 of Notice 2006–52. The designer does not include any amount in income on account of the § 179D deduction allocated to the designer. In addition, the designer is not required to reduce future deductions by an amount equal to the § 179D deduction allocated to the designer. Although reducing future deductions in this manner would provide equivalent treatment for designers that are allocated a § 179D deduction and building owners that are required to reduce the basis of their energy efficient commercial building property by the amount of the § 179D deduction they claim, § 179D does not provide for any reductions other than reductions to the basis of the energy efficient commercial building property.

.07 *Tax Consequences to Owner of Public Building*. The owner of the public building is not required to include any amount in income on account of the § 179D deduction allocated to the designer. The owner of the public building is, however, required to reduce the basis of the energy efficient commercial building property (or partially qualifying commercial building property) by the amount of the § 179D deduction allocated.

SECTION 4. LIST OF APPROVED SOFTWARE PROGRAMS

.01 *In General*. The Department of Energy creates and maintains a public list of software that may be used to calculate energy and power consumption and costs for purposes of providing a certification under section 4 of Notice 2006–52. This public list appears at *http://www.eere.energy.gov/buildings/info/tax_incentives.html*. Software will be included on the list if the software developer submits the following information to the Department of Energy:

(1) The name, address, and (if applicable) web site of the software developer;

(2) The name, email address, and telephone number of the person to contact for further information regarding the software;

(3) The name, version, or other identifier of the software as it will appear on the list;

(4) All test results, input files, output files, weather data, modeler reports, and the executable version of the software with which the tests were conducted; and

(5) A declaration by the developer of the software made under penalties of perjury and containing all of the following information:

(a) A statement that the software has been tested according to the American National Standards Institute/American Society of Heating, Refrigerating and Air-Conditioning Engineers (ANSI/ASHRAE) Standard 140–2007 Standard Method of Test for the Evaluation of Building Energy Analysis Computer Programs.

(b) A statement that the software can model explicitly—

(i) 8,760 hours per year;

(ii) Calculation methodologies for the building components being modeled;

(iii) Hourly variations in occupancy, lighting power, miscellaneous equipment power, thermostat setpoints, and HVAC system operation, defined separately for each day of the week and holidays;

(iv) Thermal mass effects;

(v) Ten or more thermal zones;

(vi) Part-load performance curves for mechanical equipment;

(vii) Capacity and efficiency correction curves for mechanical heating and cooling equipment; and

(viii) Air-side and water-side economizers with integrated control.

(c) A statement that the software can explicitly model each of the following HVAC systems listed in Appendix G of Standard 90.1–2004:

(i) Packaged Terminal Air Conditioner (PTAC) (air source), single-zone package (through the wall), multi-zone hydronic loop, air-to-air DX coil cooling, central boiler, hot water coil.

(ii) Packaged Terminal Heat Pump (PTHP) (air source), single-zone package (through the wall), air-to-air DX coil heat/cool.

(iii) Packaged Single Zone Air Conditioner (PSZ-AC), single-zone air, air-to-air DX coil cool, gas coil, constant-speed fan.

(iv) Packaged Single Zone Heat Pump (PSZ-HP), single-zone air, air-to-air DX coil cool/heat, constant-speed fan.

(v) Packaged Variable-Air-Volume (PVAV) with reheat, multi-zone air; multi-zone hydronic loop, air-to-air DX coil, VAV fan, boiler, hot water VAV terminal boxes.

(vi) Packaged Variable-Air-Volume with parallel fan powered boxes (PVAV with PFP boxes), multi-zone air, DX coil, VAV fan, fan-powered induction boxes, electric reheat.

(vii) Variable-Air-Volume (VAV) with reheat, multi-zone air, multi-zone hydronic loop, air-handling unit, chilled water coil, hot water coil, VAV fan, chiller, boiler, hot water VAV boxes.

(viii) Variable-Air-Volume with parallel fan powered boxes (VAV with PFP boxes), multi-zone air, air-handling unit, chilled water coil, hot water coil, VAV fan, chiller, fan-powered induction boxes, electric reheat.

(d) A statement that the software can—

(i) Either directly determine energy and power costs or produce hourly reports of energy use by energy source suitable for determining energy and power costs separately; and

(ii) Design load calculations to determine required HVAC equipment capacities and air and water flow rates.

(e) A statement describing which, if any, of the following the software can explicitly model:

(i) Natural ventilation.

(ii) Mixed mode (natural and mechanical) ventilation.

(iii) Earth tempering of outdoor air.

(iv) Displacement ventilation.

(v) Evaporative cooling.

(vi) Water use by occupants for cooking, cleaning or other domestic uses.

(vii) Water use by heating, cooling, or other equipment, or for on-site landscaping.

(viii) Automatic interior or exterior lighting controls (such as occupancy, photocells, or time clocks).

(viii) Daylighting (sidelighting, skylights, or tubular daylight devices).

(ix) Improved fan system efficiency through static pressure reset.

(x) Radiant heating or cooling (low or high temperature).

(xi) Multiple or variable speed control for fans, cooling equipment, or cooling towers.

(xii) On-site energy systems (such as combined heat and power systems, fuel cells, solar photovoltaic, solar thermal, or wind).

.02 *Addresses*. Submissions under this section must be addressed as follows:

Commercial Software List
Department of Energy
Office of Building Technologies,
EE–2J
1000 Independence Ave., SW
Washington, DC 20585–0121

.03 *Updated Lists*. The software list at *http://www.eere.energy.gov/buildings/info/tax_incentives.html* will be updated as necessary to reflect submissions received under this section.

.04 *Removal from Published List*. The Department of Energy may, upon examination, determine that software is not sufficiently accurate to justify its use in calculating energy and power consumption and costs for purposes of providing a certification under section 4 of Notice 2006–52 and remove the software from the published list. The Department of Energy may undertake such an examination on its own initiative or in response to a public request supported by appropriate analysis of the software's deficiencies.

.05 *Effect of Removal from Published List*. Software may not be used to calculate energy and power consumption and costs for purposes of providing a certification with respect to property placed in service after the date on which the software is removed from the published list. The removal will not affect the validity of any certification with respect to property placed in service on or before the date on which the software is removed from the published list.

.06 *Public Availability of Information*. The Department of Energy may make all information provided under paragraph .01 of this section available for public review.

.07 *Applicability*. The procedures in this section supersede the procedures set forth in section 6 of Notice 2006–52 for periods after March 31, 2008. Any software that is included on the public list on March 31, 2008, will remain on the public list unless and until removed under the procedures set forth in this section.

SECTION 5. CERTIFICATION REQUIREMENTS FOR INTERIM LIGHTING RULE

.01 *In General*. Section 2.03(1)(b) of Notice 2006–52 provides an interim rule under which partially qualifying property is treated as energy efficient lighting property (the Interim Lighting Rule). Before a taxpayer may claim the § 179D deduction under the Interim Lighting Rule with respect to energy efficient lighting property installed on or in a commercial building, the taxpayer must obtain a certification with respect to the property. The certification must be provided by a qualified individual. Section 4 of Notice 2006–52 provides that the certification must include a statement that qualified computer software was used to calculate energy and power consumption and costs. That section also provides that the certification must include a statement that the building owner has received an explanation of projected annual energy costs. These requirements are appropriate only in the case of certifications that involve calculations of energy and power consumption and cost. The Interim Lighting Rule is satisfied by a reduction in lighting power density and such a reduction may be computed using a spreadsheet or other similar software. This computation does not require qualified computer software to model the entire building system or a determination of projected annual energy costs. Accordingly, the requirements of section 4 of Notice 2006–52 do not apply to certifications under the Interim Lighting Rule.

.02 *Applicable Requirements*. A taxpayer is not required to attach the certification to the return on which the deduction is taken. However, § 1.6001–1(a) of the Income Tax Regulations requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any deduction claimed by the taxpayer. Accordingly, a taxpayer claiming a deduction under § 179D should retain the certification as part of the taxpayer's records for purposes of § 1.6001–1(a) of the Income Tax Regulations. The qualified individual providing a certification under the interim rule must document a reduction in lighting power density in a thorough and consistent manner. A certification under the Interim Lighting Rule will be treated as satisfying the requirements of § 179D(c)(1) if the certification contains all of the following:

(1) The name, address, and telephone number of the qualified individual;

(2) The address of the building to which the certification applies;

(3) A statement by the qualified individual that the interior lighting systems that have been, or are planned to be, incorporated into the building—

(a) Achieve a reduction in lighting power density of at least 25 percent (50 percent in the case of a warehouse) of the minimum requirements in Table 9.3.1.1 or Table 9.3.1.2 (not including additional interior lighting power allowances) of Standard 90.1–2001;

(b) Have controls and circuiting that comply fully with the mandatory and prescriptive requirements of Standard 90.1–2001;

(c) Include provision for bi-level switching in all occupancies except hotel and motel guest rooms, store rooms, restrooms, public lobbies, and garages; and

(d) Meet the minimum requirements for calculated lighting levels as set forth in the IESNA Lighting Handbook, Performance and Application, Ninth Edition, 2000;

(4) A statement by the qualified individual that—

(a) Field inspections of the building were performed by a qualified individual after the energy efficient lighting property has been placed in service;

(b) The field inspections confirmed that the building has met, or will meet, the reduction in lighting power density required by the design plans and specifications; and

(c) The field inspections were performed in accordance with inspection and testing procedures that—

(i) Have been prescribed by the National Renewable Energy Laboratory (NREL) as Energy Savings Modeling and Inspection Guidelines for Commercial Building Federal Tax Deduction; and

(ii) Are in effect at the time the certification is given;

(5) A list identifying the components of the energy efficient lighting property installed on or in the building, the energy efficiency features of the building, and its projected lighting power density;

(6) A statement that the building owner has received an explanation of the energy efficiency features of the building and its projected lighting power density;

(7) A declaration, applicable to the certification and any accompanying documents, signed by the qualified individual, in the following form:

"Under penalties of perjury, I declare that I have examined this certification, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of this certification are true, correct, and complete."

SECTION 6. APPLICATION OF THE INTERIM LIGHTING RULE TO UNCONDITIONED GARAGE SPACE

For purposes of the Interim Lighting Rule, the definition of a Building within the Scope of Standard 90.1–2001 (found in Section 5.01 of Notice 2006–52) is expanded to include a structure that—

(1) Encloses space affording shelter to persons, animals, or property within exterior walls (or within exterior and party walls) and a roof;

(2) Is not a single-family house, a multifamily structure of three stories or fewer above grade, a manufactured house (mobile home), or a manufactured house (modular); and

(3) Is unconditioned attached or detached garage space as referenced by Tables 9.3.1.1 and 9.3.1.2 of Standard 90.1–2001.

SECTION 7. CHANGES RELATING TO PARTIALLY QUALIFYING PROPERTY

.01 *Energy Savings Percentages*. A taxpayer may apply section 2.05 of Notice 2006–52 by substituting "10" for "16⅔" in section 2.05(1) of such notice. If a taxpayer makes this substitution, the taxpayer must apply sections 2.03 and 2.04 of Notice 2006–52 by substituting "20" for "16⅔" in sections 2.03(1)(a) and 2.04(1) of such notice. If § 179D is extended beyond December 31, 2008, the Internal Revenue Service and the Treasury Department expect, in the absence of other changes to § 179D, that the substitute percentages set forth in this section will be the only percentages used in determining whether property placed in service after December 31, 2008, is partially qualifying property.

.02 *Limitation on Deduction for Partially Qualifying Property*.

(1) *In General*. If property installed on or in a building is treated as partially qualifying property under sections 2.03, 2.04, and 2.05 of Notice 2006–52, the deduction for the cost of such property shall not exceed the greatest of the following amounts:

(a) The sum of the deductions allowable under sections 2.03 and 2.04 of such notice;

(b) The sum of the deductions allowable under sections 2.04 and 2.05 of such notice; or

(c) The sum of the deductions allowable under sections 2.03 and 2.05 of such notice.

(2) *Application to Multiple Taxpayers*. If two or more taxpayers install property on or in the same building and the deduction for the cost of the property is subject to the limitation in section 7.02(1) of this notice, the aggregate amount of the § 179D deductions allowed to all such taxpayers with respect to the building shall not exceed the amount determined under section 7.02(1) of this notice.

SECTION 8. PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–2004.

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

The collections of information are in sections 4 and 6 of Notice 2006–52 and sections 4 and 5 of this notice. This information is required to be collected and retained in order to ensure that energy efficient commercial building property meets the requirements for the deduction under § 179D. This information will be used to determine whether commercial building property for which certifications are provided is property that qualifies for the deduction.

The collection of information is required to obtain a benefit.

The likely respondents are two groups: qualified individuals providing a certification under § 179D (section 4 of Notice 2006–52 and section 5 of this notice) and software developers seeking to have software included on the public list created by the Department of Energy (section 6 of Notice 2006–52 and section 4 of this notice).

For qualified individuals providing a certification under § 179D, the likely respondents are individuals. The likely number of certifications is 20,000. The estimated burden per certification ranges from 15 to 30 minutes with an estimated average burden of 22.5 minutes. The estimated total annual reporting burden is 7,500 hours.

For software developers seeking to have software included on the public list created by the Department of Energy, the likely respondents are individuals, corporations and partnerships. The estimated total annual reporting burden is 75 hours. The estimated annual burden per respondent varies from 1 to 2 hours, depending on individual circumstances, with an estimated average burden of 1½ hours to complete the submission required to have the software added to the public list. The estimated number of respondents is 50. The estimated frequency of responses is once.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return

information are confidential, as required by 26 U.S.C. 6103.

SECTION 9. DRAFTING INFORMATION

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

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulation

Time and Manner for Electing Capital Asset Treatment for Certain Self-Created Musical Works

REG–153589–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulation.

SUMMARY: In this issue of the Bulletin, the IRS is issuing a temporary regulation (T.D. 9379) that provides the time and manner for making an election to treat the sale or exchange of musical compositions or copyrights in musical works created by the taxpayer (or received by the taxpayer from the works' creator in a transferred basis transaction) as the sale or exchange of a capital asset. The temporary regulation reflects changes to the law made by the Tax Increase Prevention and Reconciliation Act of 2005 and the Tax Relief and Health Care Act of 2006. The temporary regulation affects taxpayers making the election under section 1221(b)(3) of the Internal Revenue Code (Code) to treat gain or loss from such a sale or exchange as capital gain or loss. The text of the temporary regulation also serves as the text of this proposed regulation.

DATES: Written or electronic comments and requests for a public hearing must be received by May 8, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–153589–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 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–153589–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C., or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–153589–06).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulation, Jamie Kim, (202) 622–4950; concerning submission of comments or requesting a hearing, *Richard.A.Hurst@irscounsel.treas.gov*, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulation in this issue of the Bulletin amends the Income Tax Regulations (26 CFR Part 1) relating to section 1221(b)(3) of the Internal Revenue Code (Code). The temporary regulation provides rules regarding the time and manner for making an election under section 1221(b)(3) to treat the sale or exchange of certain musical compositions or copyrights in musical works as the sale or exchange of a capital asset. The text of the temporary regulation also serves as the text of this proposed regulation. The preamble to the temporary regulation explains the amendments.

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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, 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 a Public Hearing

Before this proposed regulation is adopted as a final regulation, consideration will be given to any written comments (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 regulations is Jamie Kim of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated 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 continues to read in part as follows:

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

Par. 2. Section 1.1221–3 is added to read as follows:

§1.1221–3 Time and manner for electing capital asset treatment for certain self-created musical works.

[The text of proposed §1.1221–3 is the same as the text of §1.1221–3T(a) through (d)(1) published elsewhere in this issue of the Bulletin.]

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

(Filed by the Office of the Federal Register on February 7, 2008, 8:45 a.m., and published in the issue of the Federal Register for February 8, 2008, 73 F.R. 7503)

Issuance of Opinion and Advisory Letters and Opening of the EGTRRA Determination Letter Program for Pre-Approved Defined Contribution Plans

Announcement 2008–23

The Service will soon issue opinion and advisory letters for pre-approved (*i.e.*, master and prototype (M&P) and volume submitter (VS)) defined contribution plans that were timely filed with the Service to comply with the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107–16, ("EGTRRA") and other changes in plan qualification requirements listed in Notice 2004–84, 2004–2 C.B. 1030 ("the 2004 Cumulative List"). The Service expects to issue the letters on March 31, 2008, or, in some cases, as soon as possible thereafter. Employers using these pre-approved plan documents to restate a plan for EGTRRA will be required to adopt the EGTRRA-approved plan document by April 30, 2010. The Service will accept applications for individual determination letters submitted by adopters of these pre-approved plans starting on May 1, 2008. This announcement describes certain changes to the determination letter application procedures for pre-approved plans that will simplify the application process for many applicants, and it informs plan sponsors that revised application forms for these plans will be available in the near future.

Background

Rev. Proc. 2007–44, 2007–28, I.R.B. 54, and Rev. Proc. 2005–16, 2005–1 C.B. 674, describe a staggered remedial amendment system for plans that are qualified under § 401(a) of the Internal Revenue Code, with five-year amendment/approval cycles for individually designed plans and six-year cycles for pre-approved plans. The submission period for the initial cycle for pre-approved defined contribution plans was February 17, 2005, through January 31, 2006. Sponsors and practitioners were required to restate their pre-approved defined contribution plans for EGTRRA and the 2004 Cumulative List and apply for new opinion or advisory letters during this submission period.

Section 16.03 of Rev. Proc. 2007–44 provides that when the review of a cycle for pre-approved plans has neared completion, the Service will publish an announcement providing the date by which adopting employers must adopt the newly approved plans. This date is intended to give adopting employers a window of approximately two years in which to adopt the plans.

Procedures for filing determination letter applications are contained in Rev. Proc. 2008–6, 2008–1 I.R.B. 192. Section 6.05 of Rev. Proc. 2008–6 requires a determination letter application to include a copy of the plan's signed and dated timely good faith EGTRRA amendments, interim and other plan amendments. These documents are in addition to the restated plan or, in the case of M&P and certain VS plans, the completed adoption agreement.

In general, an application for an individual determination letter on a pre-approved plan is to be filed on Form 5307, Application for *Determination for Adopters of Master or Prototype or Volume Submitter Plans*. These applications will be reviewed on the basis of the Cumulative List of Changes in Plan Qualification Requirements that was used to review the underlying pre-approved plan, that is, the 2004 Cumulative List in the case of an application filed for the cycle that includes the pre-approved plan submission period that ended on January 31, 2006.

In certain circumstances, however, an application for an individual determination letter on a pre-approved plan is to be filed on Form 5300, *Application for Determination for Employee Benefit Plan*, rather than Form 5307. These circumstances include the following: (1) where the adopter of an M&P plan amends the basic plan document or adoption agreement, other than by choosing among options permitted under the plan or amending the plan in the manner described in sections 5.02 and 19.03 of Rev. Proc. 2005–16; (2) where the adopter of a VS plan makes changes to the pre-approved plan that are too extensive or complex or otherwise determined by the Service to be incompatible with the purposes of the volume submitter program; and (3) where the adopter of a pre-approved plan is requesting a determination regarding partial termination, affiliated service group status or leased employees, or where the pre-approved plan is a multiple employer VS plan.

Except as otherwise provided in this announcement, an application for an individual determination letter on a pre-approved plan that is filed on Form 5300 will be reviewed on the basis of the Cumulative List in effect when the application is filed. For example, a determination letter application filed on Form 5300 on May 1, 2008, will be reviewed on the basis of the 2007 Cumulative List (Notice 2007–94, 2007–51 I.R.B. 1179).

Deadline for Employer Adoption of EGTRRA-approved Defined Contribution M&P and VS Plans

An adopting employer whose plan is eligible for the six-year remedial amendment cycle under section 17 of Rev. Proc. 2007–44 and that adopts an EGTRRA-approved M&P or VS defined contribution plan by April 30, 2010, will have adopted the plan within the employer's six-year remedial amendment cycle.[1] The end of the plan's remedial amendment cycle with respect to EGTRRA and the changes in plan qualification requirements on the 2004 Cumulative List is April 30, 2010.

Individual Determination Letter Filing Procedures for Pre-approved Plans

The Service will accept applications for individual determination letters for EGTRRA-approved M&P and VS defined contribution plans starting May 1, 2008. The procedures for filing such applications are clarified and revised as follows:

- An application for a determination letter that is filed on Form 5307 generally need not include the plan's EGTRRA good faith amendments that were adopted prior to the adoption of the EGTRRA-restated plan or any interim plan amendments, regardless of when adopted, unless the plan is a VS

[1] Section 20 of Rev. Proc. 2007–44 provides that an opinion or advisory letter for a new pre-approved plan submitted for approval after the end of the submission period may not be relied on for the period prior to the date of submission.

plan that does not authorize the practitioner to amend the plan on behalf of the adopting employer. The Service may, however, request evidence of adoption of good faith and interim amendments during the course of its review of a particular plan. Applications filed on Form 5307 for VS plans that do not authorize the practitioner to amend the plan on behalf of the adopting employer must include the plan's EGTRRA good faith amendments and any interim amendments that were adopted for qualification changes on the 2004 Cumulative List.

- An application for a determination letter on a pre-approved plan that is required to file Form 5300 only because the plan is a multiple employer VS plan or because the employer is requesting a determination regarding partial termination, affiliated service group status or leased employees will be reviewed on the basis of the Cumulative List that was used to review the underlying pre-approved plan, that is, the 2004 Cumulative List, as if the application had been filed on Form 5307. The Service's review of the application will not consider changes in the qualification requirements subsequent to the 2004 Cumulative List. Except in the case of VS plans that do not authorize the practitioner to amend the plan on behalf of the adopting employer, an application described in this paragraph need not include the plan's EGTRRA good faith amendments that were adopted prior to the adoption of the EGTRRA-restated plan or any interim plan amendments, regardless of when adopted. The Service may, however, request evidence of adoption of good faith and interim amendments during the course of its review of a particular plan. An application for a VS plan that is described in this paragraph but which does not authorize the practitioner to amend on behalf of the adopting employer must include the plan's EGTRRA good faith amendments and any interim amendments that were adopted for qualification changes on the 2004 Cumulative List.

- An application for a determination letter on any other pre-approved plan that is required to file Form 5300 will be reviewed on the basis of the Cumulative List in effect on the date the application is filed. The application must include a copy of the plan's signed and dated timely good faith EGTRRA amendments, and interim and other plan amendments for all the changes in qualification requirements on the Cumulative List that is in effect when the application is filed. Applications described in this paragraph include (1) applications for determination letters on M&P plans that have been amended by the adopting employer in a manner other than to choose among options permitted under the plan or as described in sections 5.02 and 19.03 of Rev. Proc. 2005–16, and (2) applications for determination letters on VS plans that have been modified by the adopting employer in a manner that is too extensive or complex or otherwise determined by the Service to be incompatible with the purposes of the volume submitter program.

These changes will be published as modifications to Rev. Proc. 2008–6 when that revenue procedure is next revised. Until the modifications to the revenue procedures are published, plan sponsors may rely on this announcement regarding the changes.

Plan sponsors and their advisors are encouraged to review the frequently asked questions on the following web site: *http://www.irs.gov/retirement/article/0,,id=179990,00.html* for additional information regarding the issuance of opinion, advisory and determination letters for pre-approved plans and the documents that must be submitted with a determination letter application.

Revision of Form 5307

Form 5307 is being revised to allow the form to be optically scanned and thereby improve the Service's processing of determination letter applications filed with the form. It is expected that the revised form will be available soon. However, applications filed with the current form (revised 2001) will continue to be accepted through September 30, 2008.

Consolidated Returns; Intercompany Obligations

Announcement 2008–25

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of notice of proposed rulemaking.

SUMMARY: This document withdraws a portion of a notice of proposed rulemaking (REG–107592–00, 2007–44 I.R.B. 908) published in the **Federal Register** on September 28, 2007 (72 FR 55139). The withdrawn portion relates to the treatment of transactions involving the provision of insurance between members of a consolidated group.

FOR FURTHER INFORMATION CONTACT: Frances L. Kelly, (202) 622–7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On September 28, 2007, the IRS and the Treasury Department published a notice of proposed rulemaking (REG–107592–00) in the **Federal Register** (72 FR 55139) which proposed to amend §1.1502–13(g) (regarding the treatment of transactions involving obligations between members of a consolidated group) and to add §1.1502–13(e)(2)(ii)(C) (regarding the treatment of certain transactions involving the provision of insurance between members of a consolidated group).

Under proposed §1.1502–13(e)(2)(ii)(C), certain intercompany insurance transactions would be taken into account on a single entity basis. Written comments were received with respect to proposed §1.1502–13(e)(2)(ii)(C). After consideration of these comments, the IRS and the Treasury Department have decided to withdraw proposed §1.1502–13(e)(2)(ii)(C). However, the IRS and the Treasury Department continue to study whether revisions to the rules for intercompany transactions are necessary to clearly reflect the taxable income of consolidated groups.

* * * * *

Partial Withdrawal of a Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805 and 26 U.S.C. 1502, §1.1502–13(e)(2)(ii)(C) of the notice of proposed rulemaking (REG–107592–00) that was published in the **Federal Register** on September 28, 2007 (72 FR 55139) is withdrawn.

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

(Filed by the Office of the Federal Register on February 20, 2008, 8:48 a.m., and published in the issue of the Federal Register for February 25, 2008, 73 F.R. 9972)

Foundations Status of Certain Organizations

Announcement 2008–28

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Absolute Positive Influences, Fort Worth, TX
Academy Community Development Corporation, Greensboro, NC
Adams Clubhouse, Prescott Valley, AZ
Alternative Decisions Incorporation, Wynocote, PA
Bridges Ministry, Renton, WA
Carolina Assistance Programs, Inc., Greer, SC
Christopher House, Inc., Fancy Farm, KY
Coalition for Safe Community Needle Disposal, Inc., Houston, TX
Colonial Chapel Foundation at the American Village, Montevallo, AL
Dominion College, Cape Girardeau, MO
Door of Hope Recovery House for Women, Inc., Indianapolis, IN
Dorothy Below Lesher Scholarship Trust, Lansing, MI
Eco Mentors Alliance, Mahtomedi, MN
Eisner Research Associates, Inc., Encino, CA
Florence Indian Education Parent Committee, Florence, OR
Friends of Western Missouri Medical Foundation, Warrensburg, MS
Global Community Development, Inc., Birmingham, AL
Gratiot Residents East Area Together, Detroit, MI
Greater Zion Community Outreach Center, Inc., Baltimore, MD
Habitat for Education, Danville, CA
Here Too Help, Los Angeles, CA
Hosannas Horse Granger, Duluth, GA
Housing Counselors of Texas, Inc., Dallas, TX
Impact Housing Corporation, Mequon, WI
Ivory & Billie Crittendon Foundation, Tacoma, WA
James 2 Association, Arlington, VA
Knowledge Management Associates, Columbia, MO
Lambs Vision Christian Fellowship, Garden Grove, CA
Lindsay Educational Foundation, Lindsay, OK
Maandeeq Womans Organization, Inc., Oxford, GA
Manna Ministry, Inc., Centreville, MD
Metro Community Assistance, Inc., Dallas, GA
Mississippi Housing Opportunity Coalition, Inc., Collins, MS
Morning Glory Temple Shelter of Hope, Chicago, IL
Museum of Black-African American History and Learning Center, Lincoln, NE
Museum of Life or Death Incorporation, Irvington, NJ
Myers Community Tutoring Service, Inc., Cordova, TN
National Cave Museum, Park City, KY
New Horizons Educational Center, Inc., Philadelphia, PA
North Carolina Community Solutions Network, Durham, NC
Paws From the Ghetto, Inc., New York, NY
Phoenix Project, Inc., Nashville, TN
Prostate Cancer Project, North Miami, FL
Providence Childrens Home, Victorville, CA
Quest Depot, Inc., Goshen, AR
Rhodius Booster Club, Plainfield, IN
Scent-cerely Yours, Desert Hot Springs, CA
Seledorwon USA, Inc., Dorchester, MA
Share Care Prayer Mission, Gonzales, LA
Sherman Chamber Foundation, Inc., Sherman, TX
Silver Threads & Golden Needles, Inc., Lawrenceville, GA
Snell Development Group, San Leandro, CA
Society for the Prevention of Domestic Violence, Inc., New York, NY
Sonoma Mountain Institute, Petaluma, CA
Sonshine Financial Ministries, Inc., Odenton, MD
Spirit of a Child Foundation, Hayward, WI
State Committee on the Life and History of Black Georgians, Atlanta, GA
Turnage Transitional Home for Clean Living, Los Angeles, CA
Tyler Court Interfaith Housing Corporation, Lemon Grove, CA
Victoria House Corporation, San Diego, CA
VIP Care Services, Pomona, CA
Wheel Productions, Phoenix, AZ
Your New Beginnings, Inc., Aberdeen, MS

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

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.
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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2007–27 through 2007–52 is in Internal Revenue Bulletin 2007–52, dated December 26, 2007.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2007–27 through 2007–52 is in Internal Revenue Bulletin 2007–52, dated December 26, 2007.

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