

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

Ct. D. 2074, page 954.

Lookback period. The Supreme Court has concluded that under sections 6501, 6322, and 6323 of the Code, the lookback period is tolled during the pendency of a prior bankruptcy petition. **Young, et ux., v. United States.**

Rev. Rul. 2002-27, page 925.

Cafeteria plans. Cafeteria plans may use an automatic enrollment process whereby the employee's salary is reduced each year to pay for a portion of the group health coverage under the plan unless the employee affirmatively elects cash. In addition, employers may treat all participants as being in the cafeteria plan for section 415 purposes even though the plan mandates salary reduction and coverage for uninsured participants.

Rev. Rul. 2002-29, page 940.

LIFO; price indexes; department stores. The March 2002 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, March 31, 2002.

T.D. 8988, page 929.

REG-163892-01, page 968.

Temporary and proposed regulations under section 355(e) of the Code relate to the recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. These regulations provide guidance on whether an acquisition is part of a plan that includes the distribution. The proposed regulations withdraw REG-107566-00 (2001-1 C.B. 346).

T.D. 8989, page 920.

REG-107184-00, page 967.

Final, temporary, and proposed regulations are designed to eliminate regulatory impediments to the electronic filing of Form 1040, *U.S. Individual Income Tax Return*.

T.D. 8990, page 947.

Final regulations under section 1092 of the Code provide rules under which equity options with flexible terms and certain qualifying over-the-counter options may, under certain conditions, be eligible for qualified covered call treatment. This regulation also provides a maximum term limitation of 33 months for certain qualified covered calls.

Rev. Proc. 2002-32, page 959.

Waiver of 60-month bar on reconsolidation after disaffiliation. This procedure provides guidance to certain taxpayers in obtaining a waiver of the general rule of section 1504(a)(3)(A) of the Code barring a corporation from filing a consolidated return with a group of which it had ceased to be a member for 60 months following the year of disaffiliation. Rev. Proc. 91-71 clarified and superseded.

EMPLOYEE PLANS

Rev. Rul. 2002-27, page 925.

Cafeteria plans. Cafeteria plans may use an automatic enrollment process whereby the employee's salary is reduced each year to pay for a portion of the group health coverage under the plan unless the employee affirmatively elects cash. In addition, employers may treat all participants as being in the cafeteria plan for section 415 purposes even though the plan mandates salary reduction and coverage for uninsured participants.

(Continued on the next page)

Finding Lists begin on page ii.



Department of the Treasury
Internal Revenue Service

EXEMPT ORGANIZATIONS

Rev. Rul. 2002-28, page 941.

Private foundation transfer of assets; notification, filing, and other implications. This ruling addresses a private foundation's responsibilities relating to sections 507 and 4940 through 4945 of the Code and its tax return filing obligations in sections 6033 and 6043 when it transfers all of its assets to one or more effectively controlled private foundations.

ADMINISTRATIVE

Rev. Proc. 2002-33, page 963.

Additional first year depreciation. This procedure provides ways for taxpayers to claim the additional first year depreciation and other deductions for qualified property or qualified New York Liberty Zone (Liberty Zone) property that the taxpayers did not claim on their federal tax returns filed before June 1, 2002. This procedure also explains how taxpayers may elect not to deduct the additional first year depreciation for qualified property and Liberty Zone property. Rev. Proc. 2002-9 modified and amplified.

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

Section 48.—Energy Credit; Reforestation Credit

26 CFR 1.48–12: *Qualified rehabilitated building; expenditures incurred after December 31, 1981.*

T.D. 8989

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

Guidance Necessary to Facilitate Electronic Tax Administration

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations designed to eliminate regulatory impediments to the electronic filing of Form 1040, *U.S. Individual Income Tax Return*. These regulations generally affect taxpayers who file Form 1040 electronically and who are required to file any of the following forms: Form 56, *Notice Concerning Fiduciary Relationship*; Form 2120, *Multiple Support Declaration*; Form 2439, *Notice to Shareholder of Undistributed Long-Term Capital Gains*; Form 3468, *Investment Credit*; and Form T (Timber), *Forest Activities Schedules*. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in REG–107184–00 on page 968 of this issue of the Bulletin.

EFFECTIVE DATE: These regulations are effective April 24, 2002.

FOR FURTHER INFORMATION CONTACT: James C. Gibbons, (202) 622–4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1783. Responses to these collections of information are mandatory.

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

For further information concerning these collections of information, and where to submit comments on the collections of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin.

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

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) and the Procedure and Administration Regulations (26 CFR part 301) designed to eliminate regulatory impediments to the electronic filing of Form 1040.

In 1998, Congress enacted the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Public Law 105–206 (112 Stat. 685) (1998). Section 2001(a) of RRA 1998 states that the policy of Congress is that paperless filing should be the preferred and most convenient means of filing Federal tax returns. Section 2001(a) of RRA 1998 also sets a long-range goal for the IRS to

have at least 80 percent of all Federal tax returns filed electronically by 2007. Section 2001(b) of RRA 1998 requires the IRS to establish a 10-year strategic plan to eliminate barriers to electronic filing. To the extent practicable, this plan is to provide for electronic filing of electronically prepared returns for taxable years beginning after 2001.

The temporary regulations amend the Procedure and Administration Regulations to provide a regulatory statement of IRS authority to prescribe what return information or documentation must be filed with a return, statement or other document required to be made under any provision of the internal revenue laws or regulations. The regulations give the IRS maximum flexibility in prescribing (1) what needs to be filed in support of a return or claim, and (2) the form of the filing, *e.g.*, electronic versus paper. The regulations permit the IRS to prescribe required return information in forms, instructions, or other appropriate guidance.

In addition, the IRS identified five regulatory provisions that impede electronic filing by requiring the taxpayer to either include a third-party signature, or attach a document generated by a third party. The temporary regulations amend those provisions to eliminate the impediments.

Although the regulatory impediments to the electronic filing of Form 1040 are eliminated by the temporary regulations, the IRS may instruct a taxpayer who files Form 1040 on paper to attach a document that would not be required in the case of a Form 1040 filed electronically.

Explanation of Provisions

1. General Provision

Section 6001(a) of the Internal Revenue Code (Code) provides that every person liable for any tax, or for the collection thereof, will keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. The Secretary may require any person, by notice served upon such person or by regulations, to make

such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax.

Section 6011(a) of the Code provides that any person liable for any tax, or for the collection thereof, will make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms and regulations.

The temporary regulations amend the general provisions under § 301.6011-1 of the Procedure and Administration Regulations to provide a regulatory statement of the Secretary's authority to prescribe in forms, instructions, or other appropriate guidance what information or documentation must be filed with any return or statement required to be made or other document required to be furnished under any provision of the internal revenue laws or regulations. Under this authority, the IRS may change forms and instructions to eliminate nonstatutory impediments, such as third-party signature or document requirements, to the electronic filing of Form 1040.

2. FORM T (TIMBER): Forest Activities Schedules

Section 611 of the Code generally provides a reasonable allowance for depletion and for depreciation of improvements in computing taxable income from timber. See §§ 1.611-1(a) and 1.611-5(a) of the Income Tax Regulations. Section 1.611-3(h) provides that a taxpayer claiming a deduction for depletion of timber or for depreciation of plant and other improvements must attach to the taxpayer's income tax return a filled-out Form T for the taxable year covered by the income tax return. This section specifically provides that the information required by Form T will include a map, where necessary, to show clearly timber and land acquired, timber cut, and timber and land sold.

The attachment of a map to Form T is a regulatory impediment to the electronic filing of Form 1040 because it is a diagram not easily incorporated into an electronic return. It is also often generated by a third party. To enable the electronic filing of Form T, the temporary regulations

remove the requirement that a taxpayer attach a map to substantiate the claimed depletion and depreciation. Instead, the temporary regulations require the taxpayer to be prepared to furnish a map, where necessary, to substantiate any claimed depletion or depreciation.

3. FORM 56: Notice Concerning Fiduciary Relationship

Section 6903(b) of the Code requires a fiduciary to give notice of his or her qualification as a fiduciary to the IRS in accordance with regulations prescribed by the Secretary. Section 301.6903-1(b) of the Procedure and Administration Regulations provides that satisfactory evidence of the authority of the fiduciary to act for any other person in a fiduciary capacity must be filed with and made a part of the notice. Form 56, the notice concerning fiduciary relationship, requires a fiduciary to attach a certified copy of the document creating the fiduciary relationship. The attachment of evidence of fiduciary relationship is a regulatory impediment to the electronic filing of Form 56 because the evidence is a document generated by a third party.

To eliminate the barrier to electronic filing, Form 56 should be filed separately from Form 1040. Further, to enable the electronic filing of Form 56, the temporary regulations remove the requirement that the fiduciary attach the evidence of fiduciary relationship to Form 56. Instead, the temporary regulations require the fiduciary to be prepared to furnish the evidence to substantiate the fiduciary relationship.

4. FORM 2120: Multiple Support Declaration

Section 152(c) of the Code provides that a taxpayer will be treated as having contributed over half of the support of an individual for a calendar year if: (1) no one person contributed over half of the individual's support; (2) each person in the group that collectively contributed more than half of the support of the individual would have been entitled to claim the individual as a dependent but for the fact that the person did not contribute over half of the individual's support; (3) the taxpayer claiming the individual as a dependent contributed more than 10 per-

cent of the individual's support; and (4) every other person in the group who contributed more than 10 percent of the support files a written declaration that the person will not claim the individual as a dependent for any taxable year beginning in such calendar year. Section 1.152-3(a)(4) and (c) of the Income Tax Regulations requires that a taxpayer claiming an individual as a dependent attach to the taxpayer's income tax return a written declaration of waiver signed by the other persons described in section 152(c)(2). Form 2120 is used to make these waiver declarations.

Attaching the Form 2120 with third-party waiver declarations to Form 1040 is a regulatory impediment to the electronic filing of Form 1040 because third-party signatures are not easily incorporated into an electronic return. Therefore, the temporary regulations eliminate the requirement to attach the waiver declarations. Under the temporary regulations, a taxpayer claiming an individual as a dependent under a multiple support agreement is still required to obtain the waiver declarations but is no longer required to attach them to the taxpayer's income tax return. Instead, the temporary regulations require the taxpayer to attach a statement that (1) identifies the other persons described in section 152(c)(2) and (2) indicates that the taxpayer obtained waiver declarations from these persons. The temporary regulations will also require the taxpayer to retain the waiver declarations.

5. FORM 2439: Notice to Shareholder of Undistributed Long-Term Capital Gains

Under § 1.852-4(b)(2) of the Income Tax Regulations, a person who is a shareholder of a regulated investment company at the close of the company's taxable year must include undistributed capital gain in long-term capital gain. Section 1.852-9(a)(1) requires the regulated investment company to give its shareholders notice of a designation of undistributed capital gains. The regulations provide that mailed copies of Form 2439 (copies B and C) constitute appropriate notice to shareholders. Section 1.852-9(c) requires the shareholder to attach copy B of Form 2439 to the shareholder's return for the taxable year in which the undistributed capital gain is includible in gross income.

Attaching copy B of Form 2439 to the shareholder's income tax return prevents electronic filing of Form 1040 because copy B is a document generated by a third party. Therefore, the temporary regulations remove the requirement that the shareholder attach a copy of Form 2439 to Form 1040 but require that the shareholder retain a copy of Form 2439.

A shareholder who files Form 1040 electronically will supply information from the shareholder's copy of the Form 2439. However, a shareholder who files Form 1040 on paper will continue to attach a copy of Form 2439 to the shareholder's paper Form 1040 in accordance with Form 2439 instructions.

6. FORM 3468: Investment Credit

Section 47 of the Code generally provides a credit for rehabilitation expenditures incurred for a qualified rehabilitated building or a certified historic structure. Section 1.48-12(d)(7)(i) of the Income Tax Regulations provides that a taxpayer claiming the credit for rehabilitation of a certified historic structure must file Form 3468 with Form 1040. Form 3468 requires a copy of the final certification of completed work issued by the Secretary of the Interior. In addition, for returns filed after January 9, 1989, the taxpayer must submit evidence that the building is a certified historic structure. This status is evidenced by the final certification of completed work issued by the Secretary of the Interior. If the Secretary of the Interior has not issued a certification at the time the tax return is filed, § 1.48-12(d)(7)(ii) provides that the taxpayer must attach (1) a copy of the first page of the certification application, with an indication that it has been received by the Secretary of the Interior or designate, and (2) proof that the building is a certified historic structure (or that such status has been requested). In addition, the taxpayer is required to submit a copy of the certification as an attachment to Form 3468 accompanying the first income tax return filed after certification.

Attaching the certification impedes electronic filing of Form 3468 because it is a document generated by a third party. Therefore, the temporary regulations revise § 1.48-12(d)(7) to eliminate this requirement. For a return filed for a taxable year beginning after December 31,

2001, the taxpayer is required to provide on Form 3468 the NPS project number assigned by, and the date of the final certification of completed work received from, the Secretary of the Interior. For a taxpayer who has not received certification by the time the income tax return is filed for a year in which the credit is claimed, the current rules applicable to returns filed before receipt of the certification remain unchanged. However, the temporary regulations eliminate the requirement that the certification be attached to the first income tax return filed after its receipt. Instead, the taxpayer is required to provide the NPS project number assigned by, and the date of the final certification of completed work received from, the Secretary of the Interior on Form 3468 accompanying the first income tax return filed after certification.

Every taxpayer claiming the credit for rehabilitation of a certified historic structure must provide the required information on Form 3468 (or its successor) filed with the taxpayer's return and retain a copy of the certification. For a building owned by a pass-through entity (*i.e.*, a partnership, S corporation, estate, or trust), only the pass-through entity, not the partner, shareholder or beneficiary, must provide on Form 3468 the NPS project number assigned by, and the date of the final certification of completed work received from, the Secretary of the Interior. However, each partner, shareholder, or beneficiary claiming a credit for qualified rehabilitation expenditures from a pass-through entity must provide the employer identification number of that entity on Form 3468 (or its successor).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the persons responsible for

recordkeeping are principally individuals, and the burden is not significant as described earlier in the preamble. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Sara Paige Shepherd, Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. However, other personnel from the IRS and the Treasury Department participated in the development of the regulations.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. In § 1.48-12, paragraph (d)(7)(iii) is added to read as follows:

§ 1.48-12 *Qualified rehabilitated building; expenditures incurred after December 31, 1981.*

* * * * *

(d) * * *

(7) * * *

(iii) *Effective dates.* Paragraph (d)(7)(i) of this section applies to returns for taxable years beginning before January 1, 2002. The requirement in the fourth sentence of paragraph (d)(7)(ii) of this section applies only if the first income tax return filed after receipt by the taxpayer of the certification is for a taxable year beginning before January 1, 2002. For rules applicable to returns for taxable years beginning after December 31, 2001, see § 1.48-12T(d)(7)(iii).

Par. 3. Section 1.48-12T is revised to read as follows:

§ 1.48-12T *Qualified rehabilitated building; expenditures incurred after December 31, 1981 (temporary).*

(a) through (d)(7)(ii) [Reserved] For further guidance, see § 1.48-12(a) through (d)(7)(ii).

(iii) *Returns for taxable years beginning after December 31, 2001—(A) In general.* Except as otherwise provided in § 1.48-12(d)(7)(ii) and this paragraph (d)(7)(iii), a taxpayer claiming the credit for rehabilitation of a certified historic structure (within the meaning of section 47(c)(3) and § 1.48-12(d)(1)) for a taxable year beginning after December 31, 2001, must provide with the return for the taxable year in which the credit is claimed, the NPS project number assigned by, and the date of the final certification of completed work received from, the Secretary of the Interior. If a credit (including a credit for a taxable year beginning before January 1, 2002) is claimed under the late certification procedures of § 1.48-12(d)(7)(ii) and the first income tax return filed by the taxpayer after receipt of the certification is for a taxable year beginning after December 31, 2001, the taxpayer must provide the NPS project number assigned by, and the date of the final certification of completed work received from, the Secretary of the Interior with that return.

(B) *Reporting and recordkeeping requirements.* The information required under paragraph (d)(7)(iii)(A) of this section must be provided on Form 3468 (or its successor) filed with the taxpayer's return. In addition, the taxpayer must retain a copy of the final certification of completed work for as long as its contents may become material in the administration of any internal revenue law.

(C) *Passthrough entities.* In the case of a credit for qualified rehabilitation expenditures of a partnership, S corporation, estate, or trust, the requirements of this paragraph (d)(7)(iii) apply only to the entity. Each partner, shareholder or beneficiary claiming a credit for such qualified rehabilitation expenditures from a passthrough entity must, however, provide the employer identification number of the entity on Form 3468 (or its successor).

(D) *Effective dates.* This paragraph (d)(7)(iii) applies to returns and records for taxable years beginning after Decem-

ber 31, 2001. For rules applicable to returns and records for taxable years beginning before January 1, 2002, see § 1.48-12(d)(7)(i) and the fourth sentence of § 1.48-12(d)(7)(ii).

(e) through (f)(3) [Reserved] For further guidance, see § 1.48-12(e) through (f)(3).

§ 1.152-3 [Amended]

Par. 4. In § 1.152-3, paragraph (c) is removed and reserved.

Par. 5. Section 1.152-3T is added to read as follows:

§ 1.152-3T *Multiple support agreements (temporary).*

(a) through (b) [Reserved] For further guidance, see § 1.152-3(a) and (b).

(c) (1) The member of a group of contributors who claims an individual as a dependent for a taxable year beginning before January 1, 2002, under the multiple support agreement provisions of section 152(c) must attach to the member's income tax return for the year of the deduction a written declaration from each of the other persons who contributed more than 10 percent of the support of such individual and who, but for the failure to contribute more than half of the support of the individual, would have been entitled to claim the individual as a dependent.

(2) The taxpayer claiming an individual as a dependent for a taxable year beginning after December 31, 2001, under the multiple support agreement provisions of section 152(c) must provide with the income tax return for the year of the deduction—

(i) A statement identifying each of the other persons who contributed more than 10 percent of the support of the individual and who, but for the failure to contribute more than half of the support of the individual, would have been entitled to claim the individual as a dependent; and

(ii) A statement indicating that the taxpayer obtained a written declaration from each of the persons described in section 152(c)(2) waiving the right to claim the individual as a dependent.

(3) The taxpayer claiming the individual as a dependent for a taxable year beginning after December 31, 2001, must retain the waiver declarations and should

be prepared to furnish the waiver declarations and any other information necessary to substantiate the claim of the taxpayer. Other information that will substantiate the dependency claim of the taxpayer may include a statement showing the names of all contributors (whether or not members of the group described in section 152(c)(2)) and the amount contributed by each to the support of the claimed dependent.

§ 1.611-3 [Amended]

Par. 6. In § 1.611-3, paragraph (h) is removed and reserved.

Par. 7. Section 1.611-3T is added to read as follows:

§ 1.611-3T *Rules applicable to timber (temporary).*

(a) through (g) [Reserved] For further guidance, see § 1.611-3(a) through (g).

(h) *Reporting and recordkeeping requirements—(1) Taxable years beginning before January 1, 2002.* A taxpayer claiming a deduction for depletion of timber for a taxable year beginning before January 1, 2002, shall attach to the income tax return of the taxpayer a filled-out Form T (Timber) for the taxable year covered by the income tax return, including the following information—

(i) A map where necessary to show clearly timber and land acquired, timber cut, and timber and land sold;

(ii) Description of, cost of, and terms of purchase of timberland or timber, or cutting rights, including timber or timber rights acquired under any type of contract;

(iii) Profit or loss from sale of land, or timber, or both;

(iv) Description of timber with respect to which claim for loss, if any, is made;

(v) Record of timber cut;

(vi) Changes in each timber account as a result of purchase, sale, cutting, reestimate, or loss;

(vii) Changes in improvements accounts as the result of additions to or deductions from capital and depreciation, and computation of profit or loss on sale or other disposition of such improvements;

(viii) Operation data with respect to raw and finished material handled and inventoried;

(ix) Statement as to application of the election under section 631(a) and pertinent information in support of the fair market value claimed thereunder;

(x) Information with respect to land ownership and capital investment in timberland; and

(xi) Any other data which will be helpful in determining the reasonableness of the depletion or depreciation deductions claimed in the return.

(2) *Taxable years beginning after December 31, 2001.* A taxpayer claiming a deduction for depletion of timber on a return filed for a taxable year beginning after December 31, 2001, shall attach to the income tax return of the taxpayer a filled-out Form T (Timber) for the taxable year covered by the income tax return. In addition, the taxpayer must retain records sufficient to substantiate the right of the taxpayer to claim the deduction, including a map, where necessary, to show clearly timber and land acquired, timber cut, and timber and land sold for as long as their contents may become material in the administration of any internal revenue law.

§ 1.852-9 [Amended]

Par. 8. In § 1.852-9, paragraph (c)(1) is removed and reserved.

Par. 9. Section 1.852-9T is added to read as follows:

§ 1.852-9T Special procedural requirements applicable to designation under section 852(b)(3)(D) (temporary).

(a) through (b)(3) [Reserved] For further guidance, see § 1.852-9(a) through (b)(3).

(c) *Shareholders*—(1)(i) *Return requirements for taxable years beginning before January 1, 2002.* For taxable years beginning before January 1, 2002, the copy B of Form 2439 furnished to a shareholder by the regulated investment company or by a nominee, as provided in § 1.852-9(a) or (b) shall be attached to the income tax return of the shareholder for the taxable year in which the amount of undistributed capital gains is includible in gross income as provided in § 1.852-4(b)(2).

(ii) *Recordkeeping requirements for taxable years beginning after December 31, 2001.* For taxable years beginning after December 31, 2001, the shareholder

shall retain a copy of Form 2439 for as long as its contents may become material in the administration of any internal revenue law.

(c)(2) through (d) [Reserved] For further guidance, see § 1.852-9(c)(2) through (d).

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PART 301—PROCEDURE AND ADMINISTRATION

Par. 10. The authority citation for part 301 continues to read as follows:

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

§ 301.6011-1 [Removed]

Par. 11. Section 301.6011-1 is removed.

Par. 12. Section 301.6011-1T is added to read as follows:

§ 301.6011-1T General requirement of return, statement or list (temporary).

(a) For provisions requiring returns, statements, or lists, see the regulations relating to the particular tax.

(b) The Secretary may prescribe in forms, instructions, or other appropriate guidance the information or documentation required to be included with any return or any statement required to be made or other document required to be furnished under any provision of the internal revenue laws or regulations.

§ 301.6903-1 [Amended]

Par. 13. In § 301.6903-1, paragraph (b) is removed and reserved.

Par. 14. Section 301.6903-1T is added to read as follows:

§ 301.6903-1T Notice of fiduciary (temporary).

(a) [Reserved] For further guidance, see § 301.6903-1(a).

(b) *Manner of notice*—(1) *Notices filed before April 24, 2002.* This paragraph (b)(1) applies to notices filed before April 24, 2002. The notice shall be signed by the fiduciary, and shall be filed with the Internal Revenue Service office where the return of the person for whom the fiduciary is acting is required to be filed. The notice must state the name and address of the person for whom the fiduciary is acting, and the nature of the

liability of such person; that is, whether it is a liability for tax, and, if so, the type of tax, the year or years involved, or a liability at law or in equity of a transferee of property of a taxpayer, or a liability of a fiduciary under section 3467 of the Revised Statutes, as amended (31 U.S.C. 192) in respect of the payment of any tax from the estate of the taxpayer. Satisfactory evidence of the authority of the fiduciary to act for any other person in a fiduciary capacity must be filed with and made a part of the notice. If the fiduciary capacity exists by order of court, a certified copy of the order may be regarded as satisfactory evidence. When the fiduciary capacity has terminated, the fiduciary, in order to be relieved of any further duty or liability as such, must file with the Internal Revenue Service office with whom the notice of fiduciary relationship was filed written notice that the fiduciary capacity has terminated as to him, accompanied by satisfactory evidence of the termination of the fiduciary capacity. The notice of termination should state the name and address of the person, if any, who has been substituted as fiduciary. Any written notice disclosing a fiduciary relationship which has been filed with the Commissioner under the Internal Revenue Code of 1939 or any prior revenue law shall be considered as sufficient notice within the meaning of section 6903. Any satisfactory evidence of the authority of the fiduciary to act for another person already filed with the Commissioner or district director need not be resubmitted.

(2) *Notices filed on or after April 24, 2002.* This paragraph (b)(2) applies to notices filed on or after April 24, 2002. The notice shall be signed by the fiduciary, and shall be filed with the Internal Revenue Service Center where the return of the person for whom the fiduciary is acting is required to be filed. The notice must state the name and address of the person for whom the fiduciary is acting, and the nature of the liability of such person; that is, whether it is a liability for tax, and if so, the type of tax, the year or years involved, or a liability at law or in equity of a transferee of property of a taxpayer, or a liability of a fiduciary under 31 U.S.C. 3713(b), in respect of the payment of any tax from the estate of the

taxpayer. The fiduciary must retain satisfactory evidence of his or her authority to act for any other person in a fiduciary capacity as long as the evidence may become material in the administration of any internal revenue law.

(c) through (e) [Reserved] For further guidance, see § 301.6903-1(c) through (e).

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 15. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 16. In § 602.101, paragraph (b) is amended by adding the following entries in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.48-12T	1545-0155 1545-1783
* * * * *	
1.152-3T	1545-0071 1545-1783
* * * * *	
1.611-3T	1545-0007 1545-0099 1545-1784
* * * * *	
1.852-9T	1545-0074 1545-0123 1545-0144 1545-0145 1545-1783
* * * * *	
301.6903-1T	1545-0013 1545-1783
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved March 22, 2002.

Mark Weinberger,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on April 23, 2002, 8:45 a.m., and published in the issue of the Federal Register for April 24, 2002, 67 F.R. 20028)

Section 56.—Adjustments in Computing Alternative Minimum Taxable Income

In determining the alternative minimum taxable income, is there an adjustment under § 56 of the Internal Revenue Code for the additional first year depreciation deduction, and the depreciation deduction otherwise allowable, for qualified property or qualified New York Liberty Zone property? See Rev. Proc. 2002-33, page 963.

Section 125.— Cafeteria Plans

(Also § 106, § 415.)

Cafeteria plans. Cafeteria plans may use an automatic enrollment process

whereby the employee's salary is reduced each year to pay for a portion of the group health coverage under the plan unless the employee affirmatively elects cash. In addition, employers may treat all participants as being in the cafeteria plan for section 415 purposes even though the plan mandates salary reduction and coverage for uninsured participants.

Rev. Rul. 2002-27

ISSUES

(1) Whether employer contributions used to purchase group health coverage under § 125 of the Internal Revenue Code are included in the gross income of the employee solely because the plan uses an automatic enrollment process whereby

the employee's salary is reduced each year to pay for a portion of the coverage unless the employee affirmatively elects to receive the amount in cash.

(2) Whether an employer can treat contributions used to purchase group health coverage as compensation for purposes of § 415(c)(3) when the employee does not have the opportunity to elect cash in lieu of such contributions under a § 125 arrangement because the employee is not able to certify that he or she has other health coverage.

FACTS

Situation (1). Employer M maintains a calendar year cafeteria plan ("Plan"). The Plan offers group health insurance indemnity coverage with the option for employee-only or family coverage. The Plan is in writing and is available to all employees immediately upon hire.

The Plan provides for an automatic enrollment process. Under this Plan feature, each new employee (and each current employee for the first plan year the automatic enrollment process is effective) is automatically enrolled in employee-only indemnity coverage, with the employee's salary reduced pre-tax to pay for a portion of the cost of the coverage, unless the employee affirmatively elects cash. Alternatively, if the employee has a spouse or child, he or she can elect family coverage.

At the time an employee is hired, the employee receives a notice explaining the automatic enrollment process and the employee's right to decline coverage and have no salary reduction. The notice includes the salary reduction amounts for employee-only coverage and family coverage, procedures for exercising the right to decline coverage, information on the time by which an election must be made, and the period for which an election will be effective. The notice is also given to each current employee before the beginning of each subsequent plan year, except that the notice for a current employee includes a description of the employee's existing coverage, if any.

For a new hire, an election to receive cash or to have family coverage rather than employee-only coverage is effective if made when the employee is hired or within a reasonable period ending before the compensation for the first pay period

is currently available. For a current employee, an election is effective if made prior to the start of each calendar year or under any other circumstances permitted under § 1.125-4 of the Income Tax Regulations. An election made for any prior year carries over to the next succeeding plan year unless changed.

Situation (2). Employer N also maintains a plan ("Plan") that offers group health insurance indemnity coverage which includes employee-only and family coverage options and has an automatic enrollment process. The automatic enrollment process is the same as that described in Situation (1), except that, under N's automatic enrollment process a new employee (and each current employee for the first calendar plan year the automatic enrollment process is effective) can affirmatively elect to receive cash, either at hire or during the annual election period under the Plan, only if the employee certifies that he or she has other health coverage. Employer N does not otherwise request or collect from employees information regarding other health coverage as part of the enrollment process. The Plan procedures relating to notice to employees and elections under this Plan are otherwise the same as those under the Plan sponsored by Employer M.

LAW AND ANALYSIS

Sections 106 and 125

In general, § 106(a) provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 125(a) states that no amount will be included in the gross income of a participant in a cafeteria plan solely because, under the plan, the participant may choose among the benefits of the plan. Section 125(d) defines a cafeteria plan as a written plan under which all participants are employees and the participants may choose among two or more benefits consisting of cash and qualified benefits.

Section 125(f) defines qualified benefits as any benefit not includible in the gross income of the employee by reason of an express provision of Chapter 1 of the Code other than certain specified benefits that are not qualified benefits. Quali-

fied benefits include employer-provided accident or health coverage under § 106(a).

Section 125 applies if the employee can choose between cash and qualified benefits. However, § 125 permits an employee's choice to be either in the form of an affirmative election to receive qualified benefits in lieu of cash or an affirmative election to receive cash in lieu of qualified benefits. Under Employer M's automatic enrollment process as described in Situation (1), an employee's salary is reduced pursuant to a procedure under which the employee receives a notice explaining his or her right to have group health coverage through salary reduction or to decline such coverage and receive the cash instead. After receiving the notice, the employee has an opportunity to choose between cash and a qualified benefit. Therefore, the Plan's automatic enrollment process is subject to the requirements of § 125.

The same conclusions apply to Situation (2) to the extent that an employee can elect cash. However, under Employer N's automatic enrollment process as described in Situation (2), an employee who does not have other health coverage is not given a choice between cash and a qualified benefit with respect to the employee-only option under the indemnity coverage. Rather, if the employee cannot certify that he or she has other health coverage, the pre-tax salary reduction is mandatory and the employee is automatically enrolled in the employee-only indemnity coverage. With respect to these employees, because there is no ability to elect cash instead of employee-only coverage, § 125 is not applicable to the employee-only coverage. (§ 125 is applicable, however, to these employees' elections to take family coverage instead of employee-only coverage).

Section 415

Section 415 imposes limitations on contributions and benefits under qualified retirement plans. Some of the limitations under § 415 that may apply to contributions or benefits provided on behalf of a participant are based on the participant's compensation, within the meaning of § 415(c)(3). The definition of compensation under § 415(c)(3) is also used for

purposes of a number of other plan qualification requirements (*see* § 414(s)(1)). Section 415(c)(3)(D)(ii) provides that an employee's compensation under § 415(c)(3) includes any amount that is contributed by the employer at the election of the employee and that is not includible in the gross income of the employee by reason of § 125. Section 415(c)(3)(D) is effective for years beginning after December 31, 1997.

Section 1.415-2(d) provides rules regarding acceptable definitions of compensation under § 415(c)(3). Under § 1.415-2(d)(3)(iv), amounts that receive special tax benefits, such as premiums for group-term life insurance (to the extent the premiums are not includible in gross income of the employee) are not included in compensation for purposes of § 415(c)(3). Thus, pursuant to § 1.415-2(d)(3)(iv), premiums for group health coverage are not treated as compensation for purposes of § 415(c)(3), except for amounts that are contributed by the employer at the election of the employee and that are not includible in the gross income of the employee by reason of § 125.

Section 415(j) directs the Secretary to prescribe such regulations as may be necessary to carry out the purposes of § 415. Section 1.415-2(d)(13) provides that the Commissioner may, in revenue rulings, notices, and other guidance of general applicability, provide additional definitions of compensation that are treated as satisfying § 415(c)(3).

Pursuant to § 1.415-2(d)(13), this revenue ruling provides that a definition of compensation does not fail to satisfy the requirements of § 415(c)(3) and § 1.415-2(d) merely because the definition provides that amounts that are not available to an employee in cash in lieu of group health coverage because the employee is not able to certify that he or she has other health coverage are treated as subject to

§ 125. Under this definition, amounts are permitted to be treated as subject to § 125 only if the employer does not otherwise request or collect information regarding the employee's other health coverage as part of the enrollment process for the health plan.

An employer may apply this rule for any plan year or limitation year beginning after December 31, 1997.

Section 401(b) and the regulations thereunder provide a remedial amendment period during which an amendment to a disqualifying provision may be made retroactively effective, under certain circumstances, to comply with the requirements of § 401(a). Section 1.401(b)-1(b) provides that a disqualifying provision includes an amendment to an existing plan that causes the plan to fail to satisfy the requirements of § 401(a). Notice 2001-42 (2001-30 I.R.B. 70) provides a remedial amendment period under Code § 401(b) ending not prior to the last day of the first plan year beginning on or after January 1, 2005, in which any needed retroactive amendment with regard to the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16, (EGTRRA), may be adopted. The availability of this remedial amendment period is conditioned on the adoption of a good faith EGTRRA plan amendment no later than the later of: (i) the end of the plan year in which the EGTRRA change in the qualification requirement is required to be, or is optionally, put into effect under the plan; or (ii) the end of the GUST¹ remedial amendment period for the plan.

HOLDINGS

(1) Under Situation (1), contributions used to purchase group health coverage under § 125 are not included in the gross income of the employee solely because the plan uses an automatic enrollment process whereby the employee's salary is reduced each year to pay for a portion of

the group health coverage under the plan unless the employee affirmatively elects cash.

Under Situation (2), contributions used to purchase group health coverage under § 125 are not included in the gross income of the employee to the extent that an employee can elect cash. Section 125 does not apply to the employee-only coverage of an employee in Situation (2) who cannot certify that he or she has other health coverage and, therefore, does not have the ability to elect cash in lieu of health coverage. The lack of a choice between cash and a qualified benefit for these employees has no effect on whether the Plan satisfies the requirements for the exclusion from gross income of accident or health coverage under § 106(a).

(2) In determining compensation of employees for purposes of § 415(c)(3) under Holding (1), Situation (2) above, the employer can choose to treat "deemed § 125 compensation" as subject to § 125. For this purpose, "deemed § 125 compensation" is an excludable amount that is not available to an employee in cash in lieu of group health coverage under a § 125 arrangement because that employee is not able to certify that he or she has other health coverage. Under this definition, an amount is permitted to be treated as "deemed § 125 compensation" only if the employer does not otherwise request or collect information regarding the employee's other health coverage as part of the enrollment process for the health plan.

Pursuant to § 1.415-2(d)(13), a definition of compensation that otherwise satisfies § 415(c)(3) will not fail to satisfy § 415(c)(3) merely because it is amended to incorporate deemed § 125 compensation, as provided in this revenue ruling. A definition of compensation under § 415(c)(3) as amended to incorporate deemed § 125 compensation may also be used for purposes of other plan qualifica-

¹The term "GUST" refers to the following:

- The Uruguay Round Agreements Act, Pub. L. 103-465;
- The Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103-353;
- The Small Business Job Protection Act of 1996, Pub. L. 104-188;
- The Taxpayer Relief Act of 1997, Pub. L. 105-34;
- The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206; and
- The Community Renewal Tax Relief Act of 2000, Pub. L. 106-554.

Unless § 19 of Rev. Proc. 2002-20, 2000-6 I.R.B. 553, as modified by Notice 2001-42 and Rev. Proc. 2001-55, 2001-55 I.R.B. 552, applies, the GUST remedial amendment period generally ended on February 28, 2002.

tion requirements (e.g., § 414(s)). To the extent that a definition of compensation incorporates deemed § 125 compensation, it must apply uniformly to all employees with respect to whom amounts subject to § 125 are included in compensation.

This additional definition of compensation under § 415(c)(3) may be used in any plan year or limitation year beginning after December 31, 1997.

Retroactive Application—Pursuant to § 7805(b), for plan years beginning after December 31, 1997, and prior to January 1, 2002, the Service will not treat a qualified plan as having failed to satisfy the requirements of § 401(a) merely because the plan treated “deemed § 125 compensation” as compensation for purposes of § 415(c)(3), provided the plan is amended to provide the definition of “deemed § 125 compensation” on or before the end of the 2002 plan year and the amendment is effective for all years the plan operated in accordance with this definition.

Prospective Application. A plan that has not in operation been including “deemed §125 compensation” for purposes of § 415(c)(3) for plan or limitation years beginning before January 1, 2002, may not be amended retroactively, but must be amended for years beginning on or after January 1, 2002, in order for such amounts to be treated as § 415(c)(3) compensation in such years. Such amendment must be adopted no later than the end of the plan year in which it is effective.

Any plan amendment adopted in a timely manner pursuant to this revenue ruling will, if it results in a disqualifying provision, have the same remedial amendment period as the EGTRRA remedial amendment period. See Notice 2001–42. The Appendix provides a model plan amendment that a plan sponsor, or a sponsor of a pre-approved plan, may adopt to use the alternative definition of compensation. Adoption of the model amendment will not result in a disqualifying provision.

EFFECT ON OTHER REVENUE RULINGS

None

DRAFTING INFORMATION

The principal authors of this Revenue Ruling are Felix Zech of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) and Andrew Zuckerman of Employee Plans (Tax Exempt and Government Entities Division). For further information regarding this Revenue Ruling, please contact the Employee Plans’ taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Mr. Zech may be reached at 1–202–622–6080 and Mr. Zuckerman may be reached at 1–202–283–9655 (not toll-free numbers).

APPENDIX — MODEL AMENDMENT

The following is a model amendment that a sponsor of a qualified plan may choose to adopt if the sponsor maintains a health program in conjunction with a § 125 arrangement but permits an employee to elect cash in lieu of group health coverage only if the employee is able to certify that he or she has other health coverage. The use of this amendment will generally also apply to the definition of compensation for purposes of Code § 414(s) unless the plan otherwise specifically excludes all amounts described in § 414(s)(2).

A pre-approved plan (that is, a master or prototype or volume submitter plan) may be amended by the document’s sponsor to use the alternative definition of compensation to the extent authorized. Alternatively, adopting employers may adopt a plan amendment as an addendum to the plan or adoption agreement. The inclusion of the model plan amendment below in an addendum to a plan adopted to comply with EGTRRA will not cause a pre-approved plan to be treated as an individually designed plan. A plan sponsor that adopts the model amendment verbatim (or with only minor changes) will have reliance that the form of its plan satisfies the requirements of this revenue ruling, and the adoption of such an amendment will not adversely affect the plan sponsor’s or the adopting employer’s reliance on a favorable determination, opinion or advisory letter.

1. Effective date. This section _____ shall apply to plan years and limitation years beginning on and after [insert the later of January 1, 1998, or the first day of the first plan year the plan was operated in accordance with the definition in this section.]

2. For purposes of the definition of compensation under section(s) _____, amounts under § 125 include any amounts not available to a participant in cash in lieu of group health coverage because the participant is unable to certify that he or she has other health coverage. An amount will be treated as an amount under § 125 only if the Employer does not request or collect information regarding the participant’s other health coverage as part of the enrollment process for the health plan. [Insert in the blank section references for the plan’s provisions that refer to amounts under § 125.]

Section 168.—Accelerated Cost Recovery System

How does a taxpayer elect not to deduct the additional first year depreciation provided by § 168(k) of the Internal Revenue Code for qualified property and what is the applicable depreciation method and recovery period for qualified New York Liberty Zone leasehold improvement property for purposes of § 168(a) or § 168(g)? See Rev. Proc. 2002-33, page 963.

Section 179.—Election to Expense Certain Depreciable Business Assets

What is the limitation under § 179(b)(1) of the Internal Revenue Code for § 179 property that is qualified New York Liberty Zone property? See Rev. Proc. 2002-33, page 963.

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355-7T: Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

T.D. 8988

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Guidance Under Section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities in Connection With an Acquisition.

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. Changes to the applicable law were made by the Taxpayer Relief Act of 1997. These temporary regulations affect corporations and are necessary to provide them

with guidance needed to comply with these changes. The text of these temporary regulations also serves as the text of the proposed regulations (REG-163892-01) set forth in this issue of the Bulletin.

DATES: Effective Date: These temporary regulations are effective April 26, 2002.

Applicability Date: These temporary regulations apply to distributions occurring after April 26, 2002. For rules applicable to distributions occurring after August 3, 2001, and on or before April 26, 2002, see § 1.355-7T as in effect prior to April 26, 2002 (see 26 CFR part 1 revised April 1, 2002). Taxpayers, however, may apply these regulations in whole, but not in part, to a distribution occurring on or before April 26, 2002.

FOR FURTHER INFORMATION CONTACT: Amber R. Cook of the Office of Associate Chief Counsel (Corporate), (202) 622-7530 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 355(e) of the Internal Revenue Code of 1986 provides that the stock of a controlled corporation will not be qualified property under section 355(c)(2) or 361(c)(2) if the stock is distributed as “part of a plan (or series of related transactions) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation.” For this purpose, a 50-percent or greater interest means stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock. See I.R.C. § 355(e)(4)(A) (referring to section 355(d)(4) for the definition of 50-percent or greater interest).

On January 2, 2001, the IRS and Treasury published in the **Federal Register** (REG-107566-00, 2001-1 C.B. 346 [66 F.R. 66]) a notice of proposed rulemaking (the 2001 proposed regulations) under section 355(e). The 2001 proposed regulations provide guidance concerning the interpretation of the phrase “plan (or series of related transactions).” The 2001

proposed regulations generally provide that whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances. The 2001 proposed regulations list a number of factors that tend to show that an acquisition and a distribution are part of a plan and a number of factors that tend to show that an acquisition and a distribution are not part of a plan. In addition, they set forth six safe harbors, the satisfaction of which confirms that a distribution and an acquisition are not part of a plan.

A public hearing regarding the 2001 proposed regulations was held on May 15, 2001. In addition, written comments were received. In response to comments that immediate guidance under section 355(e) was needed, on August 3, 2001, the IRS and Treasury published in the **Federal Register** (T.D. 8960, 2001-34 I.R.B. 176 [66 F.R. 40590]) the 2001 proposed regulations as temporary regulations (the original temporary regulations). The original temporary regulations were identical to the 2001 proposed regulations, except that, pending further study of the comments received regarding the 2001 proposed regulations, they reserved § 1.355-7(e)(6) (suspending the running of any time period prescribed in the 2001 proposed regulations during which there is a substantial diminution of risk of loss under the principles of section 355(d)(6)(B)) and *Example 7* of the 2001 proposed regulations (interpreting the term *similar acquisition* in the context of a situation involving multiple acquisitions).

Explanation of Provisions

The IRS and Treasury have studied the comments received regarding the 2001 proposed regulations and have concluded that it is desirable to revise various aspects of the original temporary regulations. Accordingly, the IRS and Treasury are promulgating these regulations (the revised temporary regulations) as temporary to amend the original temporary regulations. The following sections describe a number of the most significant comments and the extent to which they have been incorporated in the revised temporary regulations. Further changes to

the revised temporary regulations, however, are possible before these regulations are finalized.

A. Facts and Circumstances Generally

The 2001 proposed regulations identify a number of facts and circumstances that tend to show whether a distribution and an acquisition are part of a plan. While some of those facts and circumstances relating to a post-distribution acquisition focus on discussions before the distribution between the acquired corporation and the acquirer regarding the acquisition or a similar acquisition, others are unrelated to whether there were such discussions before the distribution. A number of comments suggested that the relevant facts and circumstances that evidence whether a distribution and a post-distribution acquisition are part of a plan for purposes of section 355(e) generally should focus more heavily on whether there were bilateral discussions or even an agreement, understanding, or arrangement regarding the acquisition within a certain period of time prior to the distribution.

The IRS and Treasury agree with these comments and, accordingly, have revised the 2001 proposed regulations to reflect this emphasis. In particular, the revised temporary regulations provide that, other than in the case of an acquisition involving a public offering, a distribution and a post-distribution acquisition can be part of a plan only if there was an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition at some time during the 2-year period ending on the date of the distribution. In addition, the list of facts and circumstances in the revised temporary regulations that tend to show that a distribution and an acquisition are part of a plan has been revised to reflect this change in emphasis.

B. Special Rules Relating to Auctions

As set forth in the 2001 proposed regulations, the facts and circumstances tending to show whether a distribution and an acquisition are part of a plan distinguish between acquisitions other than acquisitions involving a public offering or auction, on the one hand, and acquisitions involving a public offering or auction, on

the other hand. For example, while the distributing or controlled corporation's discussions with an acquirer regarding a post-distribution acquisition involving a public offering or auction are not listed as evidence that the distribution and the acquisition are part of a plan, the distributing or controlled corporation's discussions with an acquirer regarding a post-distribution acquisition not involving a public offering or auction tend to show that the distribution and the acquisition are part of a plan.

One commentator suggested that the facts that tend to indicate that a distribution and an acquisition are part of a plan should not distinguish between an acquisition (other than an acquisition involving a public offering) that results from an auction and an acquisition (other than an acquisition involving a public offering) that does not result from an auction. In particular, the commentator asserted that although the factors might be weighted differently depending on the particular type of acquisition, in the context of both of these types of acquisitions, discussions with the acquirer regarding the acquisition are relevant to the determination of whether a distribution and an acquisition are part of a plan.

The IRS and Treasury believe that it is difficult to define an auction in a manner that identifies those situations to which it is appropriate to apply the special auction rules contained in the 2001 proposed regulations. For this reason, the revised temporary regulations eliminate the distinction between acquisitions (other than acquisitions involving a public offering) that result from an auction and acquisitions (other than acquisitions involving a public offering) that do not result from an auction. Accordingly, those facts and circumstances related to negotiations with the acquirer that evidence whether a post-distribution acquisition (other than an acquisition involving a public offering) that does not result from an auction is part of a plan are relevant to whether a post-distribution acquisition that results from an auction is part of a plan.

C. Similar Acquisition

As described above, the 2001 proposed regulations identify a number of facts and circumstances that are relevant for purposes of determining whether a

distribution and an acquisition are part of a plan. In the case of an acquisition after a distribution, certain factors focus on whether certain persons engaged in discussions regarding the acquisition or a "similar acquisition" before the distribution. The 2001 proposed regulations provide that an acquisition and an intended acquisition may be similar even though the identity of the person acquiring stock of the distributing or controlled corporation, the timing of the acquisition or the terms of the actual acquisition are different from the intended acquisition.

Example 7 of the 2001 proposed regulations interprets the term *similar acquisition* in the context of multiple acquisitions following a distribution that was motivated by an acquisition business purpose. The example treats an acquisition where neither the distributing nor the controlled corporation had identified the acquirer prior to the distribution and another acquisition where the acquirer had been identified but not contacted regarding the acquisition prior to the distribution as similar to an acquisition that was in fact discussed with the acquirer prior to the distribution and that was consummated prior to these additional acquisitions. After analyzing the facts and circumstances, the example concludes that these additional acquisitions and the distribution are part of a plan.

A number of commentators asserted that the interpretation of the term plan in the 2001 proposed regulations is overly broad, principally as a result of the illustration of the scope of the term *similar acquisition* in *Example 7*. Some of these commentators suggested that the unilateral intentions of one party should not result in a distribution and an acquisition being treated as part of a plan, unless that party has the unilateral ability to control both the distribution and the acquisition. In the context of acquisitions other than public offerings, therefore, some of these commentators argued that a distribution and an acquisition should not be treated as part of a plan unless there is some objective evidence of a bilateral agreement regarding the significant economic terms of the acquisition.

In addition, while the comments generally reflected the view that an acquisition should not avoid being treated as part of a plan merely because the terms of the

specific acquisition intended at the time of the distribution were modified, some comments suggested that the term similar acquisition should be narrowed. For example, certain comments suggested that where there is a change in acquirer and the new acquirer is not related to the originally intended acquirer under section 267(b) or 707(b), the new acquisition should not be treated as similar to the originally intended acquisition.

Consistent with the comments' suggestions, the revised temporary regulations set forth a definition of *similar acquisition* that is narrower than the one set forth in the 2001 proposed regulations. The revised temporary regulations provide, in general, that an actual acquisition (other than a public offering or other stock issuance for cash) is similar to another potential acquisition if the actual acquisition effects a direct or indirect combination of all or a significant portion of the same business operations as the combination that would have been effected by such other potential acquisition. Further clarification is provided in the definition of *similar acquisition*, *Example 6*, and *Example 7* of the revised temporary regulations. The revised definition of *similar acquisition* (and the revisions to the plan and non-plan factors) have the effect of reversing the conclusion of *Example 7* of the 2001 proposed regulations that the additional acquisitions (*i.e.*, the Y and Z acquisitions) and the distribution are part of a plan.

D. Substantial Negotiations

In addition to the comments regarding the general approach of the 2001 proposed regulations, the IRS and Treasury received a number of technical comments regarding the 2001 proposed regulations. A number of commentators suggested that *substantial negotiations* be defined. The revised temporary regulations add a definition of *substantial negotiations* providing that, in the case of an acquisition other than a public offering, substantial negotiations generally require discussions of significant economic terms, *e.g.*, the exchange ratio in a reorganization, by one or more officers, directors, or controlling shareholders of the distributing or controlled corporation, or another person or persons with the implicit or explicit permission of one or more officers, directors,

or controlling shareholders of the distributing or controlled corporation, with the acquirer or a person or persons with the implicit or explicit permission of the acquirer. This definition is intended to clarify that both the content of, and persons engaging in, the discussions are probative of whether discussions are properly treated as substantial negotiations.

E. Safe Harbors I and II

Safe Harbors I and II of the 2001 proposed regulations provide certainty that a distribution and an acquisition occurring after the distribution will not be treated as part of a plan if, among other conditions, the acquisition occurs more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition before a date that is 6 months after the distribution. Safe Harbors I and II of the 2001 proposed regulations, therefore, are not available if there was an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition at any time prior to the distribution. Commentators, however, suggested that not all pre-distribution substantial negotiations should prevent those Safe Harbors from being available. In particular, a number of commentators suggested that, even if the relevant parties engage in substantial negotiations regarding an acquisition prior to a distribution, provided that those negotiations terminate without agreement prior to the distribution and do not resume until 6 months or 1 year after the distribution, those substantial negotiations should not cause Safe Harbors I and II of the 2001 proposed regulations to be unavailable. After consideration of these comments, the IRS and Treasury have decided that an agreement, understanding, arrangement, or substantial negotiations concerning the acquisition should make Safe Harbors I and II unavailable only if such events exist or occur during the period that begins 1 year prior to the distribution and ends 6 months thereafter.

A number of commentators noted that Safe Harbors I and II of the 2001 proposed regulations would be available if there was an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition similar to another acquisition prior to the date that

is 6 months after the distribution. At least one commentator suggested that these Safe Harbors should not be available in these circumstances. The IRS and Treasury agree and have modified those Safe Harbors accordingly.

Safe Harbor I of the 2001 proposed regulations states that it is only available if "[t]he distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of § 1.355-2(b)) other than a business purpose to facilitate an acquisition of Distributing or Controlled." Commentators proposed that Safe Harbor I of the 2001 proposed regulations be modified so that in testing the qualification of an acquisition for the Safe Harbor, only acquisitive business purposes related to the acquired corporation should be relevant. Safe Harbor I of the revised temporary regulations reflects this comment.

Safe Harbor II of the 2001 proposed regulations is available only where (1) the amount of stock of the distributing corporation or the controlled corporation that is subject to an acquisition business purpose is not more than 33 percent of the distributing corporation or the controlled corporation; and (2) no more than 20 percent of the acquired corporation is acquired before a date that is 6 months after the distribution. Commentators suggested the elimination of one of the 2 prongs. Alternatively, they suggested increasing the percentage of stock in the second prong. One commentator also suggested that certain acquisitions that were not treated as part of a plan that includes a distribution be disregarded for purposes of the second prong.

To simplify Safe Harbor II of the 2001 proposed regulations, the revised temporary regulations eliminate the quantitative restriction of the first prong and increase the percentage of stock in the second prong to 25 percent. Furthermore, for purposes of the 25-percent test, only stock that is acquired or is the subject of an agreement, understanding, arrangement, or substantial negotiations at some time during the period that begins 1 year before the distribution and ends 6 months thereafter, other than stock that is acquired in a transaction described in Safe Harbor V, Safe Harbor VI, or new Safe Harbor VII, described below, of the revised temporary regulations, is counted.

F. Safe Harbor V

Subject to certain exceptions, Safe Harbor V of the 2001 proposed regulations provides that an acquisition of stock of the distributing or controlled corporation that is listed on an established market is not part of a plan if the acquisition occurs pursuant to a transfer between shareholders of the distributing corporation or the controlled corporation, neither of which is a 5-percent shareholder. Some commentators suggested that this Safe Harbor should be available for stock transfers between persons that do not actively participate in the management of the corporation, even if such persons are 5-percent shareholders. These commentators suggested that such acquisitions of stock are not part of a plan that includes a distribution. The IRS and Treasury generally agree that the trading activities of persons that do not actively participate in the management of the corporation should not cause an acquisition and a distribution to be treated as part of a plan. Accordingly, the revised temporary regulations extend the availability of Safe Harbor V to persons that are neither controlling shareholders nor 10-percent shareholders either immediately before or immediately after the transfer.

Finally, the IRS and Treasury have become aware of the proposed use of publicly-traded stock, the voting rights associated with which decrease upon certain transfers, in connection with acquisitions that are part of a plan that includes a distribution. Questions have been asked regarding whether acquisitions of stock that result from public trading between persons that are not 5-percent shareholders immediately before or immediately after the transfer are protected by Safe Harbor V, even where the transferee does not succeed to all of the voting rights exercisable by the transferor with respect to such stock.

Although the IRS and Treasury believe that Safe Harbor V may be available to prevent the acquisition of such stock that is listed on an established market from being treated as part of a plan, the revised temporary regulations clarify that, if Safe Harbor V applies to an acquisition of stock that is listed on an established market and that acquisition results in an indirect acquisition of voting power by a per-

son other than the acquirer of such stock, Safe Harbor V does not prevent an acquisition of stock (with the voting power such stock represents after the acquisition to which Safe Harbor V applies) by such other person from being treated as part of a plan. New *Example 5* of the revised temporary regulations illustrates the application of Safe Harbor V of the revised temporary regulations and the plan and non-plan factors in the context of the public trading of stock, the relative voting power associated with which varies as a result of the trading.

G. Safe Harbor VI and New Safe Harbor VII

Safe Harbor VI of the 2001 proposed regulations generally applies to acquisitions of the stock of the distributing or controlled corporation “by an employee or director of Distributing, Controlled, or a person related to Distributing or Controlled under section 355(d)(7)(A), in connection with the performance of services as an employee or director for the corporation or a person related to it under section 355(d)(7)(A).” One commentator suggested that Safe Harbor VI of the 2001 proposed regulations should be extended to stock acquired by independent contractors in connection with the performance of services and stock acquired pursuant to certain stock compensation plans. Another commentator suggested that Safe Harbor VI of the 2001 proposed regulations should not protect management leveraged buy-outs and going private transactions that are part of a plan that includes a distribution. Safe Harbor VI of the revised temporary regulations incorporates these comments and other technical comments received.

Commentators also suggested that Safe Harbor VI of the 2001 proposed regulations be extended to acquisitions of stock by qualified plans under section 401. In response to these commentators, the revised temporary regulations add new Safe Harbor VII. Subject to certain limitations, new Safe Harbor VII provides that acquisitions of stock of the distributing or controlled corporation by a retirement plan of an employer that qualifies under section 401(a) or 403(a) will not be treated as part of a plan that includes a distribution.

H. Operating Rules

1. Reasonable certainty

Under the 2001 proposed regulations, the fact that the distribution was motivated by a business purpose to facilitate the acquisition or a similar acquisition of the distributing or controlled corporation tends to show that a distribution and an acquisition are part of a plan. The 2001 proposed regulations provide that evidence of a business purpose to facilitate an acquisition after a distribution exists if, at the time of the distribution, there was “reasonable certainty” that, within six months after the distribution, an acquisition would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding an acquisition. In addition, the 2001 proposed regulations provide that in the case of an acquisition before a distribution, if at the time of the acquisition, it was reasonably certain that before a date that is 6 months after the acquisition the distribution would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding the distribution, the reasonable certainty is evidence of a business purpose to facilitate an acquisition. The IRS and Treasury received a number of comments regarding the reasonable certainty rule. The revised temporary regulations delete the reasonable certainty operating rules in light of the emphasis in the revised temporary regulations on discussions or an agreement, understanding, arrangement, or substantial negotiations regarding the first step before the second step.

2. Substantial diminution of risk

The 2001 proposed regulations contain an operating rule that suspends the running of any time period prescribed in the regulations during which risk of loss is diminished under the principles of section 355(d)(6)(B). Commentators questioned the proper application of this rule. In light of these comments, as stated above, the original temporary regulations reserve as to the substantial diminution of risk rule pending IRS and Treasury consideration of its proper application. Although the revised temporary regulations have eliminated the substantial diminution of risk

rule, the IRS and Treasury continue to consider its proper application.

I. Options

The 2001 proposed regulations provide that under certain circumstances, the acquisition of stock upon the exercise of an option, as that term is defined in the 2001 proposed regulations, may be treated as an agreement to acquire stock on the date the option was written, unless the distributing corporation establishes that on the later of the date of the stock distribution or the writing of the option, the option was not more likely than not to be exercised. Commentators suggested that, because an option may become more likely than not to be exercised for reasons other than the distribution, the date of the distribution should not be relevant in testing for the existence of a plan. Instead, the date the option is written, transferred or modified in a manner that materially increases the likelihood of exercise should be the relevant dates for purposes of determining whether an option is properly treated as an agreement to acquire stock. The revised temporary regulations modify the rule for determining whether and when an option will be treated as an agreement, understanding, or arrangement to acquire stock in a manner consistent with these comments and certain other technical comments received.

J. Effective Date

The revised temporary regulations are effective for distributions occurring after April 26, 2002. A number of commentators requested that taxpayers be permitted to rely on the 2001 proposed regulations for distributions occurring after April 16, 1997. In response to these comments, the revised temporary regulations permit taxpayers to apply the revised temporary regulations in whole, but not in part, to distributions occurring after April 16, 1997, and on or before April 26, 2002.

Special Analyses

It has been determined that these temporary regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of

the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these temporary regulations, and, because no preceding notice of proposed rulemaking is required for these temporary regulations, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be 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 temporary regulations is Amber R. Cook. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.355-7T also issued under 26 U.S.C. 355(e)(5). * * *

Par. 2. Section 1.355-0 is amended by revising the heading and the entry for § 1.355-7T to read as follows:

§ 1.355-0 Table of contents.

* * * * *

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Par. 3. Section 1.355-7T is revised to read as follows:

§ 1.355-7T Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

(a) *In general.* Except as provided in section 355(e) and in this section, section 355(e) applies to any distribution—

(1) To which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) That is part of a plan (or series of related transactions) (hereinafter, plan) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation (Distributing) or any controlled corporation (Controlled).

(b) *Plan*—(1) *In general.* Whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances. The facts and circumstances to be considered in demonstrating whether a distribution and an acquisition are part of a plan include, but are not limited to, the facts and circumstances set forth in paragraphs (b)(3) and (4) of this section. In general, the weight to be given each of the facts and circumstances depends on the particular case. Whether a distribution and an acquisition are part of a plan does not depend on the relative number of facts and circumstances set forth in paragraph (b)(3) that evidence that a distribution and an acquisition are part of a plan as compared to the relative number of facts and circumstances set forth in paragraph (b)(4) that evidence that a distribution and an acquisition are not part of a plan.

(2) *Certain post-distribution acquisitions.* In the case of an acquisition (other than involving a public offering) after a distribution, the distribution and the acquisition can be part of a plan only if there was an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition at some time during the 2-year period ending on the date of the distribution. In the case of an acquisition (other than involving a public offering) after a distribution, the existence of an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition at some time during the 2-year period ending on the date of the distribution tends to show that the distribution and the acquisi-

tion are part of a plan. See paragraph (b)(3)(i) of this section. However, all facts and circumstances must be considered to determine whether the distribution and the acquisition are part of a plan. For example, in the case of an acquisition (other than involving a public offering) after a distribution, if the distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of § 1.355-2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled (see paragraph (b)(4)(v) of this section) and would have occurred at approximately the same time and in similar form regardless of whether the acquisition or a similar acquisition was effected (see paragraph (b)(4)(vi) of this section), the taxpayer may be able to establish that the distribution and the acquisition are not part of a plan.

(3) *Plan factors.* Among the facts and circumstances tending to show that a distribution and an acquisition are part of a plan are the following:

(i) In the case of an acquisition (other than involving a public offering) after a distribution, at some time during the 2-year period ending on the date of the distribution, there was an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition. The weight to be accorded this fact depends on the nature, extent, and timing of the agreement, understanding, arrangement, or substantial negotiations. The existence of an agreement, understanding, or arrangement at the time of the distribution is given substantial weight.

(ii) In the case of an acquisition involving a public offering after a distribution, at some time during the 2-year period ending on the date of the distribution, there were discussions by Distributing or Controlled with an investment banker regarding the acquisition or a similar acquisition. The weight to be accorded this fact depends on the nature, extent, and timing of the discussions.

(iii) In the case of an acquisition (other than involving a public offering) before a distribution, at some time during the 2-year period ending on the date of the acquisition, there were discussions by Distributing or Controlled with the acquirer regarding a distribution. The

weight to be accorded this fact depends on the nature, extent, and timing of the discussions. In addition, in the case of an acquisition (other than involving a public offering) before a distribution where a person other than Distributing or Controlled intends to cause a distribution and, as a result of the acquisition, can meaningfully participate in the decision regarding whether to make a distribution.

(iv) In the case of an acquisition involving a public offering before a distribution, at some time during the 2-year period ending on the date of the acquisition, there were discussions by Distributing or Controlled with an investment banker regarding a distribution. The weight to be accorded this fact depends on the nature, extent, and timing of the discussions.

(v) In the case of an acquisition either before or after a distribution, the distribution was motivated by a business purpose to facilitate the acquisition or a similar acquisition.

(4) *Non-plan factors.* Among the facts and circumstances tending to show that a distribution and an acquisition are not part of a plan are the following:

(i) In the case of an acquisition involving a public offering after a distribution, during the 2-year period ending on the date of the distribution, there were no discussions by Distributing or Controlled with an investment banker regarding the acquisition or a similar acquisition.

(ii) In the case of an acquisition after a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the distribution that resulted in the acquisition that was otherwise unexpected at the time of the distribution.

(iii) In the case of an acquisition (other than involving a public offering) before a distribution, during the 2-year period ending on the date of the acquisition, there were no discussions by Distributing or Controlled with the acquirer regarding a distribution. This paragraph (b)(4)(iii) does not apply if the acquisition occurred after the date of the public announcement of the planned distribution. In addition, this paragraph (b)(4)(iii) does not apply in the case of an acquisition where a person other than Distributing or Controlled intends to cause a distribution and, as a result of the acquisition, can meaningfully

participate in the decision regarding whether to make a distribution.

(iv) In the case of an acquisition before a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the acquisition that resulted in a distribution that was otherwise unexpected.

(v) In the case of an acquisition either before or after a distribution, the distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of § 1.355-2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition.

(vi) In the case of an acquisition either before or after a distribution, the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition.

(c) *Operating rules.* The operating rules contained in this paragraph (c) apply for all purposes of this section.

(1) *Internal discussions and discussions with outside advisors evidence of business purpose.* Internal discussions and discussions with outside advisors by or on behalf of officers or directors of Distributing or Controlled may be indicative of one or more business purposes for the distribution and the relative importance of such purposes.

(2) *Takeover defense.* If Distributing engages in discussions with a potential acquirer regarding an acquisition of Distributing or Controlled and distributes Controlled stock intending, in whole or substantial part, to decrease the likelihood of the acquisition of Distributing or Controlled by separating it from another corporation that is likely to be acquired, Distributing will be treated as having a business purpose to facilitate the acquisition of the corporation that was likely to be acquired.

(3) *Effect of distribution on trading in stock.* The fact that the distribution made all or a part of the stock of Controlled available for trading or made Distributing's or Controlled's stock trade more actively is not taken into account in determining whether the distribution and an acquisition of Distributing or Controlled stock were part of a plan.

(4) *Consequences of section 355(e) disregarded for certain purposes.* For purposes of determining the intentions of the

relevant parties under this section, the consequences of the application of section 355(e), and the existence of any contractual indemnity by Controlled for tax resulting from the application of section 355(e) caused by an acquisition of Controlled, are disregarded.

(5) *Multiple acquisitions.* All acquisitions of stock of Distributing or Controlled that are considered to be part of a plan with a distribution pursuant to paragraph (b) of this section will be aggregated for purposes of the 50-percent test of paragraph (a)(2) of this section.

(d) *Safe harbors—(1) Safe Harbor I.* A distribution and an acquisition occurring after the distribution will not be considered part of a plan if—

(i) The distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of § 1.355-2(b)), other than a business purpose to facilitate an acquisition of the acquired corporation (Distributing or Controlled); and

(ii) The acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition or a similar acquisition during the period that begins 1 year before the distribution and ends 6 months thereafter.

(2) *Safe Harbor II.* (i) A distribution and an acquisition occurring after the distribution will not be considered part of a plan if—

(A) The distribution was not motivated by a business purpose to facilitate the acquisition or a similar acquisition;

(B) The acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition or a similar acquisition during the period that begins 1 year before the distribution and ends 6 months thereafter; and

(C) No more than 25 percent of the stock of the acquired corporation (Distributing or Controlled) was either acquired or the subject of an agreement, understanding, arrangement, or substantial negotiations during the period that begins 1 year before the distribution and ends 6 months thereafter.

(ii) For purposes of paragraph (d)(2)(i)(C) of this section, acquisitions of

stock that are treated as not part of a plan pursuant to Safe Harbor V, Safe Harbor VI, or Safe Harbor VII are disregarded.

(3) *Safe Harbor III.* If an acquisition occurs after a distribution, there was no agreement, understanding, or arrangement concerning the acquisition or a similar acquisition at the time of the distribution, and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition or a similar acquisition within 1 year after the distribution, the acquisition and the distribution will not be considered part of a plan.

(4) *Safe Harbor IV.* If a distribution occurs more than 2 years after an acquisition, and there was no agreement, understanding, arrangement, or substantial negotiations concerning the distribution at the time of the acquisition or within 6 months thereafter, the acquisition and the distribution will not be considered part of a plan.

(5) *Safe Harbor V—(i) In general.* An acquisition of Distributing or Controlled stock that is listed on an established market is not part of a plan if, immediately before or immediately after the transfer, none of the transferor, the transferee, and any coordinating group of which either the transferor or the transferee is a member is—

(A) the acquired corporation (Distributing or Controlled);

(B) a corporation that the acquired corporation (Distributing or Controlled) controls within the meaning of section 368(c);

(C) a member of a controlled group of corporations within the meaning of section 1563 of which the acquired corporation (Distributing or Controlled) is a member;

(D) an underwriter with respect to such acquisition;

(E) a controlling shareholder of the acquired corporation (Distributing or Controlled); or

(F) a 10-percent shareholder of the acquired corporation (Distributing or Controlled).

(ii) *Special rules.* (A) This paragraph (d)(5) does not apply to a transfer of stock by or to a person if the corporation the stock of which is being transferred knows, or has reason to know, that the person or a coordinating group of which

such person is a member intends to become a controlling shareholder or a 10-percent shareholder of the acquired corporation (Distributing or Controlled) at any time after the acquisition and before the date that is 2 years after the distribution.

(B) If a transfer of stock to which this paragraph (d)(5) applies results immediately, or upon a subsequent event or the passage of time, in an indirect acquisition of voting power by a person other than the transferee, this paragraph (d)(5) does not prevent an acquisition of stock (with the voting power such stock represents after the transfer to which this paragraph (d)(5) applies) by such other person from being treated as part of a plan.

(6) *Safe Harbor VI*—(i) *In general.* If stock of Distributing or Controlled is acquired by a person in connection with such person's performance of services as an employee, director, or independent contractor for Distributing, Controlled, or a person related to Distributing or Controlled under section 355(d)(7)(A) (and that is not excessive by reference to the services performed) in a transaction to which section 83 or section 421(a) applies, the acquisition and the distribution will not be considered part of a plan.

(ii) *Special rule.* This paragraph (d)(6) does not apply to a stock acquisition described in (d)(6)(i) if the acquirer or a coordinating group of which the acquirer is a member is a controlling shareholder or a 10-percent shareholder of the acquired corporation (Distributing or Controlled) immediately after the acquisition.

(7) *Safe Harbor VII*—(i) *In general.* If stock of Distributing or Controlled is acquired by a retirement plan of an employer that qualifies under section 401(a) or 403(a), the acquisition and the distribution will not be considered part of a plan.

(ii) *Special rule.* This paragraph (d)(7) does not apply to stock acquisitions described in (d)(7)(i) of this section to the extent that the stock acquired pursuant to such acquisitions by all of the qualified plans of the employer described in paragraph (d)(7)(i) of this section, and any other person treated as the same employer as that described in paragraph (d)(7)(i) of this section under section 414(b), (c), (m), or (o), during the 4-year period beginning

2 years before the distribution, in the aggregate, represents 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total value of shares of all classes of stock, of the acquired corporation (Distributing or Controlled).

(e) *Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests*—(1) *Treatment of options*—(i) *General rule.* For purposes of this section, if stock of Distributing or Controlled is acquired pursuant to an option, the option will be treated as an agreement, understanding, or arrangement to acquire the stock on the earliest of the following dates: the date that the option is written, if the option was more likely than not to be exercised as of such date; the date that the option is transferred, if the option was more likely than not to be exercised as of such date; and the date that the option is modified in a manner that materially increases the likelihood of exercise, if the option was more likely than not to be exercised as of such date; provided, however, if the writing, transfer, or modification had a principal purpose of avoiding section 355(e), the option will be treated as an agreement, understanding, arrangement, or substantial negotiations to acquire the stock on the date of the distribution. The determination of whether an option was more likely than not to be exercised is based on all the facts and circumstances, taking control premiums and minority and blockage discounts into account in determining the fair market value of stock underlying an option.

(ii) *Agreement, understanding, or arrangement to write an option.* If there is an agreement, understanding, or arrangement to write an option, the option will be treated as written on the date of the agreement, understanding, or arrangement.

(iii) *Substantial negotiations related to options.* If an option is treated as an agreement, understanding, or arrangement to acquire the stock on the date that the option is written, substantial negotiations to acquire the option will be treated as substantial negotiations to acquire the stock subject to such option. If an option is treated as an agreement, understanding, or arrangement to acquire the stock on the

date that the option is transferred, substantial negotiations regarding the transfer of the option will be treated as substantial negotiations to acquire the stock subject to such option. If an option is treated as an agreement, understanding, or arrangement to acquire the stock on the date that the option is modified in a manner that materially increases the likelihood of exercise, substantial negotiations regarding such modifications to the option will be treated as substantial negotiations to acquire the stock subject to such option.

(2) *Instruments treated as options.* For purposes of this paragraph (e), except to the extent provided in paragraph (e)(3) of this section, call options, warrants, convertible obligations, the conversion feature of convertible stock, put options, redemption agreements (including rights to cause the redemption of stock), any other instruments that provide for the right or possibility to issue, redeem, or transfer stock (including an option on an option), or any other similar interests are treated as options.

(3) *Instruments generally not treated as options.* For purposes of this paragraph (e), the following are not treated as options unless (in the case of paragraphs (e)(3)(i), (iii), and (iv) of this section) written, transferred (directly or indirectly), modified, or listed with a principal purpose of avoiding the application of section 355(e) or this section.

(i) *Escrow, pledge, or other security agreements.* An option that is part of a security arrangement in a typical lending transaction (including a purchase money loan), if the arrangement is subject to customary commercial conditions. For this purpose, a security arrangement includes, for example, an agreement for holding stock in escrow or under a pledge or other security agreement, or an option to acquire stock contingent upon a default under a loan.

(ii) *Compensatory options.* An option to acquire stock in Distributing or Controlled with customary terms and conditions provided to a person in connection with such person's performance of services as an employee, director, or independent contractor for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed), provided that—

(A) The transfer of stock pursuant to such option is described in section 421(a); or

(B) The option is nontransferable within the meaning of § 1.83-3(d) and does not have a readily ascertainable fair market value as defined in § 1.83-7(b).

(iii) *Options exercisable only upon death, disability, mental incompetency, or separation from service.* Any option entered into between shareholders of a corporation (or a shareholder and the corporation) that is exercisable only upon the death, disability, or mental incompetency of the shareholder, or, in the case of stock acquired in connection with the performance of services for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed), the shareholder's separation from service.

(iv) *Rights of first refusal.* A *bona fide* right of first refusal regarding the corporation's stock with customary terms, entered into between shareholders of a corporation (or between the corporation and a shareholder).

(v) *Other enumerated instruments.* Any other instrument the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(f) *Multiple controlled corporations.* Only the stock or securities of a controlled corporation in which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest as part of a plan involving the distribution of that corporation will be treated as not qualified property under section 355(e)(1) if—

(1) The stock or securities of more than 1 controlled corporation are distributed in distributions to which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) One or more persons do not acquire, directly or indirectly, stock representing a 50-percent or greater interest in Distributing pursuant to a plan involving any of those distributions.

(g) *Valuation.* Except as provided in paragraph (e)(1)(i) of this section, for purposes of section 355(e) and this section, all shares of stock within a single class

are considered to have the same value. Thus, control premiums and minority and blockage discounts within a single class are not taken into account.

(h) *Definitions—(1) Agreement, understanding, arrangement, or substantial negotiations.* (i) Whether an agreement, understanding, or arrangement exists depends on the facts and circumstances. The parties do not necessarily have to have entered into a binding contract or have reached agreement on all significant economic terms to have an agreement, understanding, or arrangement. However, an agreement, understanding, or arrangement clearly exists if a binding contract to acquire stock exists.

(ii) Substantial negotiations in the case of an acquisition (other than involving a public offering) generally require discussions of significant economic terms, *e.g.*, the exchange ratio in a reorganization, by one or more officers, directors, or controlling shareholders of Distributing or Controlled, or another person or persons with the implicit or explicit permission of one or more officers, directors, or controlling shareholders of Distributing or Controlled, with the acquirer or a person or persons with the implicit or explicit permission of the acquirer.

(iii) In the case of an acquisition involving a public offering by Distributing or Controlled, the existence of an agreement, understanding, arrangement, or substantial negotiations will be based on discussions by one or more officers, directors, or controlling shareholders of Distributing or Controlled, or another person or persons with the implicit or explicit permission of one or more officers, directors, or controlling shareholders of Distributing or Controlled, with an investment banker.

(2) *Controlled corporation.* For purposes of this section, a controlled corporation is a corporation the stock of which is distributed in a distribution to which section 355 (or so much of section 356 as relates to section 355) applies.

(3) *Controlling shareholder.* (i) A controlling shareholder of a corporation the stock of which is listed on an established market is a 5-percent shareholder who actively participates in the management or operation of the corporation. For pur-

poses of this paragraph (h)(3)(i), a corporate director will be treated as actively participating in the management of the corporation.

(ii) A controlling shareholder of a corporation the stock of which is not listed on an established market is any person that owns, actually or constructively under the rules of section 318, stock possessing voting power representing a meaningful voice in the governance of the corporation.

(iii) For purposes of this section, a person is a controlling shareholder if that person meets the definition of controlling shareholder in this paragraph (h)(3) immediately before or immediately after the acquisition being tested.

(iv) If a distribution precedes an acquisition, Controlled's controlling shareholders immediately after the distribution and Distributing are included among Controlled's controlling shareholders at the time of the distribution.

(4) *Coordinating group.* A coordinating group includes 2 or more persons that, pursuant to a formal or informal understanding, join in one or more coordinated acquisitions or dispositions of stock of Distributing or Controlled. A principal element in determining if such an understanding exists is whether the investment decision of each person is based on the investment decision of one or more other existing or prospective shareholders. A coordinating group is treated as a single shareholder for purposes of determining whether the coordinating group is treated as a controlling shareholder or a 10-percent shareholder.

(5) *Discussions.* Discussions by Distributing or Controlled generally require discussions by one or more officers, directors, or controlling shareholders of Distributing or Controlled, or another person or persons with the implicit or explicit permission of one or more officers, directors, or controlling shareholders of Distributing or Controlled. Discussions with the acquirer generally require discussions with the acquirer or a person or persons with the implicit or explicit permission of the acquirer.

(6) *Established market.* An established market is—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f);

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Act of 1934 (15 U.S.C. 78o-3); or

(iii) Any additional market that the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(7) *Five-percent shareholder.* A person will be considered a 5-percent shareholder of a corporation the stock of which is listed on an established market if the person owns, actually or constructively under the rules of section 318, 5 percent or more of any class of stock of the corporation whose stock is transferred. A person is a 5-percent shareholder if the person meets the requirements described above immediately before or immediately after the transfer. All options owned by a person are treated as exercised for the purpose of determining whether such person is a 5-percent shareholder. Absent actual knowledge that a person is a 5-percent shareholder, a corporation can rely on Schedules 13D and 13G (or any similar schedules) filed with the Securities and Exchange Commission to identify its 5-percent shareholders.

(8) *Similar acquisition.* In general, an actual acquisition (other than a public offering or other stock issuance for cash) is similar to another potential acquisition if the actual acquisition effects a direct or indirect combination of all or a significant portion of the same business operations as the combination that would have been effected by such other potential acquisition. Thus, an actual acquisition may be similar to another acquisition even if the timing or terms of the actual acquisition are different from the timing or terms of the other acquisition. For example, an actual acquisition of Distributing by shareholders of another corporation in connection with a merger of such other corporation with and into Distributing is similar to another acquisition of Distributing by merger into such other corporation or into a subsidiary of such other corporation. However, in general, an actual acquisition (other than a public offering or other stock issuance for cash) is not

similar to another acquisition if the ultimate owners of the business operations with which Distributing or Controlled is combined in the actual acquisition are substantially different from the ultimate owners of the business operations with which Distributing or Controlled was to be combined in such other acquisition. In the case of a public offering or other stock issuance for cash, an actual acquisition may be similar to another acquisition, even though there are changes in the terms of the stock, the class of stock being offered, the size of the offering, the timing of the offering, the price of the stock, or the participants in the offering.

(9) *Ten-percent shareholder.* A person will be considered a 10-percent shareholder of a corporation the stock of which is listed on an established market if the person owns, actually or constructively under the rules of section 318, 10 percent or more of any class of stock of the corporation whose stock is transferred. A person will be considered a 10-percent shareholder of a corporation the stock of which is not listed on an established market if the person owns, actually or constructively under the rules of section 318, stock possessing 10 percent or more of the total voting power of the stock of the corporation whose stock is transferred or stock having a value equal to 10 percent or more of the total value of the stock of the corporation whose stock is transferred. A person is a 10-percent shareholder if the person meets the requirements described above immediately before or immediately after the transfer. All options owned by a person are treated as exercised for the purpose of determining whether such person is a 10-percent shareholder. Absent actual knowledge that a person is a 10-percent shareholder, a corporation the stock of which is listed on an established market can rely on Schedules 13D and 13G (or any similar schedules) filed with the Securities and Exchange Commission to identify its 10-percent shareholders.

(i) [Reserved]

(j) *Examples.* The following examples illustrate paragraphs (a) through (h) of this section. Throughout these examples, assume that Distributing (D) owns all of the stock of Controlled (C). Assume further that D distributes the stock of C in a distribution to which section 355 applies

and to which section 355(d) does not apply. Unless otherwise stated, assume the corporations do not have controlling shareholders. No inference should be drawn from any example concerning whether any requirements of section 355 other than those of section 355(e) are satisfied. The examples are as follows:

Example 1. Unwanted assets. (i) D is in business 1. C is in business 2. D is relatively small in its industry. D wants to combine with X, a larger corporation also engaged in business 1. X and D begin negotiating for X to acquire D, but X does not want to acquire C. To facilitate the acquisition of D by X, D agrees to distribute all the stock of C *pro rata* before the acquisition. Prior to the distribution, D and X enter into a contract for D to merge into X subject to several conditions. One month after D and X enter into the contract, D distributes C and, on the day after the distribution, D merges into X. As a result of the merger, D's former shareholders own less than 50 percent of the stock of X.

(ii) The issue is whether the distribution of C and the merger of D into X are part of a plan. No Safe Harbor applies to this acquisition. To determine whether the distribution of C and the merger of D into X are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (b) of this section.

(iii) The following tends to show that the distribution of C and the merger of D into X are part of a plan: X and D had an agreement regarding the acquisition during the 2-year period ending on the date of the distribution (paragraph (b)(3)(i) of this section), and the distribution was motivated by a business purpose to facilitate the merger (paragraph (b)(3)(v) of this section). Because the merger was agreed to at the time of the distribution, the fact described in paragraph (b)(3)(i) of this section is given substantial weight.

(iv) None of the facts and circumstances listed in paragraph (b)(4) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(v) The distribution of C and the merger of D into X are part of a plan under paragraph (b) of this section.

Example 2. Public offering. (i) D's managers, directors, and investment banker discuss the possibility of offering D stock to the public. They decide a public offering of 20 percent of D's stock with D as a stand alone corporation would be in D's best interest. One month later, to facilitate a stock offering by D of 20 percent of its stock, D distributes all the stock of C *pro rata* to D's shareholders. D issues new shares amounting to 20 percent of its stock to the public in a public offering 7 months after the distribution.

(ii) The issue is whether the distribution of C and the public offering by D are part of a plan. No Safe Harbor applies to this acquisition. Safe Harbor V, relating to public trading, does not apply to public offerings (see paragraph (d)(5)(i)(A) of this section). To determine whether the distribution of C and the public offering by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (b) of this section.

(iii) The following tends to show that the distribution of C and the public offering by D are part of a plan: D discussed the public offering with its investment banker during the 2-year period ending on the date of the distribution (paragraph (b)(3)(ii) of this section), and the distribution was motivated by a business purpose to facilitate the public offering (paragraph (b)(3)(v) of this section).

(iv) None of the facts and circumstances listed in paragraph (b)(4) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(v) The distribution of C and the public offering by D are part of a plan under paragraph (b) of this section.

Example 3. Hot market. (i) D is a widely-held corporation the stock of which is listed on an established market. D announces a distribution of C and distributes C *pro rata* to D's shareholders. By contract, C agrees to indemnify D for any imposition of tax under section 355(e) caused by the acts of C. The distribution is motivated by a desire to improve D's access to financing at preferred customer interest rates, which will be more readily available if D separates from C. At the time of the distribution, although neither D nor C has been approached by any potential acquirer of C, it is reasonably certain that soon after the distribution either an acquisition of C will occur or there will be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C. Corporation Y acquires C in a merger described in section 368(a)(2)(E) within 6 months after the distribution. The C shareholders receive less than 50 percent of the stock of Y in the exchange.

(ii) The issue is whether the distribution of C and the acquisition of C by Y are part of a plan. No Safe Harbor applies to this acquisition. Under paragraph (b)(2) of this section, because prior to the distribution neither D nor C and Y had an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition, the distribution of C by D and the acquisition of C by Y are not part of a plan under paragraph (b) of this section.

Example 4. Unexpected opportunity. (i) D, the stock of which is listed on an established market, announces that it will distribute all the stock of C *pro rata* to D's shareholders. At the time of the announcement, the distribution is motivated wholly by a corporate business purpose (within the meaning of § 1.355-2(b)) other than a business purpose to facilitate an acquisition. After the announcement but before the distribution, widely-held X becomes available as an acquisition target. There were no discussions between D or C and X before the announcement. D negotiates with and acquires X before the distribution. After the acquisition, X's former shareholders own 55 percent of D's stock. D distributes the stock of C *pro rata* within 6 months after the acquisition of X.

(ii) The issue is whether the acquisition of X by D and the distribution of C are part of a plan. No Safe Harbor applies to this acquisition. To determine whether the acquisition of X by D and the distribution of C are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (b) of this section.

(iii) Depending on whether a person other than D or C intends to cause a distribution and, as a

result of the acquisition, can meaningfully participate in the decision regarding whether to cause a distribution, the fact described in (b)(3)(iii) of this section, tending to show that a distribution and an acquisition are part of a plan, may exist in this case.

(iv) Under paragraph (b)(4) of this section, D would assert that the following tends to show that the distribution of C and the acquisition of X by D are not part of a plan: the distribution was motivated by a corporate business purpose (within the meaning of § 1.355-2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition (paragraph (b)(4)(v) of this section), and the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition (paragraph (b)(4)(vi) of this section). That D decided to distribute C and announced that decision before it became aware of the opportunity to acquire X suggests that the distribution would have occurred at approximately the same time and in similar form regardless of D's acquisition of X or a similar acquisition. X's lack of participation in the decision to distribute C, even though the X shareholders may have been able to prevent a distribution of C, also helps establish that fact.

(v) In determining whether the distribution of C and acquisition of X by D are part of a plan, one should consider the importance of D's business purpose for the distribution in light of D's opportunity to acquire X. If D can establish that the distribution continued to be motivated by the stated business purpose, and if D would have distributed C regardless of D's acquisition of X, then D's acquisition of X and D's distribution of C are not part of a plan under paragraph (b) of this section.

Example 5. Vote shifting transaction. (i) D is in business 1. C is in business 2. D wants to combine with X, a larger corporation also engaged in business 1. The stock of X is closely held. X and D begin negotiating for D to acquire X, but the X shareholders do not want to acquire an indirect interest in C. To facilitate the acquisition of X by D, D agrees to distribute all the stock of C *pro rata* before the acquisition of X. D and X enter into a contract for X to merge into D subject to several conditions. Among those conditions is that D will amend its corporate charter to provide for 2 classes of stock: Class A and Class B. Under all circumstances, each share of Class A stock will be entitled to 10 votes in the election of each director on D's board of directors. Upon issuance, each share of Class B stock will be entitled to 10 votes in the election of each director on D's board of directors; however, a disposition of such share by its original holder will result in such share being entitled to only 1 vote, rather than 10 votes, in the election of each director. Immediately after the merger, the Class B shares will be listed on an established market. One month after D and X enter into the contract, D distributes C. Immediately after the distribution, the shareholders of D exchange their D stock for the new Class B shares. On the day after the distribution, X merges into D. In the merger, the former shareholders of X exchange their X stock for Class A shares of D. Immediately after the merger, D's historic shareholders own stock of D representing 51 percent of the total combined voting power of all classes of stock of D entitled to vote. During the 30-day period following the merger, none of the

Class A shares are transferred, but a number of D's historic shareholders sell their Class B stock of D in public trading with the result that, at the end of that 30-day period, the Class A shares owned by the former X shareholders represent 52 percent of the total combined voting power of all classes of stock of D entitled to vote.

(ii) *X acquisition.* (A) The issue is whether the distribution of C and the merger of X into D are part of a plan. No Safe Harbor applies to this acquisition. To determine whether the distribution of C and the merger of X into D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (b) of this section.

(B) The following tends to show that the distribution of C and the merger of X into D are part of a plan: X and D had an agreement regarding the acquisition during the 2-year period ending on the date of the distribution (paragraph (b)(3)(i) of this section), and the distribution was motivated by a business purpose to facilitate the merger (paragraph (b)(3)(v) of this section). Because the merger was agreed to at the time of the distribution, the fact described in paragraph (b)(3)(i) of this section is given substantial weight.

(C) None of the facts and circumstances listed in paragraph (b)(4) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(D) The distribution of C and the merger of X into D are part of a plan under paragraph (b) of this section.

(iii) *Public trading of Class B shares.* (A) Assuming that each of the transferors and the transferees of the Class B stock of D in public trading is not one of the prohibited transferors or transferees listed in paragraph (d)(5)(i), Safe Harbor V will apply to the acquisitions of the Class B stock during the 30-day period following the merger such that the distribution and those acquisitions will not be treated as part of the plan. However, to the extent that those acquisitions result in an indirect acquisition of voting power by a person other than the acquirer of the transferred stock, Safe Harbor V does not prevent the acquisition of the D stock (with the voting power such stock represents after those acquisitions) by the former X shareholders from being treated as part of a plan.

(B) To the extent that the transfer of the Class B shares causes the voting power of D to shift to the Class A stock acquired by the former X shareholders, such shifted voting power will be treated as attributable to the stock acquired by the former X shareholders as part of the plan that includes the distribution and the X acquisition.

Example 6. Acquisition that is not similar. (i) D, X, and Y are each corporations the stock of which is publicly traded and widely held. Each of D, X, and Y are engaged in the manufacture and sale of trucks. C is engaged in the manufacture and sale of buses. D and X engage in substantial negotiations concerning X's acquisition of the stock of D from the D shareholders in exchange for stock of X. D and X do not reach an agreement regarding that acquisition. Three months after D and X first began negotiations regarding that acquisition, D distributes the stock of C *pro rata* to its shareholders. Three months after the distribution, Y acquires the stock of D from the D shareholders in exchange for stock of Y.

(ii) Although both X and Y engage in the manufacture and sale of trucks, X's truck business and Y's truck business are not the same business operations. Therefore, because Y's acquisition of D does not effect a combination of the same business operations as X's acquisition of D would have effected, Y's acquisition of D is not similar to X's potential acquisition of D that was the subject of earlier negotiations.

Example 7. Acquisition that is similar. (i) D is engaged in the business of writing custom software for several industries (industries 1 through 6). The software business of D related to industries 4, 5, and 6 is significant relative to the software business of D related to industries 3, 4, 5, and 6. X, an unrelated corporation, is engaged in the business of writing software and the business of manufacturing and selling hardware devices. X's business of writing software is significant relative to its total businesses. X and D engage in substantial negotiations regarding X's acquisition of D stock from the D shareholders in exchange for stock of X. Because X does not want to acquire the software businesses related to industries 1 and 2, these negotiations relate to an acquisition of D stock where D owns the software businesses related only to industries 3, 4, 5, and 6. Thereafter, D concludes that the intellectual property licenses central to the software business related to industries 1 and 2 are not transferable and that a separation of the software business related to industry 3 from the software business related to industry 2 is not desirable. One month after D begins negotiating with X, D contributes the software businesses related to industries 4, 5, and 6 to C, and distributes the stock of C *pro rata* to its shareholders. In addition, X sells its hardware businesses for cash. After the distribution, C and X negotiate for X's acquisition of the C stock from the C shareholders in exchange for X stock, and X acquires the stock of C.

(ii) Although D and C are different corporations, C does not own the custom software business related to industry 3, and X sold its hardware business prior to the acquisition of C, because X's acquisition of C involves a combination of a significant portion of the same business operations as the combination that would have been effected by the

acquisition of D that was the subject of negotiations between D and X, X's acquisition of C is the same as or similar to X's potential acquisition of D that was the subject of earlier negotiations.

(k) *Effective dates.* This section applies to distributions occurring after April 26, 2002. Taxpayers, however, may apply these regulations in whole, but not in part, to a distribution occurring after April 16, 1997, and on or before April 26, 2002. For distributions occurring after August 3, 2001, and on or before April 26, 2002, with respect to which a taxpayer chooses not to apply these regulations, see § 1.355-7T as in effect prior to April 26, 2002 (see 26 CFR part 1 revised April 1, 2002).

Robert E. Wenzel,
Deputy Commissioner of
Internal Revenue.

Approved April 15, 2002.

Mark Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 23, 2002, 12:14 p.m., and published in the issue of the Federal Register for April 26, 2002, 67 F.R. 20632)

Section 446.—General Rule for Methods of Accounting

If a taxpayer changes to claiming additional first year depreciation for qualified property or qualified New York Liberty Zone property placed in service after September 10, 2001, during the taxable year beginning in 2000 or 2001, is this change a change in method of accounting under § 446(e) of the Internal Revenue Code? See Rev. Proc. 2002-33, page 963.

Section 472.—Last-in, First-out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The March 2002 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, March 31, 2002.

Rev. Rul. 2002-29

The following Department Store Inventory Price Indexes for March 2002 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46 (1986-2 C.B. 739) for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, March 31, 2002.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups — soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	Mar. 2001	Mar. 2002	Percent Change from Mar. 2001 to Mar. 2002 ¹
1. Piece Goods -----	492.1	490.6	-0.3
2. Domestic and Draperies -----	597.8	583.6	-2.4
3. Women's and Children's Shoes -----	667.2	647.4	-3.0
4. Men's Shoes -----	887.5	903.0	1.7
5. Infants' Wear -----	632.5	624.2	-1.3
6. Women's Underwear -----	563.5	563.7	0.0
7. Women's Hosiery -----	347.0	355.7	2.5
8. Women's and Girls' Accessories -----	560.3	563.4	0.6
9. Women's Outerwear and Girls' Wear -----	419.5	401.0	-4.4
10. Men's Clothing -----	589.2	594.6	0.9
11. Men's Furnishings -----	619.4	607.3	-2.0
12. Boys' Clothing and Furnishings -----	484.9	482.6	-0.5
13. Jewelry -----	939.5	905.5	-3.6
14. Notions -----	782.8	800.4	2.2
15. Toilet Articles and Drugs -----	989.4	972.7	-1.7
16. Furniture and Bedding -----	646.4	630.0	-2.5
17. Floor Coverings -----	630.7	616.3	-2.3
18. Housewares -----	771.7	756.2	-2.0
19. Major Appliances -----	225.2	223.2	-0.9
20. Radio and Television -----	55.5	51.1	-7.9
21. Recreation and Education ² -----	90.3	87.5	-3.1
22. Home Improvements ² -----	128.2	125.6	-2.0
23. Auto Accessories ² -----	109.2	110.8	1.5
Groups 1 — 15: Soft Goods -----	604.7	591.8	-2.1
Groups 16 — 20: Durable Goods -----	426.0	414.6	-2.7
Groups 21 — 23: Misc. Goods ² -----	99.0	97.2	-1.8
Store Total ³ -----	538.3	526.5	-2.2

¹ Absence of a minus sign before the percentage change in this column signifies a price increase.

² Indexes on a January 1986=100 base.

³ The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael Burkorn of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkorn at (202) 622-7718 (not a toll-free call).

Section 507.—Private Foundation Transfers of Assets

26 CFR 1.507-1, 1.507-3, 1.507-4, 1.507-7, 1.507-8: Special rules; transferee foundations; liability in case of transfers. (Also §§ 4940, 4941, 4942, 4943, 4944, 4945, 6033, 6043; 53.4940-1, 53.4941(a)-1, 53.4942(a)-3, 53.4943-3, 53.4944-1, 53.4945-5, and 1.6033-2, 1.6043-3(a)(1)).

Private foundation transfer of assets; notification, filing, and other implications. This ruling addresses a private foundation's responsibilities relating to sections 507 and 4940 through 4945 of the Code and its tax return filing obligations in sections 6033 and 6043 when it transfers all of its assets to one or more effectively controlled private foundations.

ISSUES

(1) If a private foundation transfers all of its assets to one or more private foundations, is the transferor foundation required to notify the Manager, Exempt Organizations Determinations, Tax Exempt and Government Entities Division (TE/GE), that it plans to terminate its private foundation status pursuant to § 507(a) of the Internal Revenue Code and pay the tax under § 507(c)?

(2) What are a private foundation's tax return filing obligations after it transfers all of its assets to one or more transferee private foundations and:

- (a) terminates, or
- (b) does not terminate?

(3) If a private foundation transfers all of its assets to one or more private foundations that are effectively controlled (within the meaning of the Income Tax Regulations under § 507), directly or indirectly, by the same person or persons who effectively control the transferor foundation, what are the implications under:

- (a) § 4940,
- (b) § 4941,
- (c) § 4942,
- (d) § 4943,
- (e) § 4944, and
- (f) § 4945?

(4) If a private foundation transfers all of its assets to one or more private foundations that are effectively controlled (within the meaning of the regulations under § 507), directly or indirectly, by the same person or persons who effectively control the transferor foundation, what are the implications for the transferor foundation's aggregate tax benefits under § 507(d)?

FACTS

In each of the following situations: (i) the transferee private foundations are effectively controlled (within the meaning of the regulations under § 507), directly or indirectly, by the same persons who effectively controlled the transferor private foundations; (ii) the private foundations have not committed either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter

42; (iii) the private foundations have not terminated under § 507(a)(2) or (b)(1); (iv) prior to the transactions described below, the transferor private foundations made outstanding grants to organizations not described in § 4945(d)(4)(A), which required the transferor foundations to exercise expenditure responsibility in accordance with § 4945(h); and (v) the private foundations are not operating foundations within the meaning of § 4942(j)(3).

SITUATION 1

P is recognized as exempt from federal tax under § 501(c)(3) and is classified as a private foundation under § 509(a). *P*'s current directors have divergent charitable objectives.

X, *Y*, and *Z* are recognized as exempt from federal tax under § 501(c)(3) and are classified as private foundations under § 509(a). Pursuant to a plan of dissolution, after satisfying all of its outstanding liabilities, *P* distributes all of its remaining assets in equal shares to *X*, *Y*, and *Z*. As part of the plan of dissolution, *X* agrees to exercise expenditure responsibility for all outstanding grants made by *P*. The day after *P* distributes all of its assets, *P* files articles of dissolution with the appropriate state authority.

SITUATION 2

T, a charitable trust, is recognized as exempt from federal tax under § 501(c)(3) and is classified as a private foundation under § 509(a). The trustees of *T* determine that *T*'s charitable purposes can be more effectively accomplished by operating in corporate form.

The trustees of *T* create *W*, a not-for-profit corporation, for the purpose of carrying on *T*'s activities. *W* is recognized as exempt from federal tax under § 501(c)(3) and is classified as a private foundation under § 509(a). *T* transfers all of its assets and liabilities to *W*.

SITUATION 3

J and *K* are not-for-profit corporations that are recognized as exempt from federal tax under § 501(c)(3) and are classified as private foundations under § 509(a). *J* and *K* generally confine their grantmaking activities to supporting

charitable programs in the city in which both *J* and *K* are located.

V, a newly-formed entity, is recognized as exempt from federal tax under § 501(c)(3) and is classified as a private foundation under § 509(a). To eliminate the costs of maintaining two private foundations with identical charitable purposes, *J* and *K* transfer all of their assets and liabilities to *V*.

LAW

Section 507(a) provides that, except as provided in § 507(b), the status of any organization as a private foundation shall be terminated only if: (1) such organization notifies the Secretary of its intent to accomplish such termination, or (2) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to a liability for tax under chapter 42, and the Secretary notifies such organization that it is liable for the tax imposed by § 507(c). Under § 507(a)(1) and (2), the organization's private foundation status is terminated when the organization pays the tax imposed by § 507(c) or the entire amount of such tax is abated under § 507(g). The person currently designated to receive the notice of termination described in § 507(a)(1) is Manager, Exempt Organizations Determinations (TE/GE).

Section 507(b)(2) provides that in the case of a transfer of assets of any private foundation to another private foundation pursuant to a liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 507(c) imposes a tax on each organization whose private foundation status is voluntarily or involuntarily terminated under § 507(a). The tax imposed is equal to the lower of: (1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the § 501(c)(3) status of such foundation, or (2) the value of the net assets of the foundation.

Section 1.507-1(b)(6) of the Income Tax Regulations provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in

§ 507(b)(2) and § 1.507-3(c), such transferor foundation will not have terminated its private foundation status under § 507(a)(1).

Section 1.507-1(b)(7) provides that a transfer of all the assets of a private foundation does not result in a termination of the transferor private foundation under § 507(a), unless the transferor private foundation elects to terminate pursuant to § 507(a)(1), or § 507(a)(2) is applicable.

Section 1.507-3(a)(1) provides that, in a § 507(b)(2) transfer, a transferee organization will not be treated as a newly created organization. The transferee organization is treated as possessing those attributes and characteristics of the transferor organization which are described in § 1.507-3(a)(2), (3) and (4).

Section 1.507-3(a)(2)(i) provides that a transferee organization shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit multiplied by a fraction the numerator of which is the fair market value of the assets (less encumbrances) transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor (less encumbrances) immediately before the transfer.

Section 1.507-3(a)(3) provides that, in the event of a transfer of assets under § 507(b)(2), any person who is a substantial contributor with respect to the transferor foundation shall be treated as a substantial contributor with respect to the transferee foundation, regardless of whether such person meets the \$5,000 two-percent test with respect to the transferee at any time. If a private foundation makes a transfer described in § 507(b)(2) to two or more transferee private foundations, any person who is a substantial contributor with respect to the transferor foundation prior to such transfer shall be considered a substantial contributor with respect to each transferee.

Section 1.507-3(a)(4) provides that if a private foundation incurs liability for one or more of the taxes imposed under chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in § 507(b)(2) to one or more private foundations, in any case where transferee liability applies each transferee foundation shall be treated as receiving the transferred assets

subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Section 1.507-3(a)(5) provides that, except as provided in § 1.507-3(a)(9), a private foundation is required to meet the distribution requirements of § 4942 for any taxable year in which it makes a § 507(b)(2) transfer of all or part of its net assets to another private foundation.

Section 1.507-3(a)(6) provides that whenever a private foundation makes a § 507(b)(2) transfer of all or part of its net assets to another private foundation, the applicable period of time described in § 4943(c)(4), (5), or (6) shall include both the period during which the transferor foundation held such assets and the period during which the transferee foundation holds such assets.

Section 1.507-3(a)(7) provides that, except as provided in § 1.507-3(a)(9), where the transferor has disposed of all of its assets, during any period in which the transferor has no assets, § 4945(d)(4) and (h) shall not apply to the transferee or the transferor with respect to any expenditure responsibility grants made by the transferor. However, the information reporting requirements under § 4945 will apply for any year in which any such transfer is made.

Section 1.507-3(a)(9)(i) provides that if a private foundation transfers all of its net assets to one or more private foundations that are effectively controlled, directly or indirectly, by the same person or persons that effectively controlled the transferor private foundation, the transferee private foundation will be treated as if it were the transferor private foundation for purposes of §§ 4940 through 4948 and §§ 507 through 509. However, where proportionality is appropriate, such a transferee foundation shall be treated as if it were the transferor in the proportion which the fair market value of the assets (less encumbrances) transferred to such transferee bears to the fair market value of the assets (less encumbrances) of the transferor immediately before the transfer.

Section 1.507-3(a)(9)(ii) provides that § 1.507-3(a)(9)(i) shall not apply to the requirements under § 6033, which must be complied with by the transferor foundation, nor to the requirement under § 6043 that the transferor foundation file

a return with respect to its liquidation, dissolution or termination.

Section 1.507-3(a)(9)(iii) (example 2) provides that if the transferees of a § 507(b)(2) transfer are effectively controlled by the same persons who control the transferor, each transferee is required to exercise expenditure responsibility with respect to the transferor's outstanding grants, unless, as part of the transfer, the transferor assigns and one or more transferees assume the transferor's expenditure responsibility, in which case, only the transferees assuming the transferor's expenditure responsibility are required to exercise such expenditure responsibility. Section 1.507-3(a)(9)(iii) (example 2) also provides that because such transferee foundations are treated as the transferor, rather than as recipients of expenditure responsibility grants, there are no expenditure responsibility requirements which must be exercised under § 4945(d)(4) and (h) with respect to the § 507(b)(2) transfer.

Section 1.507-3(a)(10), by reference to § 1.507-1(b)(9), provides that a private foundation that transfers all of its net assets is required to file the annual information return required by § 6033 for the taxable year in which such transfer occurs. However, the foundation will not be required to file such return for any taxable year following the taxable year in which the last of such transfers occurred, provided the foundation does not hold equitable title to any assets or engage in any activity during such subsequent taxable year.

Section 1.507-3(c)(1) provides that for purposes of § 507(b)(2), the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(c)(2) provides that the term "significant disposition of assets to one or more private foundations" includes any disposition (or series of related dispositions) by a private foundation to one or more private foundations of 25 percent or more of the fair market value of the net assets of the transferor foundation at the beginning of the taxable year in which the transfers occur.

Section 1.507-3(d) provides that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute a termination of the transferor's private foundation status under § 507(a)(1).

Section 1.507-4(b) provides that private foundations which make transfers described in § 507(b)(2) are not subject to the tax imposed under § 507(c) with respect to such transfers unless the provisions of § 507(a) become applicable.

Section 1.507-7(a) provides that the net value of assets for purposes of § 507(c) shall be determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation.

Sections 1.507-7(b)(1) and 1.507-8 provide that in the case of a termination under § 507(a)(1), the date referred to in § 1.507-7(a)(1) shall be the date on which the terminating foundation gives the notification described in § 507(a)(1).

Section 4940(a) generally imposes an excise tax on a private foundation's net investment income for the taxable year.

Section 4940(c)(1) defines net investment income as the amount by which the sum of the gross investment income and the capital gain net income exceeds the deductions allowed under § 4940(c)(3).

Section 4941(a)(1) imposes a tax on each act of self-dealing between a disqualified person and a private foundation. Section 53.4946-1(a)(8) provides that, for purposes of § 4941, the term "disqualified person" shall not include any organization described in § 501(c)(3) (other than an organization described in § 509(a)(4)).

Section 4942(a) generally imposes a tax on the undistributed income of a private foundation (other than an operating foundation under § 4942(j)(3)) for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year.

Section 4942(c) defines "undistributed income" for any taxable year as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made out of such distributable amount for such taxable year.

Section 4942(d) defines "distributable amount" as the amount equal to the sum of the minimum investment return, plus certain other amounts, reduced by the sum of the taxes imposed on such private foundation for the taxable year under subtitle A and § 4940.

Section 4942(g)(1)(A) defines "qualifying distribution" as any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(2)(B) other than a contribution to: (i) an organization controlled directly or indirectly by the foundation or by one or more disqualified persons with respect to the foundation, unless certain requirements are satisfied, or (ii) any private foundation which is not an operating foundation under § 4942(j)(3), unless certain requirements are satisfied.

Section 4942(i) provides for a carry-over of the amount by which qualifying distributions during the five preceding taxable years (other than amounts required to be distributed out of corpus under § 4942(g)(3)) have exceeded the distributable amounts for such years.

Rev. Rul. 78-387 (1978-2 C.B. 270) holds that when a private foundation transfers all its assets to another private foundation that is controlled by the same persons who controlled the transferor foundation, the transferee foundation may reduce its distributable amount under § 4942(d) by the amount of the transferor's excess qualifying distributions as described in § 4942(i).

Section 4943(a)(1) imposes a tax on the "excess business holdings" (as defined in § 4943(c)) of any private foundation in a business enterprise.

Section 4944(a)(1) imposes a tax on any amount invested by a private foundation in a manner that jeopardizes the carrying out of any of the foundation's exempt purposes.

Section 4945 imposes a tax on any "taxable expenditure" (as defined in § 4945(d)) made by a private foundation.

Section 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid or incurred as a grant to a private non-operating foundation unless the grantor foundation exercises expenditure responsibility with respect to such grant in accordance with § 4945(h).

Section 4945(h) provides that the expenditure responsibility referred to in § 4945(d)(4) means a private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to: (1) see that the grant is spent solely for the purpose for which made, (2) obtain full and complete reports from the grantee on how the funds are spent, and (3) make full and detailed reports with respect to such expenditures to the Secretary.

Section 4946(a)(1) defines a "disqualified person" for purposes of subchapter A of chapter 42.

Section 6033(a)(1) provides that, with certain exceptions, every organization exempt from taxation under § 501(a) shall file an annual return.

Section 6043(b) and § 1.6043-3(a)(1) provide that, with certain exceptions, a private foundation must provide information with respect to a liquidation, dissolution, termination or substantial contraction as required by the instructions accompanying the foundation's annual return.

ANALYSIS

SECTION 507

Section 507(b)(2) applies to a significant disposition of assets by one private foundation to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income. See § 1.507-3(c)(1). A transfer of all of a private foundation's assets to one or more private foundations constitutes a significant disposition. See § 1.507-3(c)(2). In Situations 1, 2 and 3, each transferor foundation transfers all of its assets to one or more private foundations. The transfers are not for full and adequate consideration and are not distributions out of current income. Thus, the transfers in Situations 1, 2 and 3 are § 507(b)(2) transfers.

A transfer of assets described in § 507(b)(2) does not constitute a termination of the transferor's private foundation status under § 507(a)(1) unless the transferor voluntarily gives notice pursuant to § 507(a)(1). See §§ 1.507-1(b)(6) and 1.507-3(d). The transferor foundation is not required to provide such notice. In Situation 1, P's dissolution under state

law has no effect on whether *P* has terminated its private foundation status for federal tax purposes.

In Situations 1, 2, and 3, if the transferor foundation does not give notice to the Manager, Exempt Organizations Determinations (TE/GE), of its intent to terminate, the transferor retains its private foundation status and the § 507(c) tax does not apply. *See* § 507(a)(1) and § 1.507-4(b). The transferor foundation is required to file a Form 990-PF for the taxable year of the transfer(s), but is not required to file a Form 990-PF for subsequent taxable years during which it does not have equitable title to any assets and does not engage in any activity. *See* §§ 6033(a)(1) and 6043(b), and §§ 1.507-1(b)(9) and 1.507-3(a)(10). If, at any time following the transfer(s), the transferor foundation receives additional assets or engages in any activity, the transferor foundation must file a Form 990-PF. Additionally, because the transferor foundation has not terminated its private foundation status, the transferor foundation continues to be treated as a private foundation.

In Situations 1, 2, and 3, if the transferor foundation does give notice to the Manager, Exempt Organizations Determinations (TE/GE), of its intent to terminate, then the § 507(c) tax applies on the date such notice is given. *See* § 1.507-7(a) and (b)(1). Thus, in Situations 1, 2, and 3, if the transferor foundation provides notice at least one day after it transfers all of its assets, the tax imposed by § 507(c) will be zero. The transferor foundation is required to file a Form 990-PF for the taxable year of the transfer(s). *See* §§ 6033(a)(1) and 6043(b).

Regardless of whether the transferor foundation provides notice of its intent to terminate, the transferee foundations are treated as possessing the aggregate tax benefit of the transferor foundations. *See* § 1.507-3(a)(1) and (2)(i). In Situation 1, *X*, *Y*, and *Z* succeed to *P*'s aggregate tax benefit in proportion to the assets transferred to each. *See* § 1.507-3(a)(2)(i).

Moreover, regardless of whether the transferor foundation provides notice of its intent to terminate, where transferee liability applies, each transferee foundation is treated as receiving the transferred assets subject to the transferor foundation's prior excise tax liabilities under

chapter 42 (and any penalties resulting therefrom), if any, to the extent the transferor did not previously satisfy those liabilities. *See* § 1.507-3(a)(1) and (4).

SECTION 4940

In Situations 1, 2 and 3, the transfers do not constitute investments of the transferor for purposes of § 4940; therefore, the transfers do not give rise to net investment income subject to tax under § 4940(a).

In Situations 1, 2, and 3, because each transferor foundation transfers all of its assets to one or more private foundations effectively controlled by the same persons that effectively control the transferor, any excess § 4940 tax paid by the transferor may be used by the transferees to offset the transferees' § 4940 tax liability. *See* § 1.507-3(a)(9)(i). In Situation 1, where there are several transferees, proportionality is appropriate, and *X*, *Y*, and *Z* will each succeed to one third of any excess § 4940 tax paid by *P*. *See* § 1.507-3(a)(9)(i).

SECTION 4941

In Situations 1, 2 and 3, the transfers are to § 501(c)(3) organizations, which are not treated as disqualified persons for purposes of § 4941. *See* § 53.4946-1(a)(8). Thus, the transfers do not constitute self-dealing transactions and are not subject to tax under § 4941(a)(1).

SECTION 4942

In Situations 1, 2 and 3, because each transferor foundation transfers all of its assets to one or more private foundations effectively controlled by the same persons that effectively control the transferor, the transferee foundations are treated as though they were the transferor for purposes of § 4942. *See* § 1.507-3(a)(9)(i). Accordingly, the transfers to the transferee foundations are not treated as qualifying distributions of the transferor foundation. In addition, in Situations 2 and 3, each transferee foundation assumes all obligations with respect to the transferor's "undistributed income" within the meaning of § 4942(c), if any, and reduces its own distributable amount under § 4942 by the transferor foundation's excess qualifying distributions under § 4942(i).

In Situation 1, where there are several transferee foundations, proportionality is appropriate, and *X*, *Y* and *Z* each becomes responsible for one third of *P*'s undistributed income and succeeds to one third of *P*'s excess qualifying distributions, if any. *See* § 1.507-3(a)(9)(i) and Rev. Rul. 78-387.

SECTION 4943

Whether the transfers cause a transferee foundation to have excess business holdings and be subject to tax under § 4943(a) depends on the facts and circumstances. In Situations 1, 2, and 3, because each transferor foundation transfers all of its assets to one or more private foundations effectively controlled by the same persons that effectively control the transferor, the transferee foundations are treated as though they were the transferor for purposes of §§ 4943 and 4946. *See* § 1.507-3(a)(9)(i). Accordingly, in determining whether a transferee foundation has excess business holdings, the disqualified persons of the transferee foundation are determined in part by treating the transferee as though it were the transferor. For example, both the substantial contributors of the transferee and the substantial contributors of the transferor are treated as a disqualified persons of the transferee in determining whether the transferee has excess business holdings as a result of the transfer. *See* § 4946(a)(1)(A) and § 1.507-3(a)(9)(i); *see also* § 1.507-3(a)(3). In addition, in determining whether a transferee foundation is subject to tax under § 4943, the transferee's holding period in the transferred assets for purposes of § 4943(c)(4), (5), and (6) includes both the period during which the transferor foundation held such assets and the period during which the transferee foundation holds such assets. *See* § 1.507-3(a)(6).

SECTION 4944

In Situations 1, 2, and 3, the transfers do not constitute investments for purposes of § 4944; therefore the transfers do not constitute investments jeopardizing the transferor foundation's exempt purposes and are not subject to tax under § 4944(a)(1).

SECTION 4945

In Situations 1, 2, and 3, because each transferor foundation transfers all of its assets to one or more private foundations effectively controlled by the same persons that effectively control the transferor, the transferee foundations are treated as though they were the transferor for purposes of § 4945. See § 1.507-3(a)(9)(i). Because the transferee foundations are treated as the transferor foundation rather than as recipients of expenditure responsibility grants, there are no expenditure responsibility requirements that must be exercised under § 4945(d)(4) or (h) with respect to the transfers to the transferee foundations. See § 1.507-3(a)(9)(i) and (iii)(example 2).

The transferor foundation is required to exercise expenditure responsibility over the transferor's outstanding grants until the transferor disposes of all of its assets. Thereafter, during any period in which the transferor foundation has no assets, the transferor foundation is not required to exercise expenditure responsibility over any outstanding grants. See § 1.507-3(a)(7). However, the transferor foundation still must meet the § 4945(h) reporting requirements for the outstanding grants for the year in which the transfers are made. See § 1.507-3(a)(7).

The transferee foundations assume expenditure responsibility for all the transferor's outstanding grants. See § 1.507-3(a)(9)(i). In Situation 1, because X agreed to exercise expenditure responsibility for all of P's outstanding grants, Y and Z have no expenditure responsibility over P's grants. However, in the absence of such an agreement, X, Y and Z each would be required to exercise expenditure responsibility with respect to all of P's outstanding grants. See § 1.507-3(a)(9)(i) and (iii) (example 2).

HOLDINGS

(1) A private foundation that transfers all of its assets to one or more private foundations in a transfer described in § 507(b)(2) is not required to notify the Manager, Exempt Organizations Determinations (TE/GE), that it plans to terminate its private foundation status under

§ 507(a)(1). If the private foundation does not provide notice and does not terminate, the private foundation is not subject to the § 507(c) termination tax. If the private foundation chooses to provide notice, and therefore terminates, it is subject to the § 507(c) tax; however, if the private foundation has no assets on the day it provides notice (e.g., it provides notice at least one day after it transfers all of its assets), the § 507(c) tax will be zero.

(2) (a) A private foundation that has disposed of all of its assets and terminates its private foundation status must file a Form 990-PF for the taxable year of the disposition and must comply with any expenditure responsibility reporting obligations on such return.

(b) A private foundation that has disposed of all of its assets and does not terminate its private foundation status must file a Form 990-PF for the taxable year of the disposition and must comply with any expenditure responsibility reporting obligations on such return, but does not need to file returns in the following taxable years if it has no assets and does not engage in any activities. If, in later taxable years, it receives additional assets or resumes activities, it must resume filing a Form 990-PF for those taxable years in which it has assets or activities.

(3) Where transferee liability applies, each transferee foundation is treated as receiving the transferred assets subject to the transferor foundation's prior excise tax liabilities under chapter 42 (and any penalty resulting therefrom), if any, to the extent the transferor foundation did not previously satisfy those liabilities.

(a) The transfers do not give rise to net investment income and are not subject to tax under § 4940(a). The transferee foundations may use their proportionate share of any excess § 4940 tax paid by the transferor to offset their own § 4940 tax liability.

(b) The transfers do not constitute self-dealing and are not subject to tax under § 4941(a)(1).

(c) The transfers do not constitute qualifying distributions for the transferor foundation under § 4942. The transferee foundations assume their proportionate share of the transferor foundation's undis-

tributed income under § 4942 and reduce their own distributable amount for purposes of § 4942 by their proportionate share of the transferors' excess qualifying distributions under § 4942(i).

(d) Whether the transfers cause a transferee foundation to have excess business holdings and be subject to tax under § 4943(a) depends on the facts and circumstances. In making these determinations, the disqualified persons of a transferee foundation are determined in part by treating the transferee as though it were the transferor. In addition, the transferee's holding period in the transferred assets for purposes of § 4943(c)(4), (5) and (6) includes both the period during which the transferor foundation held such assets and the period during which the transferee foundation holds such assets.

(e) The transfers do not constitute investments jeopardizing the transferor foundation's exempt purposes and are not subject to tax under § 4944(a)(1).

(f) The transferor foundation is not required to exercise expenditure responsibility under § 4945(h) with respect to the transfers. The transferor foundation is required to exercise expenditure responsibility over any outstanding grants until the time it disposes of all of its assets and must satisfy the § 4945(h) reporting requirements for the taxable year in which the transfers were made. Following the transfers and during any period in which the transferor has no assets or activities, the transferor foundation is not required to exercise expenditure responsibility with respect to any of its outstanding grants.

Each transferee foundation must exercise expenditure responsibility with respect to all outstanding grants by the transferor foundation. If, however, the transferor foundation assigns and transferees assume the transferor's expenditure responsibility with respect to a grant, only the transferees assuming the transferor's expenditure responsibility are required to exercise such expenditure responsibility with respect to such grant.

(4) The transferor foundation's aggregate tax benefits under § 507(d) are transferred to the transferee foundations in proportion to the transferor's assets transferred to each transferee.

DRAFTING INFORMATION

The principal author of this revenue ruling is Theodore R. Lieber of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, contact Theodore R. Lieber at (202) 283-8999 (not a toll-free call).

Section 1092.—Straddles

26 CFR 1.1092(c)-1: *Qualified covered calls.*

T.D. 8990

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Equity Options With Flexible Terms; Qualified Covered Call Treatment

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations providing guidance on the application of the rules governing qualified covered calls. The new rules address concerns that were created by the introduction of new financial instruments several years after the enactment of the qualified covered call rules. The final regulations provide guidance to taxpayers writing equity call options.

DATES: *Effective Date:* These regulations are effective April 29, 2002.

Applicability Date: For dates of applicability, see §§ 1.1092(c)-1(c), 1.1092(c)-2(d), 1.1092(c)-3(c), and 1.1092(c)-4(g).

FOR FURTHER INFORMATION CONTACT: Pamela Lew, (202) 622-3950 or Viva Hammer, (202) 622-0869 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On January 18, 2001, the IRS published in the **Federal Register** proposed regulations (REG-115560-99, 2001-1 C.B. 993 [66 F.R. 4751]) addressing various issues concerning qualified covered call (QCC) options under section 1092(c)(4). No requests to speak at a public hearing were received, and no public hearing was held.

The proposed regulations provide that equity options with flexible terms (FLEX options) may be QCC options as long as they satisfy the general rules for QCC treatment described in section 1092(c)(4), are not for a term of longer than one year, and meet other specified requirements. In addition, an equity option with standardized terms must be outstanding for the underlying equity. For purposes of applying the general rules, the bench marks will be the same as those for an equity option with standardized terms on the same stock having the same applicable stock price.

The proposed regulations also provide that certain over-the-counter (OTC) options may be QCC options so that OTC options that are economically similar to FLEX options may receive the same tax treatment as FLEX options. Specifically, the proposed regulations provide that an OTC option is eligible for QCC treatment if it is entered into with a person registered with the Securities and Exchange Commission (SEC) as a broker-dealer or alternative trading system and meets the same requirements for QCC treatment that apply to FLEX options.

The proposed regulations further provide that equity options with standardized terms with maturities of longer than one year cannot be QCC options.

Comments were requested about the proposed one-year limit for all QCCs, including a discussion of time limitations in general. If a commentator recommended a time limitation greater than one

year or recommended that there be no time limitation, a detailed, comprehensive description of possible solutions to the problem of increased risk reduction caused by longer term options was requested. Commentators were also asked to address the administrability of any proposed solutions.

After revisions to take into account several of the comments submitted, the proposed regulations are adopted by this Treasury decision.

Summary of Principal Comments

Four commentators responded to the request for comments. Two of the commentators addressed only the proposed 1-year limitation applicable to all QCC options. A third commentator addressed the proposed 1-year limit as well as a number of other issues. The fourth commentator focused on issues other than the proposed 1-year limitation.

One-year Term Limitation

A number of commentators object to the proposal to limit QCC treatment to options with a duration of one year or less. These commentators note that the statute does not contain any limitation on the maximum term for QCCs and argue that a one-year limitation would be overly harsh. Among other things, they note that a strict one-year rule would preclude QCC status for even out-of-the-money options. One commentator notes that section 1092(c)(4) does not remove a QCC option completely from the straddle rules. Paragraphs (c)(4)(E) and (f) of section 1092 provide special limitations on QCCs for recognition of loss and suspension of holding period.¹ This commentator suggests that these rules limit the extent to which longer-term QCCs would lead to results inconsistent with the purposes of section 1092.

In response to the request in the preamble to the proposed regulation for alternative regimes to address the

¹ Under section 1092(c)(4)(E), the exception for QCCs does not apply to a covered call that would otherwise qualify for the exception if one leg is disposed of at a loss in one year, gain on the other position is includible for a later year, and less than 30 days has elapsed between these transactions. Under section 1092(f), if a taxpayer grants an in-the-money QCC, then loss on the call is treated as long-term capital loss if gain on the underlying stock would be long-term capital gain. In addition, the holding period is suspended for the period during which the taxpayer is the grantor of the option.

increased risk reduction created by longer-term options, two commentators suggest an adjustment to the “applicable stock price” to reflect forward pricing concepts. These commentators suggest that the unadjusted applicable stock price, as determined on the date the option is granted, be multiplied by a simple adjusting factor to produce an applicable stock price adjusted for the passage of time. For each additional term year, the factor would be increased by 5%. For example, the factor for a one-to-two year option would be 105%, and the factor for a two-to-three year option would be 110 %. The adjusted applicable stock price would then be used to determine the applicable benchmarks and the lowest permitted QCC strike price. The commentators prefer, however, no limitation on the term of QCC options.

Clarification of “single fixed strike price”

Proposed § 1.1092(c)–1(c)(1)(ii) requires a QCC option to have “a single fixed strike price stated as a dollar amount.” One commentator suggests that this phrase does not account for adjustments to the strike price due to certain corporate events, such as stock splits, stock dividends, spin-offs, mergers, or substantial cash dividends that reduce the market value of the stock by at least 10%. For example, a strike price might not be considered fixed if the underlying stock split two-for-one and the option’s strike price were adjusted to one-half of its original strike price. The commentator recommends that the language be modified to account for these events.

Clarification That the Lowest Qualified Benchmark for a FLEX Option is the Same as for an Equity Option with Standardized Terms

Proposed § 1.1092(c)–1(c)(2)(i) provides that to determine whether a FLEX option is deep in the money, the taxpayer must use the same lowest qualified benchmark that is used for a standardized option on the same stock having the same applicable stock price. One commentator argues that the language in the proposed regulation is ambiguous. The commentator suggests that the language in the pro-

posed regulation be changed to provide that the lowest qualified benchmark for a FLEX option is equal to the lowest *available* strike price at which a standardized call option can be written without being deep in the money.

Requirement That an Equity Option with Standardized Terms Exist at the Time an Equity Option with Flexible Terms or Qualifying Over-the-counter Option is Written

Under § 1.1092(c)–1(c)(1)(iv) of the proposed regulation, a FLEX option can be a QCC option only if “[a]n equity option with standardized terms is outstanding for the underlying equity.” Under exchange rules, trading in a FLEX option cannot be *authorized* unless trading in a standardized option on the same stock has been *authorized*. Although a commentator believes it unlikely that a FLEX option would be written on a stock for which there were no outstanding standardized options, the commentator sees no reason to impose this restriction. Thus, the commentator recommends that the word “available” be substituted for the word “outstanding.”

Clarification of “equity option with standardized terms”

Under proposed § 1.1092(c)–1(d)(3), an equity option with standardized terms is defined as “an equity option that is traded on a national securities exchange registered with the Securities and Exchange Commission and that is not an equity option with flexible terms.” One commentator notes that there is no definition of “equity option” and wonders whether the definition of equity option in section 1256(g) applies here. That definition would include options on narrow based indexes. In addition, because an equity option with standardized terms is defined as a negative (*i.e.*, anything that is not a FLEX option), if the exchanges approve a new option product that does not meet the definition of FLEX option, that product might meet the definition of a standardized option, thus affecting the application of the regulations for FLEX options. The commentator did not provide alternative regulatory language.

Clarification of “entered into with”

Under proposed § 1.1092(c)–3(c)(2)(i), a qualifying OTC option must be “entered into with” a person registered with the SEC as a broker-dealer. One commentator is concerned that this phrase implies that the broker-dealer must act as a principal in the transaction. The commentator requests that the language be modified to say that the broker-dealer may be a principal to the transaction or may serve as an agent.

Add Banks to the List of Parties With or Through Whom a QCC May Be Transacted

One commentator requests that banks be added to the list of parties with or through whom a QCC transaction may be effected. The commentator notes that under the Gramm-Leach-Bliley Act, Public Law 106–102, 113 Stat. 1338 (1999), banks will be required to interpose a broker-dealer registered with the SEC in transactions with customers who are not “qualified investors.” Banks will be permitted to function as broker-dealers with respect to “qualified investors.”

The commentator suggests defining a bank as a “bank within the meaning of section 3(a)(6) of the Securities Exchange Act of 1934 and the regulations adopted thereunder.” The commentator argues that any such bank would be subject to a banking regulatory authority within the United States and would generally be subject to recordkeeping requirements.

Explanation of Provisions

Limitation of Option Term

As originally enacted in 1981, section 1092 did not apply to stock or to options on stock. In the legislative history to the Tax Reform Act of 1984, the House Ways and Means Committee stated that taxpayers had attempted to exploit the exemption from the loss-deferral rule for exchange-traded stock options to defer tax on income from unrelated transactions. H. Rep. No. 432, 98th Cong., 2d Sess. 1266 (1984). The Committee stated that a typical abusive stock option straddle “involves the acquisition of ‘deep-in-the-money’ offsetting option positions. Regardless of whether the

value of the underlying stock increases or decreases, one option position will result in a loss that can be realized for tax purposes, while the other position results in a gain of approximately equal size that can be deferred until the next year.” *Id.* In response to these concerns, Congress generally ended the exemption from the straddle rules for stock and exchange-traded options.

The House Ways and Means Committee noted, however, that the extension of the straddle rules to stock options and stock would affect the widely used investment strategy of writing call options on stock owned by the taxpayer. The Committee stated that it might be appropriate to exempt transactions that were undertaken primarily to enhance the taxpayer’s investment return on the stock and not to reduce the taxpayer’s risk of loss on the stock. Congress therefore amended section 1092 to permit a taxpayer owning stock and writing a covered call option generally to avoid straddle treatment if certain conditions were met. One condition was that the strike price of the call could not be less than a statutorily-prescribed level relative to the market price of the underlying stock. In establishing this exception to the straddle rules, Congress granted the Secretary broad regulatory authority to modify section 1092 to take account of changes in the practices of options exchanges or to prevent tax avoidance.

Since 1984, numerous changes have occurred in the practices of options exchanges. In 1984, no exchange-traded option had a term of greater than nine months. By contrast, certain exchange-traded options currently may have terms of up to 33 months. In light of these changes, the IRS and Treasury have considered certain economic characteristics of qualified covered call transactions as they relate to the risk reduction effects of longer-term options.

One way of looking at the risk reduction effect of a covered call option focuses on the day-to-day (or intra-day) relative changes in value of the stock and the option. In general, the values of stock and a written call option on the stock vary inversely when viewed from the perspective of the person owning the stock and writing a call option. Each movement in

the stock price produces a movement in the value of the written call that, at least partially, offsets the change in value of the long position in the stock.

Modern option pricing literature describes this relationship between the change in value of the underlying stock and the change in value of the option using the parameter “Delta”. If a change in value of the stock results in an equal movement in the value of the option, Delta equals 1. If the change in value of the option is less than the change in value of the stock, then Delta is less than 1. From the perspective of a call option writer, because of the inverse relationship between changes in stock price and changes in option value described above, Delta represents the amount of offset that a change in stock value has upon the value of the written call option. Delta values vary with a number of factors, including the extent to which the option is in or out of the money and the term of the option. All else being equal, longer-term options have higher Delta values and, therefore, have a greater risk reduction potential than short-term options with respect to movements in stock prices.

Another economic characteristic of longer-term covered call options is increased potential for the immediate recognition of a stock loss and the deferral of any gain arising from a related option. As noted above, when section 1092(c)(4) was enacted, no qualified covered call option had a term of more than nine months, and the mismatch for a QCC thus could not have spanned more than one taxable year. With the advent of longer-term options, the potential for a mismatch between a loss and the deferral of related income can extend over many taxable years, which may not have been contemplated by Congress when the QCC provisions were enacted.

After reviewing taxpayers’ comments received in light of these economic considerations, the IRS and Treasury have decided to adopt a forward pricing approach for the determination of the applicable stock price for an option with a term greater than 12 months. To determine the applicable stock price for an option with a term greater than 12 months, taxpayers are required to multiply the statutory applicable stock price by

a factor, which represents a noncompounded two percent per quarter increase in the applicable strike price. Based on certain assumptions regarding the volatility of the underlying stock and the risk-free interest rate, the use of such factors for options with a relatively short term (*i.e.*, 33 months or less) will produce Deltas that are generally similar to those for a nine-month option with no adjustment to the applicable strike price. Because no exchange-traded option currently has a term of more than 33 months, and because the application of the approach set forth above to options with terms longer than 33 months may permit the use of such options for tax avoidance, the IRS and Treasury believe that it would be inappropriate to extend this approach to such options. Thus, no option will constitute a qualified covered call option if it has a term of greater than 33 months. Additional guidance about the maximum term limit may be provided by the Commissioner in guidance published in the Internal Revenue Bulletin. This could occur, for example, if the option exchanges commence trading of equity options with standardized terms that expire more than 33 months after the date of issuance.

The definition of a QCC option also affects a number of other Code sections. These are generally provisions that require a taxpayer to bear economic risk with respect to an asset for purposes of establishing a requisite holding period in the asset. See sections 246(c)(1), 852(b)(4)(C), 857(b)(8)(B), 901(k)(5), 1059(d)(3), and 1259(c)(3)(A)(iii). The IRS and the Treasury have taken into account the interaction of the QCC qualification rules and these other Code sections in light of the risk reduction potential of longer-term options. If, however, experience suggests that longer-term QCC options are being exploited to achieve risk reduction while allowing taxpayers to establish holding periods in ways that are inconsistent with another Code provision (*e.g.*, section 1259), the IRS and Treasury may reconsider the issue of term limitations for QCCs, either generally for purposes of section 1092 or specifically for purposes of such other Code provision.

Clarification of “single fixed strike price”

After consideration of the comment submitted, a definition for “single fixed strike price” is added at § 1.1092(c)–4(d), providing that adjustments to the strike price for certain significant corporate events subsequent to the writing of the option will not cause the option to fail the requirement of a single fixed strike price. The definition is intended to cover adjustments to the strike price made under Section 11 of Article VI of the Options Clearing Corporation By-Laws.

Clarification That the Lowest Qualified Benchmark for a FLEX Option is the Same as for an Equity Option with Standardized Terms

After consideration of the comment submitted, examples have been added at § 1.1092(c)–2(c)(2)(ii) to clarify that the lowest qualified benchmark for a FLEX option is the same as the lowest qualified benchmark for an equity option with standardized terms on the same stock having the same applicable stock price.

Requirement That an Equity Option with Standardized Terms Exist at the Time an Equity Option with Flexible Terms or Qualifying Over-the-counter Option is Written

After consideration of the comment submitted, the language is finalized as proposed.

This provision was inserted in the proposed regulation for two reasons. The first reason was to provide benchmarks for FLEX options. Because FLEX option strike prices can be written in one penny intervals, without this provision every FLEX option would be deep-in-the-money if the strike price were one penny less than the applicable stock price. By tying every FLEX option to a standardized option, the benchmarks are the strike prices set by the exchanges for standardized options. For this purpose, an authorized standardized option would suffice.

The second reason underlying this provision is to facilitate the discovery of attempts to use off-market pricing of FLEX options or qualifying OTC options as a method of effecting collateral trans-

actions. If a FLEX option or qualifying OTC option were written for an off-market premium, that would warn of the potential for the existence of one or more other transactions. For example, a qualifying OTC option might be written by a corporation and held by a shareholder. If the premium were excessively low compared to that for a standardized option on that same stock, the additional value received by the holder might be appropriately characterized as a dividend. Thus, with an outstanding standardized option on the same stock, the existence of an excessively low premium for a FLEX option would be more transparent.

Clarification of “equity option with standardized terms”

After consideration of the comment submitted, a new definition for “equity option with standardized terms” is provided at § 1.1092(c)–4(b). The factors listed in this section were based on the rules of the exchanges establishing required provisions of exchange-traded equity options.

Clarification of “entered into with”

After consideration of the comment submitted, a clarification is added to § 1.1092(c)–4(c)(2)(i) to explain that the broker-dealer may be a principal to the transaction or can serve as an agent.

Add Banks to the List of Parties With or Through Whom a QCC May Be Transacted

After consideration of the comment submitted and review of the recordkeeping requirements of 12 CFR 12.3, 12 CFR 208.34, and 12 CFR 344.4, banks that are required to comply with these recordkeeping requirements are added to the list of parties with or through whom a qualifying over-the-counter option may be transacted.

Other Provisions

Section § 1.1092(c)–1 was redesignated § 1.1092(c)–2 to facilitate the insertion of the general term limitations applying to all QCC options. The definitions in former § 1.1092(c)–1(d) were moved to

§ 1.1092(c)–4 to facilitate consolidation of definitions that apply to QCC options.

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. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the only category of small entities likely to be affected are small broker-dealers or small federally-regulated financial institutions who may be included among the financial intermediaries implementing the changes effected by these regulations. The requirements contained in these regulations do not impose more than a minimal compliance burden because the required changes in computer programs and back office procedures are insignificant. In addition, these regulations do not impose any recordkeeping or reporting requirements and therefore impose minimal compliance costs, if any, upon any small entities that may be affected. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Drafting Information

The principal authors of these regulations are Pamela Lew, Office of Associate Chief Counsel (Financial Institutions and Products) and Viva Hammer, Office of Tax Policy (Department of Treasury). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.1092(c)-2 also issued under 26 U.S.C.1092(c)(4)(H).

Section 1.1092(c)-3 also issued under 26 U.S.C.1092(c)(4)(H).

Section 1.1092(c)-4 also issued under 26 U.S.C. 1092(c)(4)(H).* * *

Par. 2. Section 1.1092(c)-1 is redesignated as § 1.1092(c)-2.

Par. 3. A new § 1.1092(c)-1 is added to read as follows:

§ 1.1092(c)-1 *Qualified covered calls.*

(a) *In general.* Section 1092(c) defines a straddle as offsetting positions with respect to personal property. Under section 1092(d)(3)(B)(i)(I), stock is personal property if the stock is part of a straddle that involves an option on that stock or substantially identical stock or securities. Under section 1092(c)(4), however, writing a qualified covered call option and owning the optioned stock is not treated as a straddle under section 1092 if certain conditions, described in section 1092(c)(4)(B), are satisfied. Section 1092(c)(4)(H) authorizes the Secretary to modify these conditions to carry out the purposes of section 1092(c)(4) in light of changes in the marketplace.

(b) *Term limitation*—(1) *General rule.* Except as provided in paragraph (b)(2) of this section, an option is not a qualified covered call unless it is granted not more

than 12 months before the day on which the option expires or satisfies term limitation and qualified benchmark requirements established by the Commissioner in guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter).

(2) *Special benchmark rule for an option granted not more than 33 months before the day on which the option expires* (i) *In general.* The 12-month limitation described in paragraph (b)(1) of this section is extended to 33 months provided the lowest qualified benchmark is determined using the adjusted applicable stock price, as defined in § 1.1092(c)-4(e).

(ii) *Examples.* The following examples illustrate the rules set out in paragraph (b)(2)(i) of this section:

Example 1. Taxpayer owns stock in Corporation X. Taxpayer writes an equity option with standardized terms on Corporation X stock through a national securities exchange with a term of 21 months. The applicable stock price for Corporation X stock is \$100. The bench marks for a 21-month equity option with standardized terms with an applicable stock price of \$100 will be based upon the adjusted applicable stock price. Using the table at § 1.1092(c)-4(e), the applicable stock price of \$100 is multiplied by the adjustment factor 1.12, resulting in an adjusted applicable stock price of \$112. Using the bench marks for an equity option with standardized terms with an adjusted applicable stock price of \$112, the highest available strike price less than the adjusted applicable stock price is \$110, and the second highest strike price less than the adjusted applicable stock price is \$105. Therefore, a 21-month equity call option with standardized terms on Corporation X stock will not be deep in the money if the strike price is not less than \$105.

Example 2. Taxpayer owns stock in Corporation Y. Taxpayer writes an equity option with standardized terms on Corporation Y stock through a national securities exchange with a term of 21 months. The applicable stock price for Corporation Y stock is \$13.25. The bench marks for a 21-month

equity option with standardized terms with an applicable stock price of \$13.25 will be based upon the adjusted applicable stock price. Using the table at § 1.1092(c)-4(e), the applicable stock price of \$13.25 is multiplied by the adjustment factor 1.12, resulting in an adjusted applicable stock price of \$14.84. Using the bench marks for an equity option with standardized terms with an adjusted applicable stock price of \$14.84, the highest available strike price less than the adjusted applicable stock price is \$12.50. However, under section 1092(c)(4)(D), the lowest qualified bench mark can be no lower than 85% of the applicable stock price, which for Corporation Y stock is \$12.61 (85% of the adjusted applicable stock price of \$14.84). Thus, because the highest available strike price less than the adjusted applicable stock price for an equity option with standardized terms is lower than the lowest qualified bench mark under section 1092(c)(4)(D), the lowest strike price at which a qualified covered call option can be written is the next higher strike price, or \$15.00. Therefore, a 21-month equity call option with standardized terms on Corporation Y stock will not be deep in the money if the strike price is not less than \$15.

(c) *Effective date.* This section applies to qualified covered call options entered into on or after July 29, 2002.

Par. 4. Section 1.1092(c)-4 is added to read as follows:

§ 1.1092(c)-4 *Definitions.*

The following definitions apply for purposes of §§ 1.1092(c)-1 through 1.1092(c)-3:

Par. 5. Section 1.1092(c)-2 is amended as follows:

1. Paragraph (b) is revised.
2. Paragraph (c) is added.
3. The paragraph in § 1.1092(c)-2 indicated in the first column is redesignated as a paragraph in § 1.1092(c)-4 as indicated in the second column as follows:

§ 1.1092(c)-2	§ 1.1092(c)-4
(d)(1) introductory text	(a) introductory text
(d)(1)(i) introductory text	(a)(1) introductory text
(d)(1)(i)(A)	(a)(1)(i)
(d)(1)(i)(B)	(a)(1)(ii)
(d)(1)(i)(C)	(a)(1)(iii)
(d)(1)(i)(D)	(a)(1)(iv)
(d)(1)(ii) introductory text	(a)(2) introductory text
(d)(1)(ii)(A)	(a)(2)(i)
(d)(1)(ii)(B)	(a)(2)(ii)
(d)(2)	(f)

- 4. Paragraph (d) is revised.
- 5. Paragraph (e) is removed.

The revisions and additions read as follows:

§ 1.1092(c)–2 Equity options with flexible terms.

* * * * *

(b) *No effect on lowest qualified benchmark for standardized options.* The availability of strike prices for equity options with flexible terms does not affect the determination of the lowest qualified benchmark, as defined in section 1092(c)(4)(D), for an equity option with standardized terms.

(c) *Qualified covered call option status—(1) Requirements.* An equity option with flexible terms is a qualified covered call option only if—

(i) The option meets the requirements of section 1092(c)(4)(B) and § 1.1092(c)–1 (taking into account paragraph (c)(2) of this section);

(ii) The only payments permitted with respect to the option are a single fixed premium paid not later than 5 business days after the day on which the option is granted, and a single fixed strike price, as defined in § 1.1092(c)–4(d), that is payable entirely at (or within 5 business days of) exercise;

(iii) An equity option with standardized terms is outstanding for the underlying equity; and

(iv) The underlying security is stock in a single corporation.

(2) *Lowest qualified benchmark—(i) In general.* For purposes of determining whether an equity option with flexible terms is deep in the money within the meaning of section 1092(c)(4)(C), the lowest qualified benchmark under section 1092(c)(4)(D) is the same for an equity option with flexible terms as the lowest qualified benchmark for an equity option with standardized terms on the same stock having the same applicable stock price.

(ii) *Examples.* The following examples illustrate the rules set out in paragraph (c)(2)(i) of this section:

Example 1. Taxpayer owns stock in Corporation X. Taxpayer writes an equity call option with flexible terms on Corporation X stock through a national securities exchange for a term of not more than 12 months. The applicable stock price for Cor-

poration X stock is \$73.75. Using the benchmark for an equity option with standardized terms with an applicable stock price of \$73.75, the highest available strike price less than the applicable stock price is \$70, and the second highest strike price less than the applicable stock price is \$65. Therefore, an equity call option with flexible terms on Corporation X stock with a term of 90 days or less will not be deep in the money if the strike price is not less than \$70. If the term is greater than 90 days, an equity call option with flexible terms on Corporation X will not be deep in the money if the strike price is not less than \$65.

Example 2. Taxpayer owns stock in Corporation Y. Taxpayer writes a 9-month equity call option with flexible terms on Corporation Y stock through a national securities exchange. The applicable stock price for Corporation Y stock is \$14.75. Using the benchmark for an equity option with standardized terms with an applicable stock price of \$14.75, the highest available strike price less than the applicable stock price is \$12.50. However, under section 1092(c)(4)(D), the lowest qualified benchmark can be no lower than 85% of the applicable stock price, which for Corporation Y stock is \$12.54. Thus, because the highest available strike price less than the applicable stock price for an equity option with standardized terms is lower than the lowest qualified benchmark under section 1092(c)(4)(D), the lowest strike price at which a qualified covered call option can be written is the next higher strike price, or \$15.00. This \$15.00 strike price requirement for a qualified covered call option applies to equity options with flexible terms, equity options with standardized terms, and qualifying over-the-counter options.

Example 3. Taxpayer owns stock in Corporation Z. On May 8, 2003, Taxpayer writes a 21-month equity call option with flexible terms on Corporation Z stock through a national securities exchange. The applicable stock price for Corporation Z stock is \$100. The benchmark for a 21-month equity option with standardized terms with an applicable stock price of \$100 will be based upon the adjusted applicable stock price. Using the table at § 1.1092(c)–4(e), the applicable stock price of \$100 is multiplied by the adjustment factor 1.12, resulting in an adjusted applicable stock price of \$112. The highest available strike price less than the adjusted applicable stock price is \$110, and the second highest strike price less than the adjusted applicable stock price is \$105. Therefore, a 21-month equity call option with flexible terms on Corporation Z stock will not be deep in the money if the strike price is not less than \$105.

(d) *Effective date—(1) In general.* Except as provided in paragraph (d)(2) of this section, this section applies to equity options with flexible terms entered into on or after January 25, 2000.

(2) *Effective date for paragraphs (b) and (c) of this section.* Paragraphs (b) and (c) of this section apply to equity options with flexible terms entered into on or after July 29, 2002.

Par. 6. Section 1.1092(c)–3 is added to read as follows:

§ 1.1092(c)–3 Qualifying over-the-counter options.

(a) *In general.* Under section 1092(c)(4)(B)(i), an equity option is not a qualified covered call option unless it is traded on a national securities exchange that is registered with the Securities and Exchange Commission or other market that the Secretary determines has rules adequate to carry out the purposes of section 1092(c)(4). In accordance with section 1092(c)(4)(H), this requirement is modified as provided in paragraph (b) of this section.

(b) *Qualified covered call option status.* A qualifying over-the-counter option, as defined in § 1.1092(c)–4(c), is a qualified covered call option if it meets the requirements of §§ 1.1092(c)–1 and 1.1092(c)–2(c) after using the language “qualifying over-the-counter option” in place of “equity option with flexible terms”. For purposes of this paragraph (b), a qualifying over-the-counter option is deemed to satisfy the requirements of section 1092(c)(4)(B)(i).

(c) *Effective date.* This section applies to qualifying over-the-counter options entered into on or after July 29, 2002.

Par. 7. Section 1.1092(c)–4 is further amended as follows:

1. Newly designated paragraphs (a)(1)(iv), (a)(2) introductory text, and (a)(2)(i) are revised.

2. Paragraphs (b), (c), (d), (e), and (g) are added.

The revisions and additions read as follows:

§ 1.1092(c)–4 Definitions.

* * * * *

(a) * * *

(1) * * *

(iv) Any changes to the Security Exchange Act Releases described in paragraphs (a)(1)(i) through (iii) of this section that are approved by the Securities and Exchange Commission; or

(2) That is traded on any national securities exchange that is registered with the Securities and Exchange Commission (other than those described in the Security Exchange Act Releases set forth in paragraph (a)(1) of this section) and is—

(i) Substantially identical to the equity options described in paragraph (a)(1) of this section; and

* * * * *

(b) *Equity option with standardized terms* means an equity option—

(1) That is traded on a national securities exchange registered with the Securities and Exchange Commission;

(2) That, on the date the option is written, expires on the Saturday following the third Friday of the month of expiration;

(3) That has a strike price that is set at a uniform minimum strike price interval, that is established by the applicable national securities exchange registered with the Securities and Exchange Commission, and that is not less than \$1.00; and

(4) That has stock in a single corporation as its underlying security.

(c) *Qualifying over-the-counter option* means an equity option that—

(1) Is not traded on a national securities exchange registered with the Securities and Exchange Commission; and

(2) Is entered into with—

(i) A broker-dealer, acting as principal or agent, who is registered with the Securities and Exchange Commission under section 15 of the Securities Act of 1934 (15 U.S.C. 78a through 78mm) and the regulations thereunder and who must comply with the recordkeeping requirements of 17 CFR 240.17a-3; or

(ii) An alternative trading system under 17 CFR 242.300 through 17 CFR 242.303; or

(iii) A person, acting as principal or agent, who must comply with the recordkeeping requirements for securities transactions described in 12 CFR 12.3, 12 CFR 208.34, or 12 CFR 344.4.

(d) *Single fixed strike price* means a strike price that is fixed, determinable, and stated as a dollar amount on the date the option is written. An option will not

fail to have a single fixed strike price if, after the date the option is written, the strike price is adjusted to account for the effects of a dividend, stock dividend, stock distribution, stock split, reverse stock split, rights offering, distribution, reorganization, recapitalization, or reclassification with respect to the underlying security, or a merger, consolidation, dissolution, or liquidation of the issuer of the underlying security.

(e) *Adjusted applicable stock price* means the applicable stock price, as defined in section 1092(c)(4)(G), adjusted for time. To determine the adjusted applicable stock price, the applicable stock price, which is determined in accordance with the rules in section 1092(c)(4)(G), is multiplied by an adjustment factor. The adjustment factor table is as follows:

Option Term		Adjustment Factor
Greater Than	Not More Than	
12 months	15 months	1.08
15 months	18 months	1.10
18 months	21 months	1.12
21 months	24 months	1.14
24 months	27 months	1.16
27 months	30 months	1.18
30 months	33 months	1.20

* * * * *

(g) *Effective dates.* (1) Except for paragraph (a)(2) of this section, paragraph (a) of this section applies to equity options with flexible terms entered into on or after January 25, 2000. Paragraph (a)(2) of this section applies to equity options with flexible terms entered into on or after July 29, 2002.

(2) Paragraphs (b), (c), (d), and (e) of this section apply to equity options entered into on or after July 29, 2002.

(3) Paragraph (f) of this section applies to equity options entered into on or after January 25, 2000.

Robert E. Wenzel,
Deputy Commissioner of
Internal Revenue.

Approved April 12, 2002.

Mark A. Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 26, 2002, 8:45 a.m., and published in the issue of the Federal Register for April 29, 2002, 67 F.R. 20896)

Section 1400L.—Tax Benefits for New York Liberty Zone

How does a taxpayer elect not to deduct the additional first year depreciation provided by § 1400L(b) of the Internal Revenue Code for qualified New York Liberty Zone property and how does a taxpayer depreciate qualified New York Liberty Zone leasehold improvement property under § 1400L(c)? See Rev. Proc. 2002-33, page 963.

Section 1502.—Regulations

26 CFR 1.1502-75: Filing of consolidated returns.

WAIVER OF 60-MONTH BAR ON RECONSOLIDATION AFTER DISAFFILIATION. This procedure grants certain taxpayers a waiver of the general rule of § 1504(a)(3)(A) of the Code barring a corporation from filing a consolidated return with a group of which it had ceased to be a member for 60 months following the year of disaffiliation. The procedure clarifies and supersedes Rev. Proc. 91-71 (1991-2 C.B. 900). See Rev. Proc. 2002-32, page 959.

Section 1504.—Definitions

26 CFR 1.1504-1: Definitions (consolidated returns).

WAIVER OF 60-MONTH BAR ON RECON-SOLIDATION AFTER DISAFFILIATION.

This procedure grants certain taxpayers a waiver of the general rule of § 1504(a)(3)(A) of the Code barring a corporation from filing a consolidated return with a group of which it had ceased to be a member for 60 months following the year of disaffiliation. The procedure clarifies and supersedes Rev. Proc. 91-71 (1991-2 C.B. 900). See Rev. Proc. 2002-32, page 959.

Section 4940.—Excise Tax Based on Investment Income

Responsibilities of a private foundation relating to § 507, chapter 42 (§§ 4940-4945) and tax return filing obligations (§§ 6033 and 6043) when it transfers all of its assets to one or more effectively controlled private foundations. See Rev. Rul. 2002-28, page 941.

Section 4941.—Taxes on Self-Dealing

Responsibilities of a private foundation relating to § 507, chapter 42 (§§ 4940-4945) and tax return filing obligations (§§ 6033 and 6043) when it transfers all of its assets to one or more effectively controlled private foundations. See Rev. Rul. 2002-28, page 941.

Section 4942.—Taxes on Failure to Distribute Income

Responsibilities of a private foundation relating to § 507, chapter 42 (§§ 4940-4945) and tax return filing obligations (§§ 6033 and 6043) when it transfers all of its assets to one or more effectively controlled private foundations. See Rev. Rul. 2002-28, page 941.

Section 4943.—Taxes on Excess Business Holdings

Responsibilities of a private foundation relating to § 507, chapter 42 (§§ 4940-4945) and tax return filing obligations (§§ 6033 and 6043) when it transfers all of its assets to one or more effectively controlled private foundations. See Rev. Rul. 2002-28, page 941.

Section 4944.—Taxes on Investments Which Jeopardize Charitable Purpose

Responsibilities of a private foundation relating to § 507, chapter 42 (§§ 4940-4945) and tax return filing obligations (§§ 6033 and 6043) when it transfers all of its assets to one or more effectively controlled private foundations. See Rev. Rul. 2002-28, page 941.

Section 4945.—Taxes on Taxable Expenditures

Responsibilities of a private foundation relating to § 507, chapter 42 (§§ 4940-4945) and tax return filing obligations (§§ 6033 and 6043) when it transfers all of its assets to one or more effectively controlled private foundations. See Rev. Rul. 2002-28, page 941.

Section 6033.—Returns by Exempt Organizations

Responsibilities of a private foundation relating to § 507, chapter 42 (§§ 4940-4945) and tax return filing obligations (§§ 6033 and 6043) when it transfers all of its assets to one or more effectively controlled private foundations. See Rev. Rul. 2002-28, page 941.

Section 6043.—Liquidating, etc., Transactions

Responsibilities of a private foundation relating to § 507, chapter 42 (§§ 4940-4945) and tax return filing obligations (§§ 6033 and 6043) when it transfers all of its assets to one or more effectively controlled private foundations. See Rev. Rul. 2002-28, page 941.

Section 6501.—Limitations on Assessment and Collection

Ct. D. 2074

SUPREME COURT OF THE UNITED STATES

No. 00-1567

YOUNG, ET UX., v. UNITED STATES

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR

THE FIRST CIRCUIT

March 4, 2002

Syllabus

If the Internal Revenue Service (IRS) has a claim for certain taxes for which the return was due within three years before the individual taxpayer files a bankruptcy petition, its claim enjoys eighth priority under 11 U.S.C. Sec. 507(a)(8)(A)(i), and is nondischargeable in bankruptcy under Sec. 523(a)(1)(A). The IRS assessed a tax liability against petitioners for their failure to include payment with their 1992 income tax return filed on October 15, 1993. On May 1, 1996, petitioners filed a Chapter 13 bankruptcy petition, which they moved to dismiss before a reorganization plan was approved. On March 12, 1997, the day before the Bankruptcy Court dismissed the Chapter 13 petition, petitioners filed a Chapter 7 petition. A discharge was granted, and the case was closed. When the IRS subsequently demanded that they pay the tax debt, petitioners asked the Bankruptcy Court to reopen the Chapter 7 case and declare the debt discharged under Sec. 523(a)(1)(A), claiming that it fell outside Sec. 507(a)(8)(A)(i)'s "three-year lookback period" because it pertained to a tax return due more than three years before their Chapter 7 filing. The court reopened the case, but sided with the IRS. Petitioners' tax return was due more than three years before their Chapter 7 filing but less than three years before their Chapter 13 filing. Holding that the "lookback period" is tolled during the pendency of a prior bankruptcy petition, the court concluded that the 1992 debt had not been discharged when petitioners were granted a discharge under Chapter 7. The District Court and the First Circuit agreed.

Held: Section 507(a)(8)(A)(i)'s lookback period is tolled during the pendency of a prior bankruptcy petition. Pp. 3-11.

(a) The lookback period is a limitations period subject to traditional equitable tolling principles. It prescribes a period in which certain rights may be enforced, encouraging the IRS to protect its rights before three years have elapsed. Thus, it serves the same basic policies furthered by all limitations periods: "repose, elimination of stale claims, and certainty about a plaintiff's opportunity

for recovery and a defendant's potential liabilities." *Rotella v. Wood*, 528 U.S. 549, 555. The fact that the lookback commences on a date that may precede the date when the IRS discovers its claim does not make it a substantive component of the Bankruptcy Code as petitioners claim. Pp. 2–6.

(b) Congress is presumed to draft limitations periods in light of the principle that such periods are customarily subject to equitable tolling unless tolling would be inconsistent with statutory text. Tolling is appropriate here. Petitioners' Chapter 13 petition erected an automatic stay under Sec. 362(a), which prevented the IRS from taking steps to collect the unpaid taxes. When petitioners later filed their Chapter 7 petition, the three-year lookback period therefore excluded time during which their Chapter 13 petition was pending. Because their 1992 tax return was due within that three-year period, the lower courts properly held that the tax debt was not discharged. Tolling is appropriate regardless of whether petitioners filed their Chapter 13 petition in good faith or solely to run down the lookback period. In either case, the IRS was disabled from protecting its claim. Pp. 6–8

(c) The statutory provisions invoked by petitioners — Secs. 523(b), 108(c), and 507(a)(8)(A)(ii) — do not display an intent to preclude tolling here. Pp. 8–10. 233 F.3d 56, affirmed.

SCALIA, J., delivered the opinion for a unanimous Court.

SUPREME COURT OF THE UNITED STATES

No. 00–1567

CORNELIUS P. YOUNG, ET UX.,
PETITIONERS *v.* UNITED STATES

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF
APPEALS FOR THE FIRST CIRCUIT

March 4, 2002

JUSTICE SCALIA delivered the opinion of the Court.

A discharge under the Bankruptcy Code does not extinguish certain tax liabilities for which a return was due within three years before the filing of an individual debtor's petition. 11 U.S.C.

Sec. 523(a)(1)(A), 507(a)(8)(A)(i). We must decide whether this "three-year lookback period" is tolled during the pendency of a prior bankruptcy petition.

I

Petitioners Cornelius and Suzanne Young failed to include payment with their 1992 income tax return, due and filed on October 15, 1993 (petitioners had obtained an extension of the April 15 deadline). About \$15,000 was owing. The Internal Revenue Service (IRS) assessed the tax liability on January 3, 1994, and petitioners made modest monthly payments (\$40 to \$300) from April 1994 until November 1995. On May 1, 1996, they sought protection under Chapter 13 of the Bankruptcy Code in the United States Bankruptcy Court for the District of New Hampshire. The bulk of their tax liability (about \$13,000, including accrued interest) remained due. Before a reorganization plan was confirmed, however, the Youngs moved on October 23, 1996, to dismiss their Chapter 13 petition, pursuant to 11 U.S.C. Sec. 1307(b). On March 12, 1997, one day before the Bankruptcy Court dismissed their Chapter 13 petition, the Youngs filed a new petition, this time under Chapter 7. This was a "no asset" petition, meaning that the Youngs had no assets available to satisfy unsecured creditors, including the IRS. A discharge was granted June 17, 1997; the case was closed September 22, 1997.

The IRS subsequently demanded payment of the 1992 tax debt. The Youngs refused, and petitioned the Bankruptcy Court to reopen their Chapter 7 case and declare the debt discharged. In their view, the debt fell outside the Bankruptcy Code's "three-year lookback period," Secs. 523(a)(1)(A), 507(a)(8)(A)(i), and had therefore been discharged, because it pertained to a tax return due on October 15, 1993, more than three years before their Chapter 7 filing on March 12, 1997. The Bankruptcy Court reopened the case, but sided with the IRS. Although the Youngs' 1992 income tax return was due more than three years before they filed their Chapter 7 petition, it was due less than three years before they filed their Chapter 13 petition on May 1, 1996. Holding that the "three-year lookback period" is tolled during the pendency of a prior bankruptcy petition, the Bankruptcy Court concluded that the 1992 tax debt

had not been discharged. The District Court for the District of New Hampshire and Court of Appeals for the First Circuit agreed. 233 F.3d 56 (2000). We granted certiorari. 533 U.S. 976 (2001).

II

Section 523(a) of the Bankruptcy Code excepts certain individual debts from discharge, including any tax "of the kind and for the periods specified in section . . . 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed." Sec. 523(a)(1)(A). Section 507(a), in turn, describes the priority of certain claims in the distribution of the debtor's assets. Subsection 507(a)(8)(A)(i) gives eighth priority to "allowed unsecured claims of governmental units, only to the extent that such claims are for — . . . a tax on or measured by income or gross receipts — . . . for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition. . . ." (Emphasis added.) This is commonly known as the "three-year lookback period." If the IRS has a claim for taxes for which the return was due within three years before the bankruptcy petition was filed, the claim enjoys eighth priority under Sec. 507(a)(8)(A)(i) and is nondischargeable in bankruptcy under Sec. 523(a)(1)(A).

The terms of the lookback period appear to create a loophole: Since the Code does not prohibit back-to-back Chapter 13 and Chapter 7 filings (as long as the debtor did not receive a discharge under Chapter 13, see Secs. 727(a)(8), (9)), a debtor can render a tax debt dischargeable by first filing a Chapter 13 petition, then voluntarily dismissing the petition when the lookback period for the debt has lapsed, and finally refiled under Chapter 7. During the pendency of the Chapter 13 petition, the automatic stay of Sec. 362(a) will prevent the IRS from taking steps to collect the unpaid taxes, and if the Chapter 7 petition is filed after the lookback period has expired, the taxes remaining due will be dischargeable. Petitioners took advantage of this loophole, which, they believe, is permitted by the Bankruptcy Code.

We disagree. The three-year lookback period is a limitations period subject to traditional principles of equitable tolling.

Since nothing in the Bankruptcy Code precludes equitable tolling of the lookback period, we believe the courts below properly excluded from the three-year limitation the period during which the Youngs' Chapter 13 petition was pending.

A

The lookback period is a limitations period because it prescribes a period within which certain rights (namely, priority and nondischargeability in bankruptcy) may be enforced. 1 H. Wood, *Limitations of Actions* Sec. 1, p. 1 (4th D. Moore ed. 1916). Old tax claims — those pertaining to returns due more than three years before the debtor filed the bankruptcy petition — become dischargeable, so that a bankruptcy decree will relieve the debtor of the obligation to pay. The period thus encourages the IRS to protect its rights — by, say, collecting the debt, 26 U.S.C. Secs. 6501, 6502 (1994 ed. and Supp. V), or perfecting a tax lien, Secs. 6322, 6323(a), (f) (1994 ed.) — before three years have elapsed. If the IRS sleeps on its rights, its claim loses priority and the debt becomes dischargeable. Thus, as petitioners concede, the lookback period serves the same “basic policies [furthered by] all limitations provisions: repose, elimination of stale claims, and certainty about a plaintiff’s opportunity for recovery and a defendant’s potential liabilities. *Rotella v. Wood*, 528 U.S. 549, 555 (2000). It is true that, unlike most statutes of limitations, the lookback period bars only *some*, and not *all* legal remedies¹ for enforcing the claim (viz., priority and nondischargeability in bankruptcy); that makes it a more limited statute of limitations, but a statute of limitations nonetheless.

Petitioners argue that the lookback period is a substantive component of the Bankruptcy Code, not a procedural limitations period. The lookback period commences on the date the return for the tax debt “is last due,” Sec. 507(a)(8)(A)(i), not on the date the IRS discovers or assesses the unpaid tax. Thus, the IRS may have less than three years to protect

itself against the risk that a debt will become dischargeable in bankruptcy.

To illustrate, petitioners offer the following variation on this case: Suppose the Youngs filed their 1992 tax return on October 15, 1993, but had not received (as they received here) an extension of the April 15, 1993, due date. Assume the remaining facts of the case are unchanged: The IRS assessed the tax on January 3, 1994; petitioners filed a Chapter 13 petition on May 1, 1996; that petition was voluntarily dismissed and the Youngs filed a new petition under Chapter 7 on March 12, 1997. In this hypothetical, petitioners argue, their tax debt would have been dischargeable in the *first* petition under Chapter 13. Over three years would have elapsed between the due date of their return (April 15, 1993) and their Chapter 13 petition (May 1, 1996). But the IRS — which may not have discovered the debt until petitioners filed a return on October 15, 1993 — would have enjoyed less than three years to collect the debt or prevent the debt from becoming dischargeable in bankruptcy (by perfecting a tax lien). The Code even contemplates this possibility, petitioners believe. Section 523(a)(1)(B)(ii) renders a tax debt nondischargeable if it arises from an untimely return filed within *two years* before a bankruptcy petition. Thus, if petitioners had filed their return on April 30, 1994 (more than two years before their Chapter 13 petition), and if the IRS had been unaware of the debt until the return was filed, the IRS would have had only *two years* to act before the debt became dischargeable in bankruptcy. For these reasons, petitioners believe the lookback period is not a limitations period, but rather a *definition* of dischargeable taxes.

We disagree. In the sense in which petitioners use the term, *all* limitations periods are “substantive”: They *define* a subset of claims eligible for certain remedies. And the lookback is not distinctively “substantive” merely because it commences on a date that may precede the date when the IRS discovers its claim. There is nothing unusual about a statute

of limitations that commences when the claimant has a complete and present cause of action, whether or not he is aware of it. See 1 C. Corman, *Limitation of Actions* Sec. 6.1, Pp. 370, 378 (1991); 2 Wood, *supra*, Sec. 276c(1) at 1411. As for petitioners’ reliance on Sec. 523(a)(1)(B)(ii), that section proves, at most, that Congress put different limitations periods on different kinds of tax debts. All tax debts falling within the terms of the three-year lookback period are nondischargeable in bankruptcy. Secs. 523(a)(1)(A), 507(a)(8)(A)(i). Even if a tax debt falls outside the terms of the lookback period, it is nonetheless nondischargeable if it pertains to an untimely return filed within two years before the bankruptcy petition. Sec. 523(a)(1)(B)(ii). These provisions are complementary; they do not suggest that the lookback period is something other than a limitations period.

B

It is hornbook law that limitations periods are “customarily subject to ‘equitable tolling,’” *Irwin v. Department of Veterans Affairs*, 498 U.S. 89, 95 (1990), unless tolling would be “inconsistent with the text of the relevant statute,” *United States v. Beggerly*, 524 U.S. 38, 48 (1998). See also *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 558–559 (1974); *Holmberg v. Armbrrecht*, 327 U.S. 392, 397 (1946); *Bailey v. Glover*, 21 Wall. 342, 349–350 (1875). Congress must be presumed to draft limitations periods in light of this background principle. Cf. *National Private Truck Council, Inc. v. Oklahoma Tax Comm’n*, 515 U.S. 582, 589–590 (1995); *United States v. Shabani*, 513 U.S. 10, 13 (1994). That is doubly true when it is enacting limitations periods to be applied by bankruptcy courts, which are courts of equity and “appl[y] the principles and rules of equity jurisprudence.” *Pepper v. Litton*, 308 U.S. 295, 304 (1939); see also *United States v. Energy Resources Co.*, 495 U.S. 545, 549 (1990).

This Court has permitted equitable tolling in situations “where the claimant

¹Equitable remedies may still be available. Traditionally, for example, a mortgagee could sue in equity to foreclose mortgaged property even though the underlying debt was time barred. *Hardin v. Boyd*, 113 U.S. 756, 765–766 (1885); 2 G. Glenn, *Mortgages* Secs. 141–142, pp. 812–818 (1943); see also *Beach v. Owen Fed. Bank*, 523 U.S. 410, 415–416 (1998) (recoupment is available after a limitations period has lapsed); *United States v. Dalm*, 494 U.S. 596, 611 (1990) (same).

has actively pursued his judicial remedies by filing a defective pleading during the statutory period, or where the complainant has been induced or tricked by his adversary's misconduct into allowing the filing deadline to pass." *Irwin, supra*, at 96 (footnotes omitted). We have acknowledged, however, that tolling might be appropriate in other cases, see, e.g., *Baldwin County Welcome Center v. Brown*, 466 U.S. 147, 151 (1984) (*per curiam*), and this, we believe, is one. Cf. *Amy v. Watertown* (No. 2), 130 U.S. 320, 325–326 (1889); 3 J. Story, *Equity Jurisprudence* Sec. 1974, pp. 558–559 (14th W. Lyon ed. 1918). The Youngs' Chapter 13 petition erected an automatic stay under Sec. 362, which prevented the IRS from taking steps to protect its claim. When the Youngs filed a petition under Chapter 7, the three-year lookback period therefore excluded time during which their Chapter 13 petition was pending. The Youngs' 1992 tax return was due within that three-year period. Hence the lower courts properly held that the tax debt was not discharged when the Youngs were granted a discharge under Chapter 7.

Tolling is in our view appropriate regardless of petitioners' intentions when filing back-to-back Chapter 13 and Chapter 7 petitions — whether the Chapter 13 petition was filed in good faith or solely to run down the lookback period. In either case, the IRS was disabled from protecting its claim during the pendency of the Chapter 13 petition, and this period of disability tolled the three-year lookback period when the Youngs filed their Chapter 7 petition.

C

Petitioners invoke several statutory provisions which they claim display an intent to preclude tolling here. First they point to Sec. 523(b), which, they believe, explicitly permits discharge in a Chapter 7 proceeding of certain debts that were nondischargeable (as this tax debt was) in a prior Chapter 13 proceeding. Petitioners misread the provision. Section 523(b) declares that

“a debt that was *excepted from discharge* under subsection (a)(1), (a)(3), or (a)(8) of this section . . . in a prior case concerning the debtor . . . is dischargeable in a case under this title unless, by the terms of sub-

section (a) of this section, such debt is not dischargeable in the case under this title.” (Emphasis added.)

The phrase “excepted from discharge” in this provision is not synonymous (as petitioners would have it) with “nondischargeable.” It envisions a prior bankruptcy proceeding that progressed to the *discharge stage*, from which discharge a particular debt was actually “excepted.” It thus has no application to the present case; and even if it did, the very same arguments in favor of tolling that we have found persuasive with regard to Sec. 507 would apply to Sec. 523 as well. One might perhaps have expected an explicit tolling provision in Sec. 523(b) if that subsection applied *only* to those debts “excepted from discharge” in the earlier proceeding that were subject to the three-year lookback — but in fact it also applies to excepted debts (see Sec. 523(a)(3)) that were subject to no limitation period. And even the need for tolling as to debts that *were* subject to the three-year lookback is minimal, since a separate provision of the Code, Sec. 727(a)(9), constrains successive discharges under Chapters 13 and 7: Generally speaking, six years must elapse between filing of the two bankruptcy petitions, which would make the need for tolling of the three-year limitation nonexistent. The absence of an explicit tolling provision in Sec. 523 therefore suggests nothing.

Petitioners point to two provisions of the Code which, in their view, do contain a tolling provision. Its presence there, and its absence in Sec. 507, they argue, displays an intent to preclude equitable tolling of the lookback period. We disagree. Petitioners point first to Sec. 108(c), which reads:

“Except as provided in section 524 of this title, if applicable nonbankruptcy law . . . fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor . . . , and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of — (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or (2) 30 days after notice of the ter-

mination or expiration of the stay . . . with respect to such claim.”

Petitioners believe Sec. 108(c)(1) contains a tolling provision. The lower courts have split over this issue, compare, e.g., *Rogers v. Corrosion Products, Inc.*, 42 F.3d 292, 297 (CA5), cert. denied, 515 U.S. 1160 (1995), with *Garbe Iron Works, Inc. v. Priester*, 99 Ill. 2d 84, 457 N.E.2d 422 (1983); we need not resolve it here. Even assuming petitioners are correct, we would draw no negative inference from the presence of an express tolling provision in Sec. 108(c)(1) and the absence of one in Sec. 507. It would be quite reasonable for Congress to instruct *nonbankruptcy* courts (including state courts) to toll *nonbankruptcy* limitations periods (including state law limitations periods) while at the same time, assuming that bankruptcy courts will use their inherent equitable powers to toll the federal limitations periods within the Code.

Finally, petitioners point to a tolling provision in Sec. 507(a)(8)(A), the same subsection that sets forth the three-year lookback period. Subsection 507(a)(8)(A) grants eighth priority to tax claims pertaining to returns that were *due* within the three-year lookback period, Sec. 507(a)(8)(A)(i), and to claims that were *assessed* within 240 days before the debtor's bankruptcy petition, Sec. 507(a)(8)(A)(ii). Whereas the three-year lookback period contains no express tolling provision, the 240-day lookback period is tolled “any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending.” Sec. 507(a)(8)(A)(ii). Petitioners believe this express tolling provision, appearing in the same subsection as the three-year lookback period, demonstrates a statutory intent *not* to toll the three-year lookback period.

If anything, Sec. 507(a)(8)(A)(ii) demonstrates that the Bankruptcy Code *incorporates* traditional equitable principles. An “offer in compromise” is a settlement offer submitted by a debtor. When Sec. 507(a)(8)(A)(ii) was enacted, it was IRS practice — though no statutory provision required it — to stay collection efforts (if the Government's interests would not be jeopardized) during the pendency of an “offer in compromise,” 26 CFR Sec. 301.7122–1(d)(2) (1978); M. Saltzman,

IRS Practice and Procedure ¶ 15.07[1], p. 15-47 (1981).² Thus, a court would not have equitably tolled the 240-day lookback period during the pendency of an “offer in compromise,” since tolling is inappropriate when a claimant has voluntarily chosen not to protect his rights within the imitations period. See, *e.g.*,

Irwin, 498 U.S. at 96. Hence the tolling provision in Sec. 507(a)(8)(A)(ii) *supplements* rather than displaces, principles of equitable tolling.

during the pendency of a prior bankruptcy petition. The judgment of the Court of Appeals for the First Circuit is affirmed.

It is so ordered.

* * * *

We conclude that the lookback period of 11 U.S.C. Sec. 507(a)(8)(A)(i) is tolled

² The Code was amended in 1998 to prohibit collection efforts during the pendency of an offer in compromise. See 26 U.S.C. Sec. 6331(k) (1994 ed., Supp. V).

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.
(Also Part I §§ 1502, 1504; 1.1502-75, 1.1504-1.)

Rev. Proc. 2002-32

SECTION 1. PURPOSE

.01 This revenue procedure clarifies and supersedes Rev. Proc. 91-71 (1991-2 C.B. 900) which grants certain taxpayers a waiver of the general rule of § 1504(a)(3)(A) of the Internal Revenue Code. Section 1504(a)(3)(A) generally provides that a corporation that ceased to be a member of a consolidated group (or a successor of such corporation) may not be included in any consolidated return filed by that affiliated group (or another affiliated group with the same common parent or a successor of such common parent) before the 61st month beginning after the first taxable year in which such corporation ceased to be a member of such group.

.02 If (1) § 1504(a)(3)(A) applies to prevent the inclusion of a corporation in a consolidated return, and (2) the representations described in sections 5.03 and 5.14 of this revenue procedure can be made with respect to such corporation, then such corporation may be included in the consolidated return for the taxable year that includes the date on which § 1504(a)(3)(A) would first apply to prevent such corporation from being included in such consolidated return if, and only if, an automatic waiver of the general rule of § 1504(a)(3)(A) is obtained pursuant to section 5 of this revenue procedure.

.03 If (1) § 1504(a)(3)(A) applies to prevent the inclusion of a corporation in a consolidated return, and (2) the representations described in section 5.03 or 5.14 of this revenue procedure cannot be made with respect to such corporation, then a waiver of the application of the general rule of § 1504(a)(3)(A) for any taxable year may only be obtained in the form of a private letter ruling pursuant to section 7 of this revenue procedure.

.04 If (1) § 1504(a)(3)(A) applies to prevent the inclusion of a corporation in a consolidated return, (2) the representations described in sections 5.03 and 5.14

of this revenue procedure can be made with respect to such corporation, and (3) the procedures for obtaining an automatic waiver of the general rule of § 1504(a)(3)(A) are not followed, then a waiver of the application of the general rule of § 1504(a)(3)(A) may be obtained only for taxable years other than the taxable year that includes the date on which § 1504(a)(3)(A) first applies to prevent such corporation from being included in a consolidated return and may only be obtained in the form of a private letter ruling pursuant to section 7 of this revenue procedure.

SECTION 2. BACKGROUND

.01 Section 1504(a)(3)(A) provides that (1) if a corporation is included (or required to be included) in a consolidated return filed by an affiliated group for a taxable year that includes any period after December 31, 1984, and (2) the corporation ceases to be a member of such affiliated group in a taxable year beginning after December 31, 1984, the corporation (and any successor of the corporation) may not be included in any consolidated return filed by such affiliated group (or by another affiliated group with the same common parent or a successor of the common parent) before the 61st month beginning after its first taxable year in which it ceased to be a member of such affiliated group. Section 1504(a)(3)(B) provides that the Secretary may waive the application of § 1504(a)(3)(A) to any corporation for any period subject to such conditions as the Secretary may prescribe.

.02 For purposes of this revenue procedure, unless otherwise provided, a reference to a successor of a corporation includes each successor of a successor of such corporation, and a reference to a predecessor of a corporation includes each predecessor of a predecessor of such corporation.

SECTION 3. APPLICATION

.01 Any corporation described in section 4.01 of this revenue procedure that requests an automatic waiver by complying with the requirements set forth in section 5 of this revenue procedure is hereby granted a waiver under § 1504(a)(3)(B)

so that the corporation may be included in the consolidated return filed (or required to be filed) by the affiliated group of which it is a member, as provided in section 6 of this revenue procedure. Any corporation described in section 4.01 of this revenue procedure that does not or cannot comply with the requirements set forth in section 5 may request a waiver of the application of the general rule of § 1504(a)(3)(A) pursuant to section 7 of this revenue procedure.

.02 If pursuant to section 4.02, 4.03, or 4.04 of this revenue procedure, § 1504(a)(3)(A) does not apply to prevent the inclusion in a consolidated return of a corporation, such corporation must be included in the consolidated return filed by the affiliated group of which it is a member. No waiver is necessary.

SECTION 4. SCOPE

.01 This revenue procedure applies to any corporation (a deconsolidated corporation) (1) that was included (or was required to be included), or whose predecessor was included (or was required to be included), in a consolidated return filed (or required to be filed) by an affiliated group (the original group), (2) that ceased, or whose predecessor ceased, to be a member of such original group, and (3) that subsequently became affiliated with that original group (or another affiliated group with the same common parent or a successor of such common parent) before the 61st month beginning after the first taxable year in which it or its predecessor ceased to be a member of the original group.

.02 Except as provided in section 4.05, § 1504(a)(3)(A) does not apply to prevent the inclusion in a consolidated return of any corporation that was a member of a consolidated group (the terminating group) and that ceased to be a member of such group solely as a result of a transaction in which a nonmember corporation acquired the assets of the common parent of the terminating group in a reorganization described in § 368(a)(1)(A), (C), (D), or (G) (but, with respect to a reorganization described in § 368(a)(1)(D) or (G), only if the requirements of § 354(b)(1)(A) and (B) are met), and immediately after

the acquisition, the acquiring corporation is the common parent of another affiliated group (the acquiring group). If the acquiring group files a consolidated return, all members of the terminating group that are includible corporations must be included in the consolidated return. See Rev. Rul. 91-70 (1991-2 C.B. 361).

.03 Except as provided in section 4.05, § 1504(a)(3)(A) does not apply to prevent the inclusion in a consolidated return of any corporation that was a member of a consolidated group (the terminating group) and that ceased to be a member of such group solely as a result of a transaction in which a member of the terminating group acquired (a) the assets of a non-member corporation in a reorganization described in § 368(a)(1)(A), (C), (D), or (G) (but, with respect to a reorganization described in § 368(a)(1)(D) or (G), only if the requirements of § 354(b)(1)(A) and (B) are met) or (b) the stock of a non-member corporation, and the acquisition was a reverse acquisition described in § 1.1502-75(d)(3) of the Income Tax Regulations in which the terminating group ceased to exist. If the group that remains in existence files a consolidated return, all members of the terminating group that are includible corporations must be included in the consolidated return. See Rev. Rul. 91-70.

.04 Except as provided in section 4.05, § 1504(a)(3)(A) does not apply to prevent the inclusion in a consolidated return of any corporation that was a member of a consolidated group (the terminating group) and that ceased to be a member of the terminating group solely as a result of a transaction in which (1) a nonmember corporation (the acquiring corporation) acquired (a) the assets of the common parent of the terminating group in a reorganization described in § 368(a)(1)(A), (C), (D), or (G) (but, with respect to a reorganization described in § 368(a)(1)(D) or (G), only if the requirements of § 354(b)(1)(A) and (B) are met) or (b) stock of the common parent of the terminating group that satisfies the requirements of § 1504(a)(2), (2) immediately after such acquisition, the acquiring corporation is a member of another affiliated group (the acquiring group), and (3) subsequent to such acquisition, the common parent of the acquiring group or a succes-

or of the common parent of the acquiring group acquires assets or stock of the former common parent of the terminating group or a successor of such former common parent. If the acquiring group files a consolidated return, the corporation must be included in the consolidated return, provided such corporation is an includible corporation. Cf. Rev. Rul. 91-70.

.05 If a corporation is described in section 4.02, 4.03, or 4.04, and such corporation (or such corporation's predecessor, as applicable) (1) was included (or was required to be included) in a consolidated return filed (or required to be filed) by an affiliated group other than the terminating group (a prior group), (2) ceased to be a member of such prior group, and (3) subsequently became affiliated with such prior group (or another affiliated group with the same common parent or a successor of the common parent of such prior group) before the 61st month beginning after the first taxable year in which it or its predecessor ceased to be a member of such group, § 1504(a)(3)(A) applies to prevent the inclusion of such corporation in a consolidated return of such prior group or another affiliated group with the same common parent or a successor of the common parent of such prior group. Accordingly, that corporation is treated as a deconsolidated corporation and must comply with the requirements set forth in section 5 of this revenue procedure (or if it cannot comply with section 5, section 7) to obtain a waiver of § 1504(a)(3)(A).

SECTION 5. PROCEDURE FOR A DECONSOLIDATED CORPORATION TO REQUEST AN AUTOMATIC WAIVER UNDER SECTION 1504(a)(3)(B)

To obtain an automatic waiver of § 1504(a)(3)(A), the deconsolidated corporation must be included in a timely-filed consolidated return (including extensions) of the affiliated group with respect to which the waiver request relates (the current group), for the taxable year that includes the date on which such corporation most recently became a member of such affiliated group. In addition, a statement, filed under penalties of perjury, that includes the information described in sec-

tions 5.01 through 5.14 of this revenue procedure, which is subject to verification on examination, as provided by section 6.02 of this revenue procedure, must be attached to such return.

.01 The following heading typed or legibly printed at the top of the statement: "AUTOMATIC WAIVER OF THE APPLICATION OF SECTION 1504(a)(3) FILED PURSUANT TO REV. PROC. 2002-32."

.02 The name, address, and employer identification number of the deconsolidated corporation, and the name, address, and employer identification number of each corporation, if any, that was a predecessor of such deconsolidated corporation at any time on or after the date a predecessor of such deconsolidated corporation ceased to be a member of the current group (or another affiliated group with the same common parent or a predecessor of the common parent of the current group).

.03 If the common parent of the current group is the common parent of the group from which the deconsolidated corporation or its predecessor disaffiliated (the former group), a representation that such common parent was not an S corporation, an entity disregarded as an entity separate from its owner, a real estate investment trust, or a regulated investment company at any time during the period of disaffiliation. If the common parent of the current group was not the common parent of the former group, a representation that the common parent of the former group and each successor of the common parent of the former group was not an S corporation, an entity disregarded as an entity separate from its owner, a real estate investment trust, or a regulated investment company at any time during the period beginning on the date of disaffiliation and ending on the date that such common parent or successor ceased to exist. In addition, if the common parent of the current group was not the common parent of the former group, a representation that the common parent of the current group was not an S corporation, an entity disregarded as an entity separate from its owner, a real estate investment trust, or a regulated investment company at any time during the period beginning on the date that such

corporation became a successor of the common parent of the former group and ending on the date the deconsolidated corporation became a member of the current group.

.04 The year in which the current group elected to file consolidated returns.

.05 The date on which the deconsolidated corporation or its predecessor ceased to be a member of either the current group or the former group.

.06 The date on which the deconsolidated corporation most recently became a member of the current group.

.07 A description of the manner by which the deconsolidated corporation or its predecessor ceased to be a member of the current group or the former group and the manner by which the deconsolidated corporation became a member of the current group (redemption of stock, new issuance of stock, etc.). This statement should include the business purposes of the transactions that caused the disaffiliation and subsequent affiliation and describe whether the transactions were with a related party.

.08 If the common parent of the current group is the common parent of the former group and the former group remained in existence throughout the period of disaffiliation, the taxable income of the current group for (1) the taxable year prior to the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of the current group, (2) the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of such group, (3) each taxable year subsequent to the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of such group but before the deconsolidated corporation again became a member of the current group, and (4) the taxable year in which the deconsolidated corporation became a member of the current group.

.09 If the common parent of the current group is the common parent of the former group and the former group ceased to exist on or after the date on which the deconsolidated corporation or its predecessor ceased to be a member of the former group and before the date the deconsolidated corporation became a member of the current group, the taxable income of the former group for (1) the

taxable year prior to the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of the former group, (2) the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of such group, and (3) each taxable year, if any, subsequent to the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of such group and during which such group existed. In addition, (1) the taxable income of the common parent of the former group or its successor for each interim taxable year (as defined herein) during which such common parent of the former group was not the common parent of a consolidated group, (2) the taxable income of any consolidated group other than the former group of which the common parent of the former group or its successor was the common parent during any interim taxable year for each interim taxable year, and (3) the taxable income of the current group for the taxable year in which the deconsolidated corporation became a member of the current group. For purposes of this section 5.09 and sections 5.10 and 5.11 of this revenue procedure, the term interim taxable year refers to any taxable year that is subsequent to the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of the former group but before the taxable year in which the deconsolidated corporation became a member of the current group.

.10 If the common parent of the current group is not the common parent of the former group, the taxable income of the former group for (1) the taxable year prior to the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of the former group, (2) the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of such group, and (3) each interim taxable year, if any, during which such group existed. In addition, (1) the taxable income of the common parent of the former group or its successor for each interim taxable year during which such common parent of the former group or its successor was not the common parent of a consolidated group, (2) the taxable income of any consolidated group other than the former group of which the com-

mon parent of the former group or its successor was the common parent during any interim taxable year for each interim taxable year, and (3) the taxable income of the current group for the taxable year in which the deconsolidated corporation became a member of the current group.

.11 The taxable income, or separate taxable income (adjusted for the items that would be taken into account in determining the consolidated net operating loss attributable to the deconsolidated corporation under § 1.1502-21(b)(2)(iv)), as the case may be, of the deconsolidated corporation or its predecessor, as applicable, for (1) the taxable year prior to the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of the current group or the former group, (2) the taxable year in which the deconsolidated corporation or its predecessor ceased to be a member of such group, (3) each interim taxable year, and (4) the taxable year in which the deconsolidated corporation became a member of the current group.

.12 An analysis of the effect of the disaffiliation and the effect of the subsequent consolidation on the following items of (a) the deconsolidated corporation and its predecessor, as applicable, (b) the current group, and (c) if the current group is not the group from which the deconsolidated corporation or its predecessor disaffiliated, the former group or, if the former group terminated as a result of the disaffiliation or during the period of the disaffiliation, the common parent of the former group and the members of the former group (or their successors, if applicable) with which such common parent (or its successor, as applicable) was affiliated at any time during the period of disaffiliation for all periods described in section 5.11 of this revenue procedure:

- (1) Taxable income;
 - (2) Gains and losses on intercompany transactions;
 - (3) Excess loss accounts;
 - (4) Tax liability;
 - (5) Net operating loss carryovers;
 - (6) Capital loss carryovers;
 - (7) Tax credits; and
 - (8) Losses deferred pursuant to § 267
- (f).

.13 In the case of a consolidated group of which one or more members are reporting corporations described in

§ 6038A(a), an analysis of the effect of the disaffiliation and the effect of the subsequent consolidation on the United States taxation of any related party within the meaning of § 6038A(c)(2) (other than a member of the group). Such analysis must take into account any transfers of money or property occurring during the period of disaffiliation and involving (directly or indirectly) the deconsolidated corporation, its predecessors, and any reporting corporation or related party, if such transfers are not in the ordinary course of business.

.14 A representation that the disaffiliation and subsequent consolidation has not provided and will not provide a benefit of a reduction in income, increase in loss, or any other deduction, credit, or allowance (a federal tax savings) that would not otherwise be secured or have been secured had the disaffiliation and subsequent consolidation not occurred, including, but not limited to, the use of a net operating loss or credit that would have otherwise expired, or the use of a loss recognized on a disposition of stock of the deconsolidated corporation or a predecessor of such corporation. In determining whether the disaffiliation and subsequent consolidation provided or will provide a federal tax savings, the net tax consequences to all parties, taking into account the time value of money, are considered.

SECTION 6. EFFECT OF WAIVER

.01 A waiver under § 1504(a)(3)(B) granted pursuant to section 3.01 of this revenue procedure is binding on the consolidated group that files the statement required by section 5 of this revenue procedure with a consolidated return and may not be revoked by such consolidated group. The waiver is binding as of the date on which the deconsolidated corporation most recently became a member of the current group and as long as the deconsolidated corporation or a successor of such corporation remains a member of the current group or another group with a common parent that is a successor of the common parent of the current group, unless permission is granted for the entire group to cease filing a consolidated return.

.02 Notwithstanding section 6.01, if the Service determines that the information provided pursuant to section 5 of this

revenue procedure was incorrect in any material respect at the time the waiver request was filed, the Service may revoke the waiver granted pursuant to this revenue procedure at any time, for all or any part of the period for which it was granted.

SECTION 7. DECONSOLIDATED CORPORATIONS THAT DO NOT QUALIFY FOR THE AUTOMATIC WAIVER

If a deconsolidated corporation cannot qualify for an automatic waiver pursuant to section 3.01 of this revenue procedure, a waiver under § 1504(a)(3)(B) may only be obtained through a letter ruling request filed in accordance with Rev. Proc. 2002-1 (2002-1 I.R.B. 1) (or similar revenue procedure applicable to a later year). If the representations described in sections 5.03 and 5.14 of this revenue procedure can be made with respect to such corporation and the procedures for obtaining an automatic waiver of the general rule of § 1504(a)(3)(A) are not followed, however, then a private letter ruling can only be obtained to waive the application of the general rule of § 1504(a)(3)(A) for taxable years other than the taxable year that includes the date on which § 1504(a)(3)(A) first applies to prevent such corporation from being included in the consolidated return. The letter ruling request must be submitted by the common parent of the affiliated group of which the deconsolidated corporation becomes a member before the due date (including extensions) of the consolidated return for the tax year with respect to which the waiver is requested. The letter ruling request must include the information set forth in section 5 of this revenue procedure. To the extent that the representations set forth in section 5.03 or section 5.14 of this revenue procedure cannot be made, however, the letter ruling request must: (1) contain information establishing that federal tax savings (as described in section 5.14 of this revenue procedure) was not a purpose of the disaffiliation, and that the amount of any federal tax savings attributable to the disaffiliation or a subsequent consolidation is not significant; and (2) state whether the deconsolidated corporation or a predecessor of such corporation was, at any time during the period of disaffiliation, in

the effective control of any member (or successor of any member) of the current group or the former group.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 91-71 (1991-2 C.B. 900) is clarified, and, as clarified, is superseded.

SECTION 9. EFFECTIVE DATE

This revenue procedure is generally effective for consolidated returns due (including extensions) on or after May 20, 2002. Section 7 of this revenue procedure, however, applies to all letter ruling requests postmarked, or if not mailed, received, after May 20, 2002. Nonetheless, the Service may ask the taxpayer to submit information specified in this revenue procedure for any ruling requests postmarked, or if not mailed, received, before that date.

SECTION 10. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1784.

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

The collections of information in this revenue procedure are in section 5 and section 7. This information is required to determine whether a taxpayer qualifies for a waiver under this revenue procedure. The collections of information are required to obtain a benefit. The likely respondents are corporations that were formerly members of consolidated groups and that later join affiliated groups.

The estimated total annual reporting burden is 100 hours.

The estimated annual burden per respondent varies from 2 hours to 8 hours, depending on individual circumstances, with an estimated average of 5 hours. The estimated number of respondents is 20.

The estimated annual frequency of responses is on occasion.

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 tax law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

SECTION 11. DRAFTING INFORMATION

The principal author of this revenue procedure is Vincent Daly of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue procedure, contact Mr. Daly at (202) 622-7770 (not a toll-free call).

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 56, 168, 179, 446, 1400L.)

Rev. Proc. 2002-33

SECTION 1. PURPOSE

This revenue procedure provides procedures for a taxpayer to claim the additional 30 percent depreciation (additional first year depreciation) provided by §§ 168(k) and 1400L(b) of the Internal Revenue Code and other deductions for qualified property or qualified New York Liberty Zone (Liberty Zone) property that the taxpayer did not claim on the taxpayer's federal tax return filed before June 1, 2002. This revenue procedure also explains how a taxpayer may elect not to deduct the additional first year depreciation for qualified property and Liberty Zone property.

SECTION 2. BACKGROUND

.01 Section 168(k), as added by § 101 of the Job Creation and Worker Assistance Act of 2002 (the Act), Pub. L. No. 107-147, 116 Stat. 21 (March 9, 2002), and § 1400L(b), as added by § 301(a) of the Act, generally allow an additional first year depreciation deduction for qualified property or Liberty Zone property placed in service by the taxpayer after September 10, 2001. The term "qualified property" is defined in § 168(k)(2) and the term "Lib-

erty Zone property" is defined in § 1400L(b)(2). The additional first year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the qualified property or Liberty Zone property is placed in service. If the property is described in both § 168(k) and § 1400L(b), only one additional first year depreciation deduction is allowable for the property.

.02 The additional first year depreciation deduction generally is determined without any proration based on the length of the taxable year in which the qualified property or Liberty Zone property is placed in service. The additional first year depreciation is equal to 30 percent of the adjusted basis of the qualified property or Liberty Zone property. The adjusted basis of this property generally is its cost or other basis multiplied by the percentage of business/investment use, reduced by the amount of any § 179 expense deduction and adjusted to the extent provided by other provisions of the Code and the regulations thereunder (for example, reduced by the amount of the disabled access credit pursuant to § 44(d)(7)).

.03 Before computing the amount otherwise allowable as a depreciation deduction for the placed-in-service year and subsequent taxable years, the adjusted basis of the qualified property or Liberty Zone property for which the additional first year depreciation is deductible must be reduced by the amount of the additional first year depreciation deduction. The remaining adjusted basis of this property is depreciated using the applicable depreciation provisions under the Code for the property (that is, § 167(f)(1) for computer software and § 168 for other property). This depreciation deduction for the remaining adjusted basis of the qualified property or Liberty Zone property for which the additional first year depreciation is deductible is allowed for both regular tax and alternative minimum tax purposes.

.04 The additional first year depreciation must not be deducted for, among other things: (1) property that is required to be depreciated under the alternative depreciation system of § 168(g) pursuant to § 168(g)(1)(A) through (D) or other provisions of the Code (for example, property described in § 263A(e)(2)(A) or

§ 280F(b)(1)); (2) property described in § 168(f); or (3) any class of property for which the taxpayer elects not to deduct the additional first year depreciation (see section 3 of this revenue procedure for further details about this election).

.05 Pursuant to §§ 168(k)(2)(C)(ii) and 1400L(b)(2)(C)(iii), Liberty Zone leasehold improvement property (as defined in § 1400L(c)(2)) is not eligible for the additional first year depreciation deduction. However, in accordance with § 1400L(c), this property is included as 5-year property for purposes of § 168. The straight-line method of depreciation is required to be used under § 168 for Liberty Zone leasehold improvement property and the class life for this property for purposes of the alternative depreciation system of § 168(g) is 9 years.

.06 For § 179 property that is Liberty Zone property, § 1400L(f) increased the amount a taxpayer may elect to expense under § 179 by the lesser of (1) \$35,000, or (2) the cost of § 179 property that is Liberty Zone property placed in service during the taxable year. Accordingly, the § 179 expense deduction that may be elected for § 179 property that is Liberty Zone property placed in service by the taxpayer after September 10, 2001, is increased (1) to a maximum of \$55,000 for a taxable year that began in 2000, and (2) to a maximum of \$59,000 for a taxable year that began in 2001.

SECTION 3. ELECTION NOT TO DEDUCT ADDITIONAL FIRST YEAR DEPRECIATION

.01 *In General.* Pursuant to §§ 168(k)(2)(C)(iii) and 1400L(b)(2)(C)(iv), a taxpayer may make an election not to deduct the additional first year depreciation for any class of property placed in service during the taxable year. If the taxpayer makes this election, it applies to all qualified property or Liberty Zone property that is in the same class and placed in service in the same taxable year. In addition, the depreciation adjustments under § 56 apply to that property for purposes of computing the taxpayer's alternative minimum taxable income. The election not to deduct the additional first year depreciation for any class of property placed in service during the taxable year is made separately by each person owning

qualified property or Liberty Zone property (for example, by each member of a consolidated group, by the partnership, or by the S corporation).

.02 Definition of Class of Property.

(1) For purposes of the election under § 168(k)(2)(C)(iii) not to deduct the additional first year depreciation for qualified property, the term “class of property” means: (a) except for the property described in this section 3.02(1)(b) and (d), each class of property described in § 168(e) (for example, 5-year property); (b) water utility property as defined in § 168(e)(5) and depreciated under § 168; (c) computer software depreciated under § 167(f)(1); or (d) qualified leasehold improvement property as defined in § 168(k)(3) and depreciated under § 168.

(2) For purposes of the election under § 1400L(b)(2)(C)(iv) not to deduct the additional first year depreciation for Liberty Zone property, the term “class of property” means: (a) except for the property described in this section 3.02(2)(b), (d), and (e), each class of property described in § 168(e) (for example, 5-year property); (b) water utility property as defined in § 168(e)(5) and depreciated under § 168; (c) computer software depreciated under § 167(f)(1); (d) non-residential real property described in § 1400L(b)(2)(B) and depreciated under § 168; or (e) residential rental property described in § 1400L(b)(2)(B) and depreciated under § 168.

.03 Time and Manner of Making the Election.

(1) *In general.* An election not to deduct the additional first year depreciation for any class of property that is qualified property or Liberty Zone property placed in service during the taxable year must be made by the due date (including extensions) of the federal tax return for the taxable year in which the qualified property or Liberty Zone property is placed in service by the taxpayer. The election must be made in the manner prescribed on Form 4562, *Depreciation and Amortization*, and its instructions. However, see section 3.03(3) of this revenue procedure for the procedures for making the election not to deduct the additional first year depreciation for any class of property placed in service by the taxpayer after September 10, 2001, during the tax-

able year beginning in 2000 or 2001 (2000 or 2001 taxable year).

(2) Limited relief for late election.

(a) *Automatic 6-month extension.* Pursuant to § 301.9100–2(b) of the Procedure and Administration Regulations, an automatic extension of 6 months from the due date of the federal tax return (excluding extensions) for the placed-in-service year of the qualified property or Liberty Zone property is granted to make the election not to deduct the additional first year depreciation, provided the taxpayer timely filed the taxpayer’s federal tax return for the placed-in-service year and the taxpayer satisfies the requirements in § 301.9100–2(c) and § 301.9100–2(d).

(b) *Other extensions.* A taxpayer that fails to make the election not to deduct the additional first year depreciation for the placed-in-service year for the qualified property or Liberty Zone property as provided in section 3.03(1), 3.03(2)(a), 3.03(3), or 4.02 of this revenue procedure but wants to do so must file a request for an extension of time to make the election under the rules in § 301.9100–3.

(3) Special rules for 2000 or 2001 return.

(a) *Return filed on or after June 1, 2002.* If a taxpayer files the 2000 or 2001 federal tax return on or after June 1, 2002, the procedures in section 3.03(1) of this revenue procedure apply for making the election not to deduct the additional first year depreciation for any class of property that is qualified property or Liberty Zone property placed in service by the taxpayer after September 10, 2001, during the 2000 or 2001 taxable year. However, the taxpayer must follow the instructions for the 2001 Form 4562 (Rev. March 2002). These instructions require the taxpayer to attach to the federal tax return a statement indicating the class of property for which the taxpayer is electing not to deduct the additional first year depreciation.

(b) *Return filed before June 1, 2002.* If a taxpayer has filed the 2000 or 2001 federal tax return before June 1, 2002, see section 4.02 of this revenue procedure for the procedures for making the election not to deduct the additional first year depreciation for any class of property that is qualified property or Liberty Zone property placed in service by

the taxpayer after September 10, 2001, during the 2000 or 2001 taxable year.

.04 Revocation. An election not to deduct the additional first year depreciation for a class of property that is qualified property or Liberty Zone property placed in service during the taxable year is revocable only with the prior written consent of the Commissioner of Internal Revenue. To seek the Commissioner’s consent, the taxpayer must submit a request for a letter ruling in accordance with the provisions of Rev. Proc. 2002–1 (2002–1 I.R.B. 1) (or any successor).

.05 Failure to make election not to deduct additional first year depreciation. If a taxpayer does not make the election not to deduct the additional first year depreciation for a class of property that is qualified property or Liberty Zone property within the time and in the manner prescribed in section 3.03 or 4.02 of this revenue procedure, the amount of depreciation allowable for that property under § 167(f)(1) or under § 168, as applicable, must be determined for the placed-in-service year and for all subsequent years by taking into account the additional first year depreciation deduction. Thus, the election not to deduct the additional first year depreciation cannot be made by the taxpayer in any other manner (for example, through a request under § 446(e) to change the taxpayer’s method of accounting).

SECTION 4. PROCEDURES FOR RETURNS FILED BEFORE JUNE 1, 2002

.01 Additional First Year Depreciation. If a taxpayer has filed a 2000 or 2001 federal tax return before June 1, 2002, and did not claim on that return the additional first year depreciation for a class of property that is qualified property or Liberty Zone property placed in service by the taxpayer after September 10, 2001, during the 2000 or 2001 taxable year but wants to do so, the taxpayer may claim the additional first year depreciation for that class of property under this section 4.01, provided the taxpayer did not make an election not to deduct the additional first year depreciation for the class of property pursuant to section 4.02(1) or (2) of this revenue procedure. The taxpayer has the option of claiming this additional first year depreciation either by:

(1) filing an amended federal tax return (or a qualified amended return under Rev. Proc. 94-69 (1994-2 C.B. 804), if applicable) on or before the due date (*excluding* extensions) of the federal tax return for the next succeeding taxable year. The amended return (or qualified amended return) should include the statement "Filed Pursuant to Rev. Proc. 2002-33" at the top of the amended return (or qualified amended return); or

(2) Filing a Form 3115, *Application for Change in Accounting Method*, with the taxpayer's federal tax return for the next succeeding taxable year. This Form 3115 is to be filed in accordance with the automatic change in method of accounting provisions in Rev. Proc. 2002-9 (2002-3 I.R.B. 327), as modified by Rev. Proc. 2002-19 (2002-13 I.R.B. 696), and as modified and clarified by Announcement 2002-17 (2002-8 I.R.B. 561) (or any successor) with the following modifications:

(a) The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply, and

(b) To assist the Service in processing changes in method of accounting under this section of the revenue procedure, and to ensure proper handling, section 6.02(4)(a) of Rev. Proc. 2002-9 is modified to require that a Form 3115 filed under this revenue procedure include the statement: "Automatic Change Filed Under Rev. Proc. 2002-33." This statement should be legibly printed or typed on the appropriate line on any Form 3115 filed under this revenue procedure.

.02 *Election Not to Deduct Additional First Year Depreciation.*

(1) *In general.* A taxpayer that has filed a 2000 or 2001 federal tax return before June 1, 2002, has made the election not to deduct the additional first year depreciation for a class of property that is qualified property or Liberty Zone property placed in service by the taxpayer after September 10, 2001, during the 2000 or 2001 taxable year, if:

(a) the taxpayer made the election within the time prescribed in section 3.03(1) or 3.03(2)(a) of this revenue procedure and in the manner prescribed in the instructions for the 2001 Form 4562 (Rev. March 2002); or

(b) the taxpayer made the election within the time prescribed in section

3.03(1) or 3.03(2)(a) of this revenue procedure and included with the taxpayer's 2000 or 2001 federal tax return an affirmative statement to the effect that the taxpayer is not deducting the additional first year depreciation for the class of property. The affirmative statement may be a statement attached to, or written on, the return (for example, writing on the Form 4562 "not deducting 30 percent").

(2) *Deemed election.* If section 4.02(1) of this revenue procedure does not apply, a taxpayer that has filed a 2000 or 2001 federal tax return before June 1, 2002, will also be treated as making the election not to deduct the additional first year depreciation for a class of property that is qualified property or Liberty Zone property placed in service by the taxpayer after September 10, 2001, during the 2000 or 2001 taxable year, if the taxpayer:

(a) on that return, did not claim the additional first year depreciation for that class of property but did claim depreciation; and

(b) does not file an amended federal tax return (or a qualified amended return) or a Form 3115 within the time prescribed in section 4.01 of this revenue procedure to claim the additional first year depreciation for the class of property.

.03 *Increased Section 179 Expensing for Liberty Zone Property.* If a taxpayer has filed a 2000 or 2001 federal tax return before June 1, 2002, and did not elect on that return to expense the increased § 179 amount for § 179 property that is Liberty Zone property placed in service by the taxpayer after September 10, 2001, during the 2000 or 2001 taxable year, the taxpayer must file an amended return (or a qualified amended return under Rev. Proc. 94-69, if applicable) on or before the due date (*excluding* extensions) of the federal tax return for the next succeeding taxable year to make this election. This amended return (or qualified amended return) should include the statement "Filed Pursuant to Rev. Proc. 2002-33" at the top of the amended return (or qualified amended return).

.04 *Liberty Zone Leasehold Improvement Property.* If a taxpayer has filed a 2000 or 2001 federal tax return before June 1, 2002, and did not depreciate on that return Liberty Zone leasehold improvement property placed in service

by the taxpayer after September 10, 2001, during the 2000 or 2001 taxable year as 5-year property for purposes of § 168 using the straight-line method of depreciation, the taxpayer should file an amended tax return (or a qualified amended return under Rev. Proc. 94-69, if applicable) before the taxpayer files the federal tax return for the next succeeding taxable year. The amended return (or qualified amended return) should include the statement "Filed Pursuant to Rev. Proc. 2002-33" at the top of the amended return (or qualified amended return).

SECTION 5. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 2002-9 is modified and amplified to include the accounting method change provided in section 4.01 of this revenue procedure in section 2 of the APPENDIX.

.02 Section 2.01 of the APPENDIX of Rev. Proc. 2002-9 is modified as follows:

(1) Section 2.01(2)(a)(ii) of the APPENDIX is modified to read as follows:

"(ii) for which depreciation is determined under § 56(a)(1), § 56(g)(4)(A), § 167, § 168, § 197, § 1400L(b), or § 1400L(c), or under § 168 prior to its amendment in 1986 (former § 168); and"

(2) Section 2.01(2)(c)(vi) of the APPENDIX is modified to read as follows:

"(vi) any property for which a taxpayer is revoking a timely valid election, or making a late election, under § 167, § 168, § 1400L(b), former § 168, or § 13261(g)(2) or (3) of the Revenue Reconciliation Act of 1993 (1993 Act), 1993-3 C.B. 1, 128 (relating to amortizable § 197 intangibles). A taxpayer may request consent to revoke or make the election by submitting a request for a letter ruling under Rev. Proc. 2002-1 (2002-1 I.R.B. 1) (or any successor);"

(3) Section 2.01(2)(c)(xii) of the APPENDIX is modified to read as follows:

"(xii) any change in method of accounting involving both a change from treating the cost or other basis of the property as nondepreciable property to treating the cost or other basis of the property as depreciable property and the adoption of a method of accounting for depreciation requiring an election under

§ 167, §168, § 1400L(b), former § 168, or § 13261(g)(2) or (3) of the 1993 Act (for example, a change in the treatment of the space consumed in landfills placed in service in 1990 from nondepreciable to depreciable property (assuming section 2.01(2)(c)(xiii) of the APPENDIX does not apply) and the making of an election under § 168(f)(1) to depreciate this property under the unit-of-production method of depreciation under § 167);”

(4) Section 2.01(6)(d) of the APPENDIX is modified to read as follows:

“(d) *Section 167 property*. Generally, for any taxable year, the depreciation allowable for property for which depreciation is determined under § 167, is determined either:

(i) under the depreciation method adopted by a taxpayer for the property; or
(ii) if that depreciation method does not result in a reasonable allowance for depreciation or a taxpayer has not adopted a depreciation method for the property, under the straight-line depreciation method.

For determining the estimated useful life and salvage value of the property, see § 1.167(a)–1(b) and (c), respectively.

The depreciation allowable for any taxable year for property subject to § 167(f) (regarding certain property excluded from § 197) is determined by using the depreciation method and useful life prescribed in § 167(f). If computer software is depreciated under § 167(f)(1) and is qualified property (as defined in § 168(k)(2)) or qualified New York Liberty Zone (Liberty Zone) property (as defined in § 1400L(b)(2)), the depreci-

ation allowable for that computer software under § 167(f)(1) is also determined by taking into account the additional 30 percent depreciation (additional first year depreciation) deduction provided by § 168(k) or § 1400L(b), as applicable, unless the taxpayer made a timely valid election not to deduct the additional first year depreciation for the property.”

(5) Section 2.01(6)(e) of the APPENDIX is modified to read as follows:

“(e) *Section 168 property*. The depreciation allowable for any taxable year for property for which depreciation is determined under § 168, is determined as follows:

(i) by using either:

(A) the general depreciation system in § 168(a); or

(B) the alternative depreciation system in § 168(g) if the property is required to be depreciated under the alternative depreciation system pursuant to § 168(g)(1) or other provisions of the Code (for example, property described in § 263A(e)(2)(A) or § 280F(b)(1)). Property required to be depreciated under the alternative depreciation system pursuant to § 168(g)(1) includes property in a class (as set out in § 168(e)) for which the taxpayer made a timely election under § 168(g)(7); and

(ii) if the property is qualified property or Liberty Zone property, by taking into account the additional first year depreciation deduction provided by § 168(k) or § 1400L(b), as applicable, unless the taxpayer made a timely valid election not to deduct the additional first year depreciation for the property.”

(6) Section 2.01(6) of the APPENDIX is modified by adding a new paragraph (h) to read as follows:

“(h) *Qualified New York Liberty Zone leasehold improvement property*. The depreciation allowable for any taxable year for qualified New York Liberty Zone leasehold improvement property (as defined in § 1400L(c)(2)) is determined by using the depreciation method and recovery period prescribed in § 1400L(c).”

.03 Section 2.02(2)(c)(vi) of the APPENDIX of Rev. Proc. 2002–9 is modified as follows:

“(vi) any property for which depreciation is determined under § 56(a)(1), § 56(g)(4)(A)(i), (ii), (iii), or (v), § 168, § 1400L(b), or § 1400L(c), or under § 168 prior to its amendment in 1986 (former § 168);”

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for qualified property, Liberty Zone property, and Liberty Zone leasehold improvement property placed in service after September 10, 2001.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Douglas Kim and Kathleen Reed of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Kim at (202) 622–3110 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Guidance Necessary to Facilitate Electronic Tax Administration

REG-107184-00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: The IRS is proposing regulations designed to eliminate regulatory impediments to the electronic filing of the Form 1040, *U.S. Individual Income Tax Return*. The text of the temporary regulations (T.D. 8989) published in this issue of the Bulletin also serves as the text of these proposed regulations. These regulations generally affect taxpayers who file Form 1040 electronically and who are required to file any of the following forms: Form 56, *Notice Concerning Fiduciary Relationship*; Form 2120, *Multiple Support Declaration*; Form 2439, *Notice to Shareholder of Undistributed Long-Term Capital Gains*; Form 3468, *Investment Credit*; and Form T (Timber), *Forest Activities Schedules*.

DATES: Written or electronically generated comments and requests for a public hearing must be received by July 23, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG-107184-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG-107184-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS internet site at www.irs.gov/regs.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, James C. Gibbons, (202) 622-4910; concerning submissions of comments and/or requests for a hearing, LaNita Van Dyke, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

PAPERWORK REDUCTION ACT

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224. Comments on the collections of information should be received by June 24, 2002. Comments are specifically requested concerning:

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

The accuracy of the estimated burden associated with the proposed collection of information (see below);

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

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

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

The collections of information in this proposed regulation are in §§ 1.48-12T(d)(7), 1.152-3T(c), 1.611-3T(h), 1.852-9T(c), and 301.6903-1T(b). The proposed regulations require taxpayers to

retain their tax records for as long as the contents may become material in the administration of any internal revenue law. This information is required for substantiation purposes. This information will be used to verify the information provided by the taxpayer. The likely respondents are individuals.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103. The burden imposed in §§ 1.48-12T(d)(7), 1.152-3T(c), 1.611-3T(h), 1.852-9T(c), and 301.6903-1T(b) will be reflected in Form 3468, Form 2120, Form T (Timber), Form 2439, and Form 56 respectively.

Background

Temporary regulations in this issue of the Bulletin contain amendments to the Income Tax Regulations (26 CFR part 1) and the Procedure and Administration Regulations (26 CFR part 301) designed to eliminate regulatory impediments to the electronic filing of the Form 1040. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations. Generally, the regulations will be effective for taxable years beginning after December 31, 2001. Taxpayers may, however, rely on these proposed regulations to the extent that the impediments were removed in forms filed for taxable years beginning after December 31, 2000.

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 these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the persons responsible for recordkeeping are principally individuals, and the burden is not significant as described earlier in the preamble. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7508(f) of the Internal Revenue Code, this notice will be 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 these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies of written comments) that are submitted timely (in the manner described in the ADDRESSES caption) to the IRS. The IRS and Treasury request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested by any person who timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Sara Paige Shepherd, Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. However, other personnel from the IRS and the Treasury Department participated in the development of the regulations.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.48–12, paragraph (d)(7)(iii) is revised to read as follows:

§ 1.48–12 Qualified rehabilitated building; expenditures incurred after December 31, 1981.

* * * * *

(d) * * *

(7)(iii) [The text of proposed paragraph (d)(7)(iii) is the same as the text of § 1.48–12T(d)(7)(iii) published elsewhere in this issue of the **Federal Register**].

Par. 3. In § 1.152–3, paragraph (c) is revised to read as follows:

§ 1.152–3 Multiple support agreements.

* * * * *

(c) [The text of proposed paragraph (c) is the same as the text of § 1.152–3T(c) published elsewhere in this issue of the **Federal Register**].

* * * * *

Par. 4. Section 1.611–3, paragraph (h) is revised to read as follows:

§ 1.611–3 Rules applicable to timber.

* * * * *

(h) [The text of proposed paragraph (h) is the same as the text of § 1.611–3T(h) published elsewhere in this issue of the **Federal Register**].

Par. 5. In § 1.852–9, paragraph (c)(1) is revised to read as follows:

§ 1.852–9 Special procedural requirements applicable to designation under section 852(b)(3)(D).

* * * * *

(c)(1) [The text of proposed paragraph (c)(1) is the same as the text of § 1.852–9T(c)(1) published elsewhere in this issue of the **Federal Register**].

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 6. The authority citation for part 301 continues to read in part as follows:

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

Par. 7. Section 301.6011–1 is revised to read as follows:

§ 301.6011–1 General Requirement of return, statement or list.

[The text of proposed section is the same as the text of §301.6011–1T published elsewhere in this issue of the **Federal Register**].

Par. 8. Section 301.6903–1(b) is added to read as follows:

§ 301.6903–1 Notice of fiduciary.

* * * * *

(b) [The text of proposed paragraph (b) is the same as the text of §301.6903–1T(b) published elsewhere in this issue of the **Federal Register**].

* * * * *

Robert E. Wenzel,
Deputy Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on April 23, 2002, 8:45 a.m., and published in the issue of the Federal Register for April 24, 2002, 67 F.R. 20072)

Withdrawal of Notice of Proposed Rulemaking and Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Guidance Under Section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities in Connection With an Acquisition

REG-163892-01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking; and notice of proposed

rulemaking by cross-reference to temporary regulations.

SUMMARY: This document withdraws the notice of proposed rulemaking (REG-107566-00, 2001-1 C.B. 346) published in the **Federal Register** on January 2, 2001. In this issue of the Bulletin, the IRS is issuing temporary regulations relating to recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. The text of those regulations also serves as the text of these proposed regulations.

DATES: Written and electronic comments and requests for a public hearing must be received by July 25, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG-163892-01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG-163892-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at www.irs.gov/reg.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Amber R. Cook at (202) 622-7530; concerning submissions, Treena Garrett, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

On January 2, 2001, the IRS and Treasury published in the **Federal Register** (66 FR 66) a notice of proposed rulemaking (REG-107566-00) under section 355(e) of the Internal Revenue Code of 1986. Those proposed regulations are withdrawn.

Temporary regulations (T.D. 8988 on page 929 of this Bulletin) in the Rules and Regulations section of the **Federal Register** amend the Income Tax Regulations (26 CFR part 1) relating to section 355(e). The temporary regulations provide rules relating to recognition of gain

on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to 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 Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) and electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they may 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 Amber R. Cook, Office of Associate Chief Counsel (Corporate). Other personnel from the IRS and Treasury Department, however, participated in their development.

* * * * *

Withdrawal of Proposed Amendments to the Regulations and Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805 and 26 U.S.C. 355(e)(5), the notice of proposed rulemaking (REG-107566-00) that was published in the **Federal Register** on Tuesday, January 2, 2001, (66 FR 66) is withdrawn. In addition, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805 * * *
Section 1.355-7 also issued under 26 U.S.C. 355(e)(5). * * *

Par. 2. Section 1.355-0 is amended by revising the introductory text and adding an entry for § 1.355-7 to read as follows:

§ 1.355-0 Table of contents.

In order to facilitate the use of §§ 1.355-1 through 1.355-7, this section lists the major paragraphs in those sections as follows:

* * * * *

§ 1.355-7 Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

- (a) In general.
- (b) Plan.
 - (1) In general.
 - (2) Certain post-distribution acquisitions.
 - (3) Plan factors.
 - (4) Non-plan factors.
- (c) Operating rules.
 - (1) Internal discussions and discussions with outside advisors evidence of business purpose.
 - (2) Takeover defense.
 - (3) Effect of distribution on trading in stock.
 - (4) Consequences of section 355(e) disregarded for certain purposes.
 - (5) Multiple acquisitions.
- (d) Safe harbors.
 - (1) Safe Harbor I.
 - (2) Safe Harbor II.
 - (3) Safe Harbor III.
 - (4) Safe Harbor IV.
 - (5) Safe Harbor V.

- (i) In general.
- (ii) Special rules.
- (6) Safe Harbor VI.
 - (i) In general.
 - (ii) Special rule.
- (7) Safe Harbor VII.
 - (i) In general.
 - (ii) Special rule.
- (e) Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests.
 - (1) Treatment of options.
 - (i) General rule.
 - (ii) Agreement, understanding, or arrangement to write an option.
 - (iii) Substantial negotiations related to options.
 - (2) Instruments treated as options.
 - (3) Instruments generally not treated as options.
 - (i) Escrow, pledge, or other security agreements.

- (ii) Compensatory options.
- (iii) Options exercisable only upon death, disability, mental incompetency, or separation from service.
 - (iv) Rights of first refusal.
 - (v) Other enumerated instruments.
- (f) Multiple controlled corporations.
 - (g) Valuation.
 - (h) Definitions.
 - (1) Agreement, understanding, arrangement, or substantial negotiations.
 - (2) Controlled corporation.
 - (3) Controlling shareholder.
 - (4) Coordinating group.
 - (5) Discussions.
 - (6) Established market.
 - (7) Five-percent shareholder.
 - (8) Similar acquisition.
 - (9) Ten-percent shareholder.
 - (i) [Reserved]
 - (j) Examples.
 - (k) Effective date.

Par. 3. Section 1.355-7 is added to read as follows:

§ 1.355-7 Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

[The text of proposed § 1.355-7 is the same as the text of § 1.355-7T published elsewhere in this issue of the Bulletin].

Robert E. Wenzel,
*Deputy Commissioner of
Internal Revenue.*

(Filed by the Office of the Federal Register on April 23, 2002, 12:14 p.m., and published in the issue of the Federal Register for April 26, 2002, 67 F.R. 20711)

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 law 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 the 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.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2001–27 through 2001–53 is in Internal Revenue Bulletin 2002–1, dated January 7, 2002.

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² A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2001–27 through 2001–53 is in Internal Revenue Bulletin 2002–1, dated January 7, 2002.

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