Internal Revenue
bulletin

Bulletin No. 2002–34
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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2002–52, page 388.
LIFO; price indexes; department stores. The June 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, June 30, 2002.

T.D. 9012, page 389.
Final regulations under section 7701 of the Code address the applicability of the elective federal tax classification regime (the check-the-box regulations) to business entities wholly owned by a foreign government and to wholly owned nonbank entities of foreign banks. These regulations also provide that the term "entity" for purposes of section 892(a)(2)(B) of the Code includes a partnership.

REG–106876–00, page 392.
Proposed regulations under sections 897 and 1445 of the Code require the use of taxpayer identifying numbers on submissions. The regulations are necessary to properly identify submissions made by foreign taxpayers for the reduction or elimination of tax under these sections. The regulations also address miscellaneous items such as the amendment to section 1445(e)(3) under the Small Business Job Protection Act of 1996. A public hearing is scheduled for November 13, 2002.

REG–106879–00, page 402.
Proposed regulations under section 1503(d) of the Code provide guidance regarding the events that require the recapture of dual consolidated losses. The regulations generally provide that certain events will not require recapture of a dual consolidated loss and provide for the reporting of certain information in such cases. This document also proposes certain conforming changes to the current regulations. A public hearing is scheduled for December 3, 2002.

REG–106359–02, page 405.
Proposed regulations under section 482 of the Code clarify that stock-based compensation is taken into account in determining the intangible development costs of a controlled participant in a qualified cost sharing arrangement. The regulations also provide rules for measuring the cost associated with stock-based compensation; clarify that stock-based compensation is appropriately taken into account as a comparability factor for purposes of the comparable profits method; and clarify the coordination of the cost sharing rules with the arm's length standard. A public hearing is scheduled for November 20, 2002.

REG–133254–02, page 412.
Proposed regulations under section 6049 of the Code relate to the reporting requirements for interest on deposits maintained at U.S. offices of certain financial institutions and paid to nonresident alien individuals that are residents of certain specified countries. A public hearing is scheduled for December 5, 2002. REG–126100–00 withdrawn.

EXEMPT ORGANIZATIONS

Announcement 2002–75, page 416.
A list is provided of organizations now classified as private foundations.

Announcements of Disbarments and Suspensions begin on page 419.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

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

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

LIFO; price indexes; department stores. The June 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, June 30, 2002.

Rev. Rul. 2002–52

The following Department Store Inventory Price Indexes for June, 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 June 30, 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	June 2001	June 2002	Percent Change from June 2001 to June 2002[1]
1. Piece Goods	478.7	494.9	3.4
2. Domestics and Draperies	603.2	577.6	-4.2
3. Women's and Children's Shoes	644.8	634.3	-1.6
4. Men's Shoes	888.8	905.7	1.9
5. Infants' Wear	605.2	603.3	-0.3
6. Women's Underwear	562.2	525.1	-6.6
7. Women's Hosiery	354.0	346.5	-2.1
8. Women's and Girls' Accessories	547.3	537.2	-1.8
9. Women's Outerwear and Girls' Wear	378.1	369.7	-2.2
10. Men's Clothing	582.1	580.7	-0.2
11. Men's Furnishings	599.6	581.7	-3.0
12. Boys' Clothing and Furnishings	488.5	475.7	-2.6
13. Jewelry	936.8	897.0	-4.2
14. Notions	780.7	805.4	3.2
15. Toilet Articles and Drugs	963.4	981.0	1.8
16. Furniture and Bedding	639.9	626.2	-2.1
17. Floor Coverings	615.4	616.6	0.2
18. Housewares	767.7	756.2	-1.5
19. Major Appliances	225.9	221.0	-2.2
20. Radio and Television	53.9	49.4	-8.3
21. Recreation and Education[2]	90.1	86.2	-4.3
22. Home Improvements[2]	124.7	125.5	0.6
23. Auto Accessories[2]	109.1	110.9	1.6
Groups 1 – 15: Soft Goods	584.1	571.9	-2.1
Groups 16 – 20: Durable Goods	422.5	411.5	-2.6
Groups 21 – 23: Misc. Goods[2]	98.5	96.4	-2.1
Store Total[3]	524.5	512.9	-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 Burkom of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkom at (202) 622–7718 (not a toll-free call).

Section 892.—Income of Foreign Governments and of International Organizations

26 CFR 1.892–5: Controlled commercial entity.

T.D. 9012

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

Clarification of Entity Classification Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations under section 7701 that address the Federal tax classification of a business entity wholly owned by a foreign government and that also provide that a nonbank entity wholly owned by a foreign bank cannot be disregarded as an entity separate from its owner (disregarded entity) for purposes of applying the special rules applicable to banks under the Internal Revenue Code. This document also contains final regulations providing that a partnership can be a controlled commercial entity for purposes of section 892(a)(2)(B) and reissues certain section 892 temporary regulations with references to the final regulations.

DATES: *Effective date:*These regulations are effective August 1, 2002.

*Applicability Dates:*The regulations that address the Federal tax classification of business entities wholly owned by a foreign government under § 301.7701–2 apply on or after January 14, 2002, to such business entities regardless of any prior entity classification, and the regulations that address the definition of the term entity for purposes of section 892(a)(2)(B) apply on or after January 14, 2002. The regulations relating to a nonbank entity that is wholly owned by a foreign bank apply to taxable years beginning after January 12, 2001.

FOR FURTHER INFORMATION CONTACT: Camille B. Evans at (202) 622–3870 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR parts 1 and 301. On January 12, 2001, the IRS and the Treasury Department issued a notice of proposed rulemaking (REG–101739–00, 2001–1 C.B. 996 [66 FR 2854]), published in the **Federal Register**, to amend the existing elective business entity classification regime under section 7701 known as the check-the-box regulations, and to amend the existing temporary rules providing for the income of entities owned by foreign governments as described under section 892. No public hearing was requested or held. Written comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision. The revisions are discussed below.

Explanation and Summary of Comments

On December 18, 1996, the IRS and Treasury published the elective Federal tax classification regime under section 7701 known as the check-the-box regulations, 61 FR 66584. On January 12, 2001, the IRS and Treasury issued a notice of proposed rulemaking (REG–101739–00, 2001–1 C.B. 996) that proposed to amend the Procedure and Administration Regulations (26 CFR Part 301) to address the Federal tax classification of an entity wholly owned by a foreign government (as defined in § 1.892–2T) and to address the Federal tax treatment to a foreign bank of income and assets and liabilities of an otherwise disregarded nonbank entity that it owns. As noted in the preamble to the notice of proposed rulemaking, the purpose of the proposed regulations was to ensure parity between the treatment of entities wholly owned by State governments and entities wholly owned by foreign governments, as well as to ensure parity between the treatment of nonbank subsidiaries owned by U.S. banks and the treatment of nonbank subsidiaries owned by foreign banks engaged in a U.S. banking business. The January 12, 2001, notice of proposed rulemaking also proposed to provide that a partnership can be a controlled commercial entity under section 892.

A. *§ 301.7701–2(b)(6)*

A commentator suggested that the rule in the proposed regulations that a business entity wholly owned by a foreign government (as defined in § 1.892–2T) is a *per se* corporation should be limited to those entities directly owned by the foreign government. As indicated above, the proposed regulations were issued because the IRS and Treasury believe that it is appropriate to treat controlled entities owned by foreign governments similarly to controlled entities owned by State governments. The *per se* rule relating to controlled entities owned by State governments is not limited to those entities directly owned by a State government. Thus, except for minor changes to language, the final regulations retain the proposed rule that a business entity wholly owned by a foreign government, like a business entity wholly owned by a State government, will be treated as a *per se* corporation.

B. *§ 301.7701–2(c)(2)(ii)*

Two comments were received on the proposed regulation that provides that foreign banks, like domestic banks, would be precluded from treating their wholly owned nonbank subsidiaries as disregarded entities for purposes of the special rules of the Internal Revenue Code (Code) applicable to banks. Both comments asked for guidance on the phrase “special rules of the Internal Revenue Code applicable to banks” and the circumstances under which the regulation would apply to entities owned by foreign banks.

As noted above, the regulations are intended to ensure parity of treatment between domestic banks and foreign banks engaged in a U.S. trade or business by providing that neither domestic banks as defined in section 581 nor foreign banks

as defined in section 585(a)(2)(B) (without regard to the second sentence thereof) may apply the special rules applicable to banks to their nonbank subsidiaries. A foreign bank is described in section 585(a)(2)(B) only when it is engaged in a U.S. trade or business that meets the requirements of section 581 but for the fact the bank is a foreign corporation. Accordingly, a foreign bank will be subject to the provisions of these final regulations only if the foreign bank is engaged in a U.S. trade or business that meets the requirements of section 581 but for the fact that the bank is a foreign corporation. The reference to "special rules applicable to banks" includes not only provisions of the Code but also regulations and other published guidance under the Code.

One of these comments specifically requested clarification on how § 301. 7701–2(c)(2)(ii) would affect a foreign bank's treatment of its disregarded entity for purposes of applying the fixed ratio election in the interest allocation rules under § 1.882–5(c)(4). Because under § 1.882–5 a foreign bank that meets the definition of section 585(a)(2)(B) does not distinguish between its banking and nonbanking activities for purposes of taking assets, liabilities and interest expense into account in the interest allocation formula, the IRS and Treasury do not believe the regulations under § 1.882–5 are appropriately considered "special rules applicable to banks" for purposes of the § 301.7701–2(c)(2)(ii) regulations. Accordingly, the final regulations clarify that a foreign bank that is defined in section 585(a)(2)(B) is entitled to use the 93 percent fixed ratio under § 1.882–5 for the assets, liabilities and interest expense of a nonbank subsidiary that otherwise is treated as a disregarded entity for federal income tax purposes. Similarly, in calculating the amount of excess interest that may be treated as interest expense paid or accrued on deposits under §1.884–4(a)(2)(iii), a foreign bank defined in section 585(a)(2)(B) is entitled to take into account its combined banking and nonbanking U.S. assets (as defined in § 1.884–1(d)), including the assets of a nonbank subsidiary that is otherwise treated as a disregarded entity for federal income tax purposes.

A similar analysis applies to the rules under §§ 1.864–4(c)(5), 1.864–5, and 1.864–6, which relate to the determination of the effectively connected income of a banking, financing or similar business. Because those rules apply to both section 585(a)(2)(B) banks and to foreign corporations that are not regulated as banks but otherwise engage in financial services activities (See *Inverworld v. Commissioner*, T.C. Memo. 1996–301, supplemented by T.C. Memo 1997–226), the final regulations clarify that these rules are not considered "special rules applicable to banks."

Effective Dates

The regulations that address the Federal tax classification of business entities wholly owned by a foreign government under § 301.7701–2 apply on or after January 14, 2002, to such business entities regardless of any prior entity classification, and the regulations that address the definition of the term entity for purposes of section 892(a)(2)(B) apply on or after January 14, 2002. The regulations relating to a nonbank entity that is wholly owned by a foreign bank apply to taxable years beginning after January 12, 2001.

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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Drafting Information

The principal author of these regulations is Camille B. Evans of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for "Sections 1.892–1T through 1.892–7T" and adding the following entries in numerical order:

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

Section 1.892–1T also issued under 26 U.S.C. 892(c).

Section 1.892–2T also issued under 26 U.S.C. 892(c).

Section 1.892–3T also issued under 26 U.S.C. 892(c).

Section 1.892–4T also issued under 26 U.S.C. 892(c).

Section 1.892–5 also issued under 26 U.S.C. 892(c).

Section 1.892–5T also issued under 26 U.S.C. 892(c).

Section 1.892–6T also issued under 26 U.S.C. 892(c).

Section 1.892–7T also issued under 26 U.S.C. 892(c). * * *

Par. 2. Section 1.892–5 is added to read as follows:

§ 1.892–5 Controlled commercial entity.

(a) through (a)(2) [Reserved]. For further information, see § 1.892–5T(a) through (a)(2).

(3) For purposes of section 892(a)(2)(B), the term *entity* means and includes a corporation, a partnership, a trust (including a pension trust described in § 1.892–2T(c)) and an estate.

(4) *Effective date.* This section applies on or after January 14, 2002. See § 1.892–5T(a) for the rules that apply before January 14, 2002.

(b) through (d) [Reserved]. For further information, see §§ 1.892–5T(b) through (d).

Par. 3. Section 1.892–5T is amended by:

1. Removing the concluding text immediately following paragraph (a)(2).

2. Adding paragraph (a)(3).

The addition reads as follows:

§ 1.892–5T Controlled commercial entity (temporary regulations).

(a) * * *

(3) [Reserved]. For further information, see § 1.892–5(a)(3).

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 4. The authority citation for part 301 continues to read in part as follows:

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

Par. 5. Section 301.7701–2 is amended by:

1. Revising paragraphs (b)(6) and (c)(2)(ii).

2. Revising the first sentence of paragraph (e).

The revisions read as follows:

§ 301.7701–2 Business entities; definitions.

* * * * *

(b) * * *

(6) A business entity wholly owned by a State or any political subdivision thereof, or a business entity wholly owned by a foreign government or any other entity described in § 1.892–2T;

* * * * *

(c) * * *

(2) * * *

(ii) *Special rule for certain business entities.* If the single owner of a business entity is a bank (as defined in section 581, or, in the case of a foreign bank, as defined in section 585(a)(2)(B) without regard to the second sentence thereof), then the special rules applicable to banks under the Internal Revenue Code will continue to apply to the single owner as if the wholly owned entity were a separate entity. For this purpose, the special rules applicable to banks under the Internal Revenue Code do not include the rules under sections 864(c), 882(c), and 884.

* * * * *

(e) *Effective date.* Except as otherwise provided in this paragraph (e), the rules of this section apply as of January 1, 1997, except that paragraph (b)(6) applies on or after January 14, 2002, to a business entity wholly owned by a foreign government regardless of any prior entity classification, and paragraph (c)(2)(ii) of this section applies to taxable years beginning after January 12, 2001. * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved July 25, 2002.

Pamela F. Olson,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 31, 2002, 8:45 a.m., and published in the issue of the Federal Register for August 1, 2002, 67 F. R. 49862)

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Revision of Income Tax Regulations Under Sections 897, 1445, and 6109 to Require Use of Taxpayer Identifying Numbers on Submissions Under the Section 897 and 1445 Regulations

REG–106876–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations to require the use of taxpayer identifying numbers on submissions under sections 897 and 1445. The proposed regulations are necessary to properly identify foreign taxpayers for which submissions are made for the reduction or elimination of tax under sections 897 and 1445. The proposed regulations also address miscellaneous items, such as the amendment to section 1445(e)(3) under the Small Business Job Protection Act of 1996. This document also provides notice of a public hearing on these proposed regulations.

DATES: Electronic or written comments and requests to speak (with outlines of oral comments) at the public hearing scheduled for November 13, 2002, must be submitted by October 23, 2002.

ADDRESSES: Send submissions to: CC: ITA:RU (REG–106876–00), room 5226 Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–106876–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in room 6718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Robert W. Lorence, (202) 622–3860; concerning submissions, the hearing, and/or to be placed on the building access list to attend the hearing, Treena Garrett, (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 September 24, 2002.

The collections of information in this proposed regulation are in §§ 1.1445–2(d)(2) and 1.1445–3. The collections of information relate to the requirement that notices of nonrecognition or applications for withholding certificates be filed with the IRS with respect to (1) dispositions of U.S. real property interests that have been used by foreign persons as a principal residence within the prior 5 years and excluded from gross income under section 121 and (2) dispositions of U.S. real property interests by foreign persons in deferred like kind exchanges that qualify for nonrecognition under section 1031. This collection of information is necessary for the proper performance of the functions of the IRS because it notifies the IRS of dispositions of U.S. real property interests by foreign persons that otherwise are subject to taxation under section 897 and the collection of a withholding tax under section 1445 except as provided in these provisions. The likely respondents will be individuals and business or other for-profit institutions.

Estimated total annual reporting burden: 600 hours.

The estimated annual burden per respondent varies from 3 hours to 5 hours, depending on individual circumstances, with an estimated average of 4 hours.

Estimated number of respondents: 150.

Estimated annual frequency of responses: On occasion.

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

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

Background

Under section 897, a foreign transferor of a U.S. real property interest (USRPI) is generally taxed on gain from the disposition of the USRPI as if the taxpayer were engaged in a U.S. trade or business and as if such gain were effectively connected with such trade or business under section 871 or 882 (ECI). As a means to ensure the collection of the tax, the transferee of the USRPI generally has a withholding tax obligation under section 1445, which is generally 10 percent of the amount realized on the disposition. The withholding agent must report and pay over the tax withheld under section 1445 on Form 8288, *"U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests"*, by the 20th day after the disposition of the USRPI. The foreign transferor also must report the gain subject to tax under section 897 by filing a U.S. income tax return. Any amounts withheld under section 1445 are credited against the foreign transferor's U.S. tax liability.

Withholding under section 1445 can be reduced or eliminated pursuant to various nonrecognition provisions (*e.g.*, certain re-

organizations under section 368(a)), pursuant to an applicable U.S. income tax treaty, by reason of the tax-exempt status of the foreign transferor, or in situations where the transferor's maximum tax liability under section 897 is less than the withholding tax. To reduce or eliminate the amount to be withheld under section 1445, either the transferor or transferee (acting as the withholding agent) may request a withholding certificate from the IRS citing the grounds for the reduction or elimination of withholding and including any supporting documentation or other evidence substantiating the request.

A withholding certificate that is issued by the IRS prior to the disposition of the USRPI serves to notify the withholding agent that no withholding or reduced withholding is required. If an application for a withholding certificate is submitted before or on the date of the transfer (so it is considered to be pending with the IRS at the time of transfer), the withholding agent is not required to file the withholding tax return and pay over the withholding tax until 20 days after the date the IRS mails the withholding certificate or notice of denial. See § 1.1445–1(c)(2)(A). An application for a withholding certificate after the date of transfer can be combined with an application for an early claim for refund. See § 1.1445–3(g).

Under section 6109(a)(1), Treasury and the IRS have the authority to issue regulations requiring taxpayers to obtain taxpayer identifying numbers (TINs) for placement on returns, statements, or other documents for the purpose of securing the proper identification of taxpayers. Under the section 6109 regulations, which govern the extent to which foreign persons must have TINs, a foreign person is not required to have a TIN for inclusion on a return, statement, or other document, unless the foreign person: (1) has ECI at any time during the taxable year, (2) has a U.S. office, U.S. place of business, or a U.S. fiscal or paying agent during the taxable year, or (3) files a tax return, an amended return, or a refund claim, excluding information returns, statements, or other documents. See § 301.6109–1(b)(2).

Explanation of Provisions

The sections 897 and 1445 regulations do not require foreign transferors of USRPIs to provide TINs on withholding tax returns, applications for withholding certificates, and other notices and elections unless the foreign transferor otherwise has previously obtained a TIN. The IRS proposes to amend regulations under sections 897 and 1445 (each discussed in greater detail below) to require foreign transferors to include TINs on such documents so that the IRS can better identify the foreign taxpayer and more easily match the applications, withholding tax returns, notices, and elections with the transferor's tax return for compliance purposes. For example, the use of the foreign transferor's TIN to match the withholding tax return with the foreign transferor's income tax return will facilitate verification of the amount of withholding tax that the foreign taxpayer may credit on its return. The use of the foreign transferor's TIN also will facilitate verification that the foreign transferor files a U.S. tax return reporting the transaction (which could be matched against a withholding tax return and any application for a withholding certificate that has been filed).

In most cases, the requirement of including a TIN under the proposed regulations will not impose a new obligation on the foreign person. Such foreign person typically will be required to file a tax return for the year in which the property was sold, which requires the foreign person to obtain a TIN at that time. Accordingly, the proposed regulations simply would accelerate the time by which the foreign person is required to obtain a TIN. The IRS is considering ways to facilitate obtaining TINs in connection with transactions subject to sections 897 and 1445. For example, the IRS is considering approaches for combining an application for a reduced withholding certificate under § 1.1445–3 with an application for a TIN.

1. *Section 6109 Regulations*

Under section 6109, every person who makes a return, statement, or other document is required to furnish its TIN as required by regulation. Under the section 6109 regulations, a foreign person generally is required to have a TIN if (1) the foreign person has ECI at any time during the taxable year; (2) the foreign person has a U.S. office or place of business or a U.S. fiscal or paying agent during the taxable year; (3) the foreign person files a tax return, amended return, or a refund claim (excluding information returns, statements, or documents). § 301.6109–1(b)(2). A person is required to furnish the TIN of another person (including a foreign person) when filing a return, statement, or other document which requires the TIN of the other person, and the other person is required to have a TIN under the section 6109 regulations. If the person does not know the TIN of the other person, the first person must request it, and if this request is denied, then the first person must file an affidavit with the filing so stating. See § 301.6109–1(c).

The IRS and Treasury propose to amend the section 6109 regulations to include a specific reference to the new provisions requiring TINs for foreign taxpayers under sections 897 and 1445. The section 6109 regulations would be amended to provide that foreign persons will be required to have TINs for placement on any return, statement, or other document required by the regulations under section 897 or section 1445. See § 301.6109–1(b)(2). The section 6109 regulations also would be amended to provide that another person (*e.g.*, the transferee as withholding agent) making a return, statement, or other document will be required to furnish the TIN of a foreign person as required by the regulations under section 897 or section 1445. See § 301.6109–1(c).

2. *Section 1445 Regulations*

(a) *§ 1.1445–1*

In connection with the withholding requirements under section 1445, the transferee generally must report and pay over any tax withheld by the 20th day after the date of the transfer. § 1.1445–1(b)(1). Form 8288 *"Withholding Tax Return"* and Form 8288–A *"Statement of Withholding"* are used for this purpose. Form 8288–A serves as a receipt of withholding tax reported and paid over and is stamped by the IRS upon receipt and mailed to the transferor. The transferor must attach the Form 8288–A to its U.S. income tax return to verify the amount of withholding tax creditable on its return.

Under § 1.1445–1(d), Forms 8288 and 8288–A only require the TIN of the transferor and the transferee to the extent the transferor and transferee otherwise have TINs. If the transferee is a U.S. person it

will have a TIN, and if the transferee is a foreign person, it must have or obtain a TIN under the section 6109 regulations when filing a Form 8288 (which is considered to be a tax return). A foreign transferor, however, will not have a TIN for placement on the Forms 8288 and 8288–A, unless it is otherwise required to have one under the section 6109 regulations (*e.g.*, the foreign person otherwise has ECI). The section 1445 regulations will be amended to provide that the transferors and transferees must have TINs for placement on the Forms 8288 and 8288–A.

Finally, the section 1445 regulations provide for various documents (including applications for withholding certificates) to be sent to the Assistant Commissioner (International). Section 1.1445–1(g)(10) provides the address of the Assistant Commissioner (International). Because of the restructuring of the IRS, the Office of the Assistant Commissioner (International) no longer exists, and its duties regarding the administration of the section 1445 regulations are performed, in general, by the Philadelphia Service Center. Section 1.1445–1(g)(10) and other provisions in the section 1445 regulations will be amended to reflect this change.

(b) *§ 1.1445–2*

Under § 1.1445–2(d)(2), a transferee is not required to withhold under section 1445, if, by reason of a nonrecognition provision of the Internal Revenue Code or a U.S. income tax treaty provision, the transferor is not required to recognize gain or loss with respect to the transfer. The transferor must notify the transferee of the nonrecognition provision or treaty provision, and the transferee must provide a copy of the transferor's notice to the IRS by the 20th day after the date of the transfer. Section 1.1445–9T specifies the information the notice must contain, such as identifying information of the transferor, a description of the transaction, and a brief summary of the law and facts supporting the claim of nonrecognition of gain on the transaction. The notice is required to include a TIN of the transferor only if the foreign transferor otherwise has a TIN. The notice forwarded by the transferee to the IRS must include a cover letter identifying the transferee. The transferee must include its TIN on the cover letter only if it has one.

The proposed regulations would withdraw section 1.1445–9T and incorporate it into § 1.1445–2(d)(2). In addition, the information required for inclusion on the notice would be revised to provide that the transferor must have a TIN for inclusion on the notice of nonrecognition. The regulations also would be amended to provide that the transferee must have a TIN for placement on the cover letter.

Certificates of Non-foreign Status Under § 1.1445–2

Under § 1.1445–2(b), no withholding is required under section 1445 if the transferor of a U.S. real property interest is not a foreign person. If the transferor provides a certificate of non-foreign status to the transferee of the U.S. real property interest prior to or at the time of the transfer, the transferee is not required to withhold under section 1445(a). The certificate of non-foreign status must certify that the transferor is not a foreign person, must set forth the transferor's name, identifying number and address, and must contain the transferor's signature under penalties of perjury.

The IRS is considering requiring Form W–9 to be used as certificates of non-foreign status under § 1.1445–2(b). Form W–9 generally contains the same information as a certificate of non-foreign status and currently is used in the context of section 1441 withholding to determine a taxpayer's non-foreign status. Because Form W–9 is not now required in real estate transactions and because payments with respect to real estate transactions are exempt from backup withholding under § 31.3406(g)–2(e) (although Form W–9 can be used to provide the TIN of the seller to the reporting person required to report the transaction on Form 1099 under § 1.6045–4(l)), the IRS requests comments on the use of Form W–9 in real estate transactions to avoid withholding under section 1445. The IRS believes that the use of Form W–9 could ease compliance with section 1445.

(c) *§ 1.1445–3*

Section 1.1445–3 provides procedures for the reduction or elimination of withholding under section 1445 pursuant to a withholding certificate issued by the IRS. A withholding certificate may be issued by the IRS in cases where the transferor is exempt from U.S. tax, the transferor's maximum tax liability under section 897 is less than the withholding tax, or where the transferor or transferee enters into an agreement for the payment of tax with the IRS. A withholding certificate that is applied for prior to or on the date of the transfer notifies the transferee that reduced or no withholding is required. A withholding certificate that is applied for after a transfer has been made may authorize a normal refund or an early refund. Either the transferor or transferee may apply for a withholding certificate.

Section § 1.1445–3(b)(2) identifies the information that must be furnished on an application for a withholding certificate. It includes the name and address of the transferee and the transferee's TIN, but only if the transferee has a TIN. It also includes the name and address of all other parties to the transaction (*e.g.*, transferors) and their TINs, but only if they have TINs. The applicant must determine if each party has a TIN, and if none exists for a particular party, the application must so state. The regulations would be amended to provide that the transferee and all other parties (*e.g.*, transferors) must have TINs for placement on an application for a withholding certificate. The regulations would further provide that the application will be denied if the TINs of all the parties are not provided.

(d) *§ 1.1445–5*

Under § 1.1445–5, special rules are provided concerning withholding required under section 1445(e) on distributions and other transactions involving domestic or foreign corporations, partnerships, trusts, and estates. Paragraph (b)(2) provides that no withholding is required for transfers of a USRPI described in section 1445(e) if no gain or loss is required to be recognized by a foreign person under a nonrecognition provision of the Internal Revenue

Code or a provision of a U.S. income tax treaty. The entity or fiduciary otherwise required to withhold must deliver a notice of the nonrecognition transfer to the IRS by the 20th day after the transfer of the USRPI. The entity or fiduciary may obtain a withholding certificate from the IRS to confirm the applicability of a nonrecognition provision, but is not required to do so.

The notice of a nonrecognition transfer delivered to the IRS must contain a description of the transfer and a supporting explanation of the claim of nonrecognition treatment, as well as identifying information of the entity or fiduciary submitting the notice and each foreign person with respect to which withholding would otherwise be required. The TINs of the entity or fiduciary and each foreign person are required to be furnished only if such persons otherwise have TINs. The regulations under §1.1445–5(b)(2)(ii) would be amended to provide that the entity or fiduciary and all foreign persons must have TINs to be furnished on the notice of nonrecognition.

(e) *§ 1.1445–6*

Section 1.1445–6 provides procedures for obtaining a withholding certificate for distributions and other transactions involving domestic or foreign corporations, partnerships, trusts, and estates subject to withholding tax under section 1445(e) and § 1.1445–5. The procedures for obtaining a withholding certificate are modeled after § 1.1445–3, which provides the procedures for obtaining a withholding certificate under section 1445(a). Hence, the entity or fiduciary (acting as withholding agent) or the foreign taxpayer subject to section 897 can apply for a withholding certificate on the basis that the foreign person is exempt from U.S. tax, the transferor's maximum tax liability under section 897 is less than the withholding tax, or an agreement is entered into by the transferor or transferee for the payment of tax.

Section 1.1445–6(b) identifies the information that must be furnished on an application for a withholding certificate. It includes the name, address of the foreign taxpayer subject to section 897 and the foreign taxpayer's TIN, but only if the taxpayer otherwise has a TIN. The regulations will be amended to require the foreign taxpayer to have a TIN for placement on an application for a withholding certificate.

3. *Section 897 Regulations*

(a) *§ 1.897–3*

Section §1.897–3 provides rules enabling a foreign corporation to make a section 897(i) election to be treated as a domestic corporation for purposes of sections 897 and 1445. A foreign corporation making a section 897(i) election is subject to all of the rules under section 897 and 1445 that apply to domestic corporations. For example, if a foreign corporation that has made the section 897(i) election is a USRPHC, interests in it are USRPIs that are subject to taxation under section 897 and withholding tax under section 1445. A foreign corporation that makes an election under section 897(i) is not treated as a domestic corporation for purposes of any other provision of the Code or regulations, except to the extent that it is required to consent to such treatment as a condition of making the election.

The election under section 897(i) must include the name, address, and place and date of incorporation of the foreign corporation and the foreign corporation's TIN but only if the foreign corporation otherwise has a TIN. The regulations would be amended to require the electing foreign corporation to have a TIN for placement on the election.

(b) *§ 1.897–5T*

Section § 1.897–5T provides that certain distributions of USRPIs (which otherwise qualify for nonrecognition treatment) are not subject to section 897 if any gain from a subsequent disposition of the USRPIs would be included in gross income of the distributee or transferee receiving the USRPI in the distribution. See, *e.g.*, § 1.897–5T(c)(2)(i). An interest will be considered subject to U.S. tax upon its subsequent disposition only if certain reporting requirements are satisfied. See § 1.897–5T(d)(1)(i). Under the reporting requirements, the distributor must file an income tax return for the taxable year of the distribution. The person filing the return must attach a document describing the distribution or exchange, including the name and address of the distributee, and its TIN, but only to the extent it has one. See § 1.897–5T(d)(1)(iii).

The regulations would be amended to require that the document attached to the return includes the TIN of the distributee. This is necessary to properly identify the foreign distributee which will be subject to section 897 upon a subsequent disposition of the USRPI.

4. *Miscellaneous Items*

(a) *§ 1445(e)(3)*

Section 1445(e)(3) provides that if a domestic corporation which is a U.S. real property holding corporation (or at any time during the preceding five year period was a U.S. real property holding corporation) distributes property to a foreign shareholder in redemption of stock under section 302 or in liquidation of the corporation, the corporation must withhold 10 percent of the amount distributed to the foreign shareholder. Withholding is not required if the domestic corporation was "purged" of its U.S. real property holding corporation status by disposing of all of its U.S. real property interests within the prior five-year period and recognizing gain (if any) pursuant to section 897(c)(1)(B).

Section 1445(e)(3) was amended by the Small Business Job Protection Act of 1996 (Public Law 104–188, Sec. 1704(c)) to provide that similar rules apply in the case of any distribution to which section 301 applies and which is not made out of earnings and profits of the domestic corporation. Because a section 301 distribution by a domestic corporation to a foreign shareholder is also governed by section 1441 (or 1442 or 1443), the section 1441 regulations provide coordination rules between withholding under sections 1445 and 1441 (or 1442 or 1443) in the case of section 301 distributions to foreign shareholders by a domestic corporation which is a U.S. real property holding corporation or was one at any time within the prior five-year period. See § 1.1441–3(c)(4).

In general, § 1.1441–3(c)(4) provides that a domestic corporation may elect to withhold on the entire distribution under section 1441 (or 1442 or 1443), and not under section 1445, regardless of whether a portion of the distribution constitutes a return of basis or capital gain. Alternatively, a domestic corporation may elect to

withhold under both sections 1445 and 1441 (or 1442 or 1443), in which case the domestic corporation must withhold under section 1441 (or 1442 or 1443) on the portion of the distribution that is estimated to be a dividend under § 1.1441–3(c)(2)(ii)(A) and must withhold under section 1445(e)(3) on the remainder of the distribution. A domestic corporation may withhold a reduced amount on the distribution under section 1445(e)(3) by obtaining a withholding certificate establishing that the amount of capital gain under section 301(c)(3) is less than the withholding tax otherwise due under section 1445(e)(3).

Section 1.1445–5(e) currently provides that if a domestic corporation, the stock of which is a U.S. real property interest, distributes property to a foreign shareholder in a redemption of stock under section 302 or in liquidation of the corporation, the domestic corporation must withhold 10 percent of the fair market value of the property distributed to the foreign shareholder. Section 1.1445–5(e) would be amended to provide that withholding is required in the case of a distribution of property under section 301(c). A cross-reference to § 1.1441–3(c)(4), which provides the coordination rules for withholding between sections 1445 and 1441 (or 1442 or 1443), is provided.

(b) *Section 121 exclusion*

Prior to the Taxpayer Relief Act of 1997 (Public Law 105–34; 111 Stat. 788) (TRA 97), section 121 provided a one-time exclusion from gross income up to $125,000 for certain gains from the sale of a principal residence by a taxpayer that was 55 years or older. The amendment of section 121 under TRA 97 expanded the exclusion to all taxpayers (not just those 55 years of age and older) and increased the amount of the exclusion to $250,000 (or $500,000, in the case of a husband and wife filing a joint return). Section 121(e) denies the exclusion to nonresident alien taxpayers who expatriated from the United States and are subject to the provisions of section 877(a).

For section 121 to apply, the taxpayer must have owned and used the property as a personal residence for periods aggregating 2 years or more during the 5-year period ending on the date of the sale. Section 121(a). An alien individual who owns and has used a U.S. real property interest as a personal residence during the 5-year period prior to the date of sale may nevertheless be a nonresident alien at the time of sale and subject to sections 897 and 1445. In addition, certain alien individuals (for example, full-time diplomats or employees of international organizations), who may own and use a U.S. real property interest as a personal residence at the time of sale, are treated as nonresident alien individuals for tax purposes under section 7701(b).

In connection with the amendments to section 121, section 1034 was repealed. Section 1034 had provided for nonrecognition of gain upon the sale of a personal residence provided that another personal residence of greater value was purchased within a specified period of time. Prior to the repeal of section 1034, withholding agents could rely on a notice of nonrecognition under § 1.1445–2(b)(2) on certain section 1034 exchanges because section 1034 exchanges were treated as nonrecognition exchanges for purposes of sections 897 and 1445. See § 1.897–6T(a)(5). Section 121 is not treated as a nonrecognition exchange for purposes of sections 897 and 1445. See § 1.897–6T(a)(2). Therefore, withholding agents cannot rely on a notice of nonrecognition under § 1.1445–2(b)(2) with respect to the section 121 exclusion, and dispositions of personal residences entitled to the section 121 exclusion are not entitled to a reduction in withholding absent a withholding certificate. Accordingly, the withholding certificate provisions of § 1.1445–3(c) are proposed to be amended to provide that a claimed adjustment to the maximum tax liability on the disposition of a U.S. real property interest will include the section 121 exclusion if the claim includes information establishing that the transferor is entitled to the benefits of section 121. Because section 1034 has been repealed, the following regulatory provisions concerning section 1034 will be withdrawn effective on the date of its repeal: § 1.897–6T(a)(5), § 1.897–6T(a)(7), *Examples 2* and *3*, and § 1.1445–9T(b)(6).

(c) *Section 1031 like-kind exchanges*

Section 1031(a) provides for the nonrecognition of gain or loss on the exchange of like-kind property which is held for productive use in a trade or business or held for investment. Section 1031(a)(3) provides for the exchange of like-kind property in deferred exchanges, where the taxpayer has 45 days after it relinquishes the property to the transferee to identify replacement property and the transferee has until the earlier of 180 days or the due date of the tax return for the year of transfer to deliver such property to the transferor. In cases where there is a simultaneous exchange of like-kind U.S. real property interests, the foreign transferor can provide a notice of recognition under § 1.1445–2(d)(2) to the transferee, and the transferee can rely on such notice because the like-kind exchange will be fully completed on the day of the exchange.

In the case of a deferred like-kind exchange of U.S. real property interests, the issue has been raised whether the transferee can rely on a notice of nonrecognition under § 1.1445–2(d)(2) when the exchange is not completed (because of the 45 day and 180 day rule) and the determination of nonrecognition is not known by the 20th day after receipt of the relinquished property by the transferee (when it has the obligation to pay withholding tax and file a withholding tax return, Form 8288). It has been the view of the IRS and Treasury that the transferee cannot rely on a notice of nonrecognition in the case of a deferred like-kind exchange, because the transferee cannot be assured that the exchange will qualify for nonrecognition treatment under section 1031. Although § 1.1445–2(d)(2) does not apply to section 1031 transactions, taxpayers have requested withholding certificates under § 1.1445–3 in the case of deferred like-kind exchanges. This practice will be incorporated in the regulations by amending § 1.1445–3(c) to provide that taxpayers may obtain withholding certificates in the case of deferred like-kind exchanges under section 1031(a)(3) (see also the safe-harbor for reverse like-kind exchanges under Rev. Proc. 2000–37, 2000–2 C.B. 308).

(d) *Transfers by an entity treated as a disregarded entity for U.S. tax purposes*

Under § 1.1445–2(a), a transferee generally has the duty to withhold under section 1445(a) if the transferor is a foreign person and the transferee is acquiring a U.S. real property interest. A transferee

generally is not required to withhold under section 1445(a) if the transferee receives a certificate of non-foreign status from the transferor without actual knowledge (or notice from an agent of the transferor or transferee) that the certificate is false. § 1.1445–2(b)(2). While the transferee is not required to request a certificate of non-foreign status and may rely on other means to determine the non-foreign status of the transferor, the transferee will be subject to the liability imposed under section 1445 if the transferor is in fact a foreign person and the transferor has not received a certificate of non-foreign status. § 1.1445–2(b)(1). Thus, the transferee may demand a certificate of non-foreign status and is entitled to withhold under section 1445 if a certificate of non-foreign status is not provided. *Id*.

Taxpayers have inquired about the operation of sections 897 and 1445 where the legal entity transferring a U.S. real property interest is disregarded as an entity separate from its owner for U.S. tax purposes, for example, under § 301.7701–3 (disregarded entity). If the transferor is a disregarded entity, the owner (and not the entity) is treated as the transferor of property for U.S. tax purposes, including sections 897 and 1445. See, *e.g.*, § 301.7701–3(a). Accordingly, if a disregarded entity disposes of a U.S. real property interest and its owner is a foreign person, the foreign person is treated as the transferor of the property and is subject to tax under sections 897 and 1445. If a disregarded entity disposes of a U.S. real property interest and its owner is a U.S. person, then the U.S. person is the transferor of the property and may provide a certificate of non-foreign status.

In order to clarify the treatment of disregarded entities, the regulations are amended to provide that a disregarded entity may not provide a certificate of non-foreign status because the disregarded entity is not the transferor. The sample certifications which an entity may provide to the transferee with respect to its non-foreign status (as provided in § 1.1445–2(b)(2)) are amended to include a certification that the entity is not a disregarded entity for U.S. tax purposes.

Proposed Effective Date

These regulations are proposed to apply to transactions occurring 30 days or more after the date final regulations are published in the **Federal Register**.

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, and because these regulations do not impose a collection of information on U.S. small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the 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 on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 13, 2002, beginning at 10:00 am, in room 6718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 30 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit timely written comments and an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by October 23, 2002.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Robert W. Lorence, Jr., of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1— INCOME TAXES

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

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

Par. 2. In § 1.897–1, paragraph (p), the first sentence is amended by adding the language "or the identification number assigned by the Internal Revenue Service (see § 301.6109–1 of this chapter)" immediately after the language "United States social security number".

Par. 3. Section 1.897–2 is amended as follows:

For each of the paragraphs listed in the first column, remove the language in the second column and add in its place the language in the third column:

Paragraphs	Remove	Add
(g)(1)(i)(B)	Director, Foreign Operations District ("Director")	Commissioner, Small Business/Self Employed Division (SB/SE)

Paragraphs	Remove	Add
(G)(1)(i), fourth sentence of concluding text immediately following paragraph (g)(1)(i)(B)	Director	Commissioner
(g)(1)(iii) heading	Director	Commissioner
(g)(1)(iii)(A), first, fourth, and last sentences	Director	Commissioner
(g)(1)(iii)(A), third sentence	Director, Foreign Operations District; 1325 K St. N.W.; Washington, D.C. 20225	Commissioner, Small Business/Self Employed Division (SB/SE); S C3–413 NCFB, 500 Ellin Road, Lanham, MD 20706
(g)(1)(iii)(B) heading	Director's	Commissioner's
(g)(1)(iii)(B) introductory text	Director	Commissioner
(g)(1)(iii)(B) concluding text immediately following (g)(1)(iii)(B)(*2*)	Director	Commissioner
(g)(1)(iii)(C) both places it appears	Director	Commissioner
(g)(1)(iii)(D) heading	Director	Commissioner
(g)(1)(iii)(D)	Director	Commissioner
(g)(2)(i)(B)	Director	Commissioner
(g)(2)(iii) heading	Director	Commissioner
(g)(2)(iii)(A), first, fourth, and fifth sentence (both places it appears).	Director	Commissioner
(g)(2)(iii)(A), third sentence	Director, Foreign Operations District; 1325 K St. N.W.; Washington, D.C. 20225	Commissioner, Small Business/Self Employed Division (SB/SE); S C3–413 NCFB, 500 Ellin Road, Lanham, MD 20706
(g)(2)(iii)(B) heading	Director's	Commissioner's
(g)(2)(iii)(B) introductory text	Director	Commissioner
(g)(2)(iii)(B) concluding text immediately following (g)(2)(iii)(B)(*2*)	Director	Commissioner
(g)(2)(iii)(C), first and second sentences	Director	Commissioner
(g)(2)(iii)(D) heading	Director	Commissioner
(g)(2)(iii)(D)	Director	Commissioner
(g)(2)(iv), fourth sentence	Director	Commissioner
(h)(2)(v), third sentence	Assistant Commissioner (International), Director, Office of Compliance, OP:I:C:E:666, 950 L'Enfant Plaza South, SW, COMSAT Building, Washington, D.C. 20024	Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114–0586
(h)(4)(ii), first sentence	Assistant Commissioner (International), Director, Office of Compliance, OP:I:C:E:666, 950 L'Enfant Plaza South, SW, COMSAT Building, Washington, D.C. 20024	Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114–0586

Par. 4. Section 1.897–3 is amended as follows:

1. For each of the paragraphs listed in the first column, remove the language in the second column and add in its place the language in the third column:

Paragraphs	Remove	Add
(c), introductory text	Director of the Foreign Operations District, 1325 K St., N.W., Washington, D.C. 20225	Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114–0586
(c)(1), introductory text, last sentence	which must set forth	which must contain all the following information
(d)(1), fourth sentence	Foreign Operations District	Philadelphia Service Center
(d)(2)(i), penultimate sentence	Director, Foreign Operations District	U.S. Treasury
(f)(1), second sentence	Director, Foreign Operations District, 1325 K St., N.W., Washington, D.C. 20225	Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114–0586
(f)(1), fifth sentence	Foreign Operations District	Philadelphia Service Center
(g)(1), second sentence	Director of the Foreign Operations District	Director, Philadelphia Service Center

2. In paragraph (c)(1)(i), remove the parenthetical "(if any)" after the words "identifying number".

Par. 5. Section 1.897–5 is added to read as follows:

§ 1.897–5 Corporate Distributions.

(a) through (d)(1)(iii)(E) [Reserved]. For further guidance, see § 1.897–5T(a) through (d)(1)(iii)(E).

(d)(1)(iii)(F) Identification by name and address of the distributee or transferee, including the distributee's or transferee's taxpayer identification number;

(d)(1)(iii)(G) through (d)(4) [Reserved]. For further guidance, see § 1.897–5T(d)(1)(iii)(G) through (d)(4).

(e) *Effective date.* This section is applicable to transfers and distributions after 30 days after publication of final regulations in the **Federal Register**.

Par.6. In § 1.897–5T, paragraph (d)(1)(iii)(F) is revised to read as follows:

§ 1.897–5T Corporate distributions (temporary).

* * * * *

(d) * * * (1) * * *

(iii) * * *

(F) [Reserved]. For further guidance, see § 1.897–5(d)(1)(iii)(F).

* * * * *

§ 1.897–6T [Amended]

Par. 7. Section 1.897–6T is amended as follows:

1. In paragraph (a)(2), second sentence, the language ", 1034" is removed.

2. Paragraph (a)(5) is removed and reserved.

3. Paragraph (a)(7), *Example 2* and *Example 3* are removed and reserved.

Par. 8. Section 1.1445–1 is amended as follows:

1. In paragraph (c)(1), second sentence, remove the language "filed with the Internal Revenue Service Center, Philadelphia, PA 19255" and add in its place the language "filed at the location as provided in the instructions to Forms 8288 and 8288–A".

2. In paragraph (c)(2)(i)(B), second sentence, remove the phrase ",if any," after the words "taxpayer identification number".

3. In paragraphs (d)(1)(i) and (d)(1)(ii), remove the parenthetical "(if any)" after the words "identifying number".

4. In paragraphs (d)(2)(i), (d)(2)(iv)(B), and (d)(2)(vi)(B), remove the parenthetical "(if any)" after the words "identifying number".

5. Paragraphs (g)(9) and (g)(10) are revised.

The revisions read as follows:

§ 1.1445–1 Withholding on dispositions of U.S. real property interests by foreign persons: In general.

* * * * *

(g) * * *

(9) *Identifying number.* Pursuant to § 1.897–1(p), an individual's identifying number is the social security number or the identification number assigned by the Internal Revenue Service (see § 301.6109–1 of this chapter). The identifying number of any other person is its United States employer identification number.

(10) *Address of the Director, Philadelphia Service Center.* Any written communication directed to the Director, Philadelphia Service Center is to be addressed as follows: P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114–0586.

Par. 9. Section 1.1445–2 is amended as follows:

1. Paragraph (b)(2)(iii) is redesignated as paragraph (b)(2)(iv), and new paragraph (b)(2)(iii) is added.

2. Newly designated paragraph (b)(2)(iv)(B) is revised.

3. In paragraph (d)(2)(i)(B), the language "Assistant Commissioner (International)" is removed, and "Director, Philadelphia Service Center" is added in its place, and the parenthetical "(if any)," is removed after the words "identifying number".

4. Paragraphs (d)(2)(iii) and (d)(2)(iv) are added immediately following the concluding text following paragraph (d)(2)(ii)(B).

5. In paragraphs (d)(3)(iii)(A)(*2*) and (d)(3)(iii)(A)(*3*), the parenthetical "(if any)" is removed after the words "identifying number".

The revision and additions read as follows:

§ 1.1445–2 Situations in which withholding is not required under section 1445(a).

* * * * *

(b) * * *

(2) * * *

(iii) *Disregarded entities.* A disregarded entity may not certify that it is the transferor of a U.S. real property interest, as the disregarded entity is not the transferor for U.S. tax purposes, including sections 897 and 1445. Rather, the owner of the disregarded entity is treated as the transferor of property and must provide a certificate of non-foreign status to avoid withholding under section 1445. A disregarded entity for these purposes means an entity that is disregarded as an entity separate from its owner under § 301.7701–3 of this chapter, a qualified REIT subsidiary as defined in section 856(i), or a qualified subchapter S subsidiary under section 1361(b)(3)(B). Any domestic entity must include in its certification of non-foreign status with respect to the transfer a certification that it is not a disregarded entity.

(iv) * * *

(B) *Entity transferor.*

"Section 1445 of the Internal Revenue Code provides that a transferee of a U.S. real property interest must withhold tax if the transferor is a foreign person. For U.S. tax purposes (including section 1445), the owner of a disregarded entity (which has legal title to a U.S. real property interest under local law) will be the transferor of the property and not the disregarded entity. To inform the transferee that withholding of tax is not required upon the disposition of a U.S. real property interest by [name of transferor] , the undersigned hereby certifies the following on behalf of [name of the transferor]:

1. [Name of transferor] is not a foreign corporation, foreign partnership, foreign trust, or foreign estate (as those terms are defined in the Internal Revenue Code and Income Tax Regulations);

2. [Name of transferor] is not a disregarded entity as defined in § 1.1445–2(b)(2)(iii);

3. [Name of transferor]'s U.S. employer identification number is _____; and

4. [Name of transferor]'s office address is ----------.

[Name of transferor] understands that this certification may be disclosed to the Internal Revenue Service by transferee and that any false statement contained herein could be punished by fine, imprisonment, or both.

Under penalties of perjury I declare that I have examined this certification and to the best of my knowledge and belief it is true, correct, and complete, and I further declare that I have authority to sign this document on behalf of [name of transferor].

[Signature(s) and date]

[Title(s)]"

* * * * *

(d) * * *

(2) * * *

(iii) *Contents of the notice.* No particular form is required for a transferor's notice to a transferee that the transferor is not required to recognize gain or loss with respect to a transfer. The notice must be verified as true and signed under penalties of perjury by the transferor, by a responsible officer in the case of a corporation, by a general partner in the case of a partnership, and by a trustee or equivalent fiduciary in the case of a trust or estate. The following information must be set forth in paragraphs labeled to correspond with the designation set forth as follows—

(A) A statement that the document submitted constitutes a notice of a nonrecognition transaction or a treaty provision pursuant to the requirements of § 1.1445–2(d)(2);

(B) The name, identifying number, and home address (in the case of an individual) or office address (in the case of an entity) of the transferor submitting the notice;

(C) A statement that the transferor is not required to recognize any gain or loss with respect to the transfer;

(D) A brief description of the transfer; and

(E) A brief summary of the law and facts supporting the claim that recognition of gain or loss is not required with respect to the transfer.

(iv) *No notice allowed.* The provisions of this paragraph (d)(2) do not apply to exclusions from income under section 121 and to non-simultaneous like-kind exchanges under section 1031 where the transferee cannot determine that the exchange has been completed and all the conditions for nonrecognition have been satisfied at the time it is otherwise required to pay the section 1445 withholding tax and file the withholding tax return (Form 8288, *"U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests"*). In these cases, the transferee is excused from withholding only upon the timely application for and receipt of a withholding certificate under § 1.1445–3 (see § 1.1445–3(b)(5) and (6) for specific rules applicable to transactions under sections 121 and 1031).

* * * * *

Par. 10. Section 1.1445–3 is amended as follows:

1. For each of the paragraphs listed in the column below, remove the language "Assistant Commissioner (International)", and add "Director, Philadelphia Service Center" in its place.

Paragraphs

(b)(1), first sentence

(f)(1), first sentence

(f)(2)(iii), heading

(f)(2)(iii), first sentence

(g), third sentence, introductory text

2. In paragraph (b)(1), last sentence, remove the language "of this section" and add ", and to the extent applicable, paragraph (b)(5) or (6) of this section" in its place.

3. Paragraph (b)(2) is revised.

4. Paragraphs (b)(5) and (b)(6) are added.

5. In paragraphs (f)(3)(i) and (g)(1), remove the parenthetical "(if any)" after the words "identifying number".

The revision and additions read as follows:

§ 1.1445–3 Adjustments to amount required to be withheld pursuant to withholding certificate.

* * * * *

(b) * * *

(2) *Parties to the transaction.* The application must set forth the name, address, and identifying number of the person submitting the application (specifying whether that person is the transferee or transferor), and the name, address, and identifying number of other parties to the transaction (specifying whether each such party is a transferee or transferor). The Service will deny the application if complete information, including the identifying numbers of all the parties, is not provided. Thus, for example, the applicant should determine if an identifying number exists for each party, and, if none exists for a particular party, the applicant should notify the particular party of the obligation to get an identifying number before the application can be submitted to the Service. The address provided in the case of an individual must be that individual's home address, and the address provided in the case of an entity must be that entity's office address. A mailing address may be provided in addition to, but not in lieu of, a home address or office address.

* * * * *

(5) *Special rule for exclusions from income under section 121.* A withholding certificate may be sought on the basis of a section 121 exclusion as a reduction in the amount of tax due under paragraph (c)(2)(v) of this section. The application must include information establishing that the transferor, who is a nonresident alien individual at the time of the sale (and is therefore subject to sections 897 and 1445) is entitled to claim the benefits of section 121. For example, a claim for reduced withholding as a result of section 121 must include information that the transferor occupied the U.S. real property interest as his or her personal residence for the required period of time.

(6) *Special rule for like-kind exchanges under Section 1031.* A withholding certificate may be requested with respect to a like-kind exchange under section 1031 as a transaction subject to a nonrecognition provision under paragraph (c)(2)(ii) of this section. The application must include information substantiating the requirements of section 1031. The IRS may require additional information during the course of the application process to determine that the requirements of section 1031 are satisfied. In the case of a deferred like-kind exchange, the transferee is excused from withholding only if the transferee or transferor submits an application for a withholding certificate prior to or on the date of transfer, in which case the withholding tax will be placed in escrow pursuant to procedures established by the IRS and ultimately paid to the IRS if the withholding certificate is denied or released for the benefit of the taxpayer if the withholding certificate is granted. See § 1.1445–1(c)(2) for rules concerning delayed reporting and payment where an application for a withholding certificate has been submitted to the IRS prior to or on the date of transfer.

* * * * *

§ 1.1445–4 [Amended]

Par. 11. In § 1.1445–4, paragraph (c)(2), second sentence, is amended by removing the language "Assistant Commissioner (International)" and adding "Director, Philadelphia Service Center" in its place.

Par. 12. Section 1.1445–5 is amended as follows:

1. In paragraph (b)(2)(ii), first sentence, remove the language "Assistant Commissioner (International)" and add "Director, Philadelphia Service Center" in its place.

2. In paragraphs (b)(2)(ii)(B) and (b)(2)(ii)(C), remove the parenthetical "(if any)" after the words "identifying number".

3. Paragraph (b)(8)(iii) is revised.

4. In paragraph (c)(3)(v), first and fifth sentences, remove the language "Assistant Commissioner (International)" and add "Director, Philadelphia Service Center" in its place.

5. Paragraph (e)(1)(ii) is revised.

6. Paragraph (e)(2) is redesignated as paragraph (e)(3), and new paragraph (e)(2) is added,

7. In newly designated paragraph (e)(3)(iii)(B), remove the language "§ 1.1445–5(e)(2)(iii)(B)" and add "§ 1.1445–5(e)(3)(iii)(B)" in its place; and remove the language "paragraph (e)(2)(iii)(B)" and add "paragraph (e)(3)(iii)(B)" in its place.

The revisions and additions read as follows:

§ 1.1445–5 Special rules concerning distributions and other transactions by corporations, partnerships, trusts and estates.

* * * * *

(b) * * *

(8) * * *

(iii) *Distributions by certain domestic corporations to foreign shareholders.* The provisions of section 1445(e)(3) and paragraph (e)(1) of this section, requiring withholding upon distributions in redemption of stock under section 302(a) or liquidating distributions under Part II of subchapter C of the Internal Revenue Code by U.S. real property holding corporations to foreign shareholders, shall apply to distributions made on or after January 1, 1985. The provisions of section 1445(e)(3) and paragraph (e)(1) of this section requiring withholding on distributions under section 301 by U.S. real property holding corporations to foreign shareholders shall apply to distributions made after August 20, 1996. The provisions of paragraph (e) of this section providing for the coordination of withholding between sections 1445 and 1441 (or 1442 or 1443) for distributions under section 301 by U.S. real property holding corporations to foreign shareholders apply to distributions after December 31, 2000 (see § 1.1441–3(c)(4) and (h)).

* * * * *

(e) * * * (1) * * *

(ii) There is a distribution of property in redemption of stock treated as an exchange under section 302(a), in liquidation of the corporation pursuant to the provisions of Part II of subchapter C of the Internal Revenue Code (sections 331 through section 341), or with respect to stock under section 301 that is not made out of earnings and profits of the corporation.

(2) *Coordination rules for Section 301 distributions.* If a domestic corporation makes a distribution of property under section 301 to a foreign person whose interest in such corporation constitutes a U.S. real property interest under the provisions of section 897 and the regulations there-

under, then see § 1.1441–3(c)(4) for rules coordinating withholding obligations under sections 1445 and 1441 (or 1442 or 1443)).

* * * * *

Par. 13. Section 1.1445–6 is amended as follows:

1. The section heading and paragraph (b)(3) are revised.

2. For each of the paragraphs listed in the column below, remove the language "Assistant Commissioner (International)" and add "Director, Philadelphia Service Center" in its place.

Paragraphs

(f)(1), first sentence

(f)(2)(iii), heading

(f)(2)(iii)

(g), introductory text, second sentence

3. Paragraphs (f)(3)(i) and (g)(1) are amended by removing the parenthetical "(if any)" after the words "identifying number".

The revision reads as follows:

§ 1.1445–6 Adjustments pursuant to withholding certificate of amount required to be withheld under section 1445(e).

* * * * *

(b) * * *

(3) *Relevant taxpayers.* An application for withholding certificate pursuant to this section must include all of the following information: the name, identifying number, and home address (in the case of an individual) or office address (in the case of an entity) of each relevant taxpayer with respect to which adjusted withholding is sought.

* * * * *

§ 1.1445–9T [Removed]

Par. 14. Section 1.1445–9T is removed.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 15. The authority for part 301 continues to read in part as follows:

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

Par. 16. Section 301.6109–1 is amended as follows:

1. In paragraph (b)(2)(v), remove the word "and".

2. In paragraph (b)(2)(vi), remove the period at the end of the paragraph and add "; and" in its place.

3. Paragraph (b)(2)(vii) is added.

4. In paragraph (c), first and third sentences, remove the language "or (vi) of this section" and add "(vi), or (vii) of this section" in its place.

The addition reads as follows:

§ 301.6109–1 Identifying numbers.

* * * * * *

(b) * * *

(2) * * *

(vii) A foreign person whose taxpayer identifying number is required to be furnished on any return, statement, or other document as required by the income tax regulations under section 897 or 1445.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 25, 2002, 8:45 a.m., and published in the issue of the Federal Register for July 26, 2002, 67 F.R. 48823)

Notice of Proposed Rulemaking and Notice of Public Hearing

Dual Consolidated Loss Recapture Events

REG–106879–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations under section 1503(d) regarding the events that require the recapture of dual consolidated losses. These regulations are issued to facilitate compliance by taxpayers with the dual consolidated loss provisions. The proposed regulations generally provide that certain events will not trigger recapture of a dual consolidated loss or payment of the associated interest charge. The proposed regulations provide for the reporting of certain information in such cases. This document also proposes conforming changes to the current regulations and provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by October 30, 2002. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for, December 3, 2002, at 10 a.m. must be received by, November 12, 2002.

ADDRESSES: Send submissions to: CC:IT:A:RU (REG–106879–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8:00 a.m. and 5:00 p.m. to CC:ITA:RU (REG–106879–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Kenneth D. Allison or Kathryn T. Holman, (202) 622–3860 (not a toll-free number); concerning submissions and the hearing, Sonya M. Cruse, (202) 622–7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224. Comments on the collection of information should be received by September 30, 2002. Comments are specifically requested concerning:

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

The accuracy of the estimated burden associated with the proposed collection of information (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 collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

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

The collection of information in this proposed regulation is in §§ 1.1503–2(g)(2)(iv)(A)(*4*) and (*5*). This information is required to ensure the proper performance of the function of the IRS because it notifies the IRS that a future triggering event may require the recapture of specified dual consolidated losses by the new consolidated group. This information will be used to identify the acquisition of an unaffiliated dual resident corporation, an unaffiliated domestic owner of a dual resident corporation, or a consolidated group that includes a dual resident corporation or a domestic owner. The identification of such an acquisition pursuant to these regulations may allow taxpayers to avoid or defer recapture of a dual consolidated loss and the payment of an interest charge. The collection of information is mandatory. The likely respondents will be corporations acquiring overseas business operations.

Estimated total annual reporting and/or recordkeeping burden: 60 hours.

Estimated average annual burden hours per respondent and/or recordkeeper: 2 hours.

Estimated number of respondents and/or recordkeepers: 30

Estimated annual frequency of responses: On occasion.

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

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

Background

On September 8, 1989, proposed and temporary regulations implementing § 1503(d) were published in the **Federal Register** at 54 FR 37314. Written comments were received in response to the proposed regulations, and a public hearing was held on March 2, 1990. After consideration of all the comments, the proposed regulations were amended and adopted as final regulations by, T.D. 8434, 1992–2 C.B. 240, on September 9, 1992, and published in the **Federal Register** at 57 FR 41079.

Explanation of Provisions

Section 1503(d) generally provides that a "dual consolidated loss" of a domestic corporation cannot offset the taxable income of any other member of the corporation's consolidated group. The statute, however, authorizes the issuance of regulations permitting the use of a dual consolidated loss to offset the income of a domestic affiliate if the loss does not offset the income of a foreign corporation under foreign law.

Section 1.1503–2(g)(2) of the final regulations permits a taxpayer to elect to use a dual consolidated loss of a dual resident corporation or separate unit to offset the income of a domestic affiliate by entering into an agreement under which the taxpayer certifies that the dual consolidated loss has not been, and will not be, used to offset the income of another person under the laws of a foreign country. Section 1.1503–2(g)(2)(iii) of the final regulations provides that, in the year of a so-called "triggering event," the taxpayer must recapture and report as gross income the amount of a dual consolidated loss subject to this agreement, as well as pay an interest charge.

Two such triggering events are (1) an unaffiliated dual resident corporation that filed the agreement or an unaffiliated domestic owner of a separate unit that filed the agreement becomes a member of a consolidated group, consisting of itself and a formerly unaffiliated domestic corporation or an existing consolidated group; and (2) a consolidated group that filed the agreement and that includes a dual resident corporation or domestic owner of a separate unit is acquired by an unaffiliated domestic corporation or a consolidated group, resulting in a new consolidated group. Section 1.1503–2(g)(2)(iv)(B) of the final regulations, however, provides that these events are not considered to be triggering events under certain conditions.

One such condition is that the parties to the transaction enter into a closing agreement with the IRS, as provided in section 7121 of the Code. Thus, in the first case described above, the unaffiliated dual resident corporation or unaffiliated domestic owner that filed the agreement and the unaffiliated domestic corporation or consolidated group must enter into a closing agreement; or, in the second case described above, the acquired consolidated group and the acquiring unaffiliated domestic corporation or consolidated group must enter into a closing agreement. The closing agreement must provide that the unaffiliated dual resident corporation, unaffiliated domestic owner, or consolidated group and the unaffiliated domestic corporation or existing consolidated group will be jointly and severally liable for the total amount of the recapture of the dual consolidated loss and the interest charge if there is a subsequent triggering event.

The IRS and Treasury believe that this requirement, that the parties to the transaction enter into a closing agreement with the IRS, imposes an unnecessary administrative burden in cases where liability for the dual consolidated loss recapture amount and interest charge would be imposed by § 1.1502–6. Section 1.1502–6 generally provides that the common parent corporation and each member of a consolidated group are severally liable for the tax computed on their consolidated U.S. income tax return for the taxable year. In certain circumstances, the several liability imposed by § 1.1502–6 provides for liability comparable to that provided by a closing agreement under § 1.1503–2(g)(2)(iv)(B)(2) and section 7121 of the Code.

Accordingly, the proposed regulations amend the final regulations by providing that a triggering event generally does not

occur when an unaffiliated dual resident corporation or unaffiliated domestic owner becomes a member of a consolidated group. Under § 1.1502–6, the dual resident corporation or domestic owner, as well as the other members of the consolidated group of which it becomes a member, are liable for the recapture amount and the interest charge in the event of a subsequent triggering event. The proposed regulations would remove § 1.1503–2(g)(2)(iv)(B)(*1*)(*ii*) of the final regulations, which addresses this particular set of circumstances only.

The proposed regulations similarly would amend the final regulations by providing that a triggering event generally does not occur when a dual resident corporation or domestic owner that is a member of a consolidated group that filed an agreement under § 1.1503–2(g)(2) becomes a member of another consolidated group in an acquisition, so long as each member of the acquired group that is an includible corporation under § 1504(b) is included immediately after the acquisition in a consolidated U.S. income tax return filed by the acquiring group. Under § 1.1502–6, each member of the new consolidated group, including each member of the former group that included the dual resident corporation or domestic owner, is liable for the recapture amount and the interest charge upon the occurrence of a subsequent triggering event.

In both cases described in the proposed regulations, a statement must be attached to the first consolidated return of the new consolidated group that includes the dual resident corporation or domestic owner. The statement must reference these proposed regulations and must set forth the information required in § 1.1503–2(g)(2)(i)(B), the amount of each dual consolidated loss, and the year incurred. The proposed regulations further require the continued reporting of certain information, when applicable, by the new consolidated group on its subsequently filed consolidated U.S. income tax returns, as provided in § 1.1503–2(g)(2)(vi).

Proposed Effective Date

These regulations amending the dual consolidated loss rules under § 1.1503–2 are proposed to apply to transactions otherwise constituting triggering events occurring on or after August 1, 2002.

Special Analyses

It has been determined that this notice of proposed rule making is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that also have a foreign affiliate, which tend to be larger businesses. Moreover, the number of taxpayers affected and the average burden are minimal. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

A public hearing has been scheduled for, December 3, 2002, at 10 a.m., room 4718, in the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors must enter at the main entrance, located at 1111 Constitution Avenue, NW. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit written or electronic comments and an outline of the topic to be discussed and time to be devoted to each topic (preferably a signed original and eight (8) copies) by, November 12, 2002. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Kenneth D. Allison and Kathryn T. Holman of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

§ 1.1503–2 also issued under 26 U.S.C. 1502 * * *

Par. 2. In § 1.1503–2, paragraphs (g)(2)(iv)(A)(*4*), (*5*) and (D) are added; paragraph (g)(2)(iv)(B)(*1*)(*ii*) is removed and paragraphs (g)(2)(iv)(B)(*1*)(*iii*) and (*iv*) are redesignated as paragraphs (g)(2)(iv)(B)(*1*)(*ii*) and (*iii*), respectively; and a sentence is added to paragraph (h)(1) to read as follows:

§ 1.1503–2 Dual Consolidated Loss.

* * * * *

(g) * * *

(2) * * *

(iv) * * *

(A) Acquisition by a member of the consolidated group.

* * * * *

(*4*) An unaffiliated dual resident corporation or unaffiliated domestic owner that filed an agreement under paragraph (g)(2)(i) of this section becomes a member of a consolidated group. A statement referencing this paragraph (g)(2)(iv)(A)(*4*) must be attached to the timely filed (including extensions) consolidated income tax return of the consolidated group, setting forth the information required in paragraph (g)(2)(i)(B) of this section, the amount of each dual consolidated loss, and

the year incurred. The consolidated group also must continue to comply in subsequent years with the reporting requirements in paragraph (g)(2)(vi) of this section for each dual consolidated loss.

(*5*) A dual resident corporation, or domestic owner, that is a member of a consolidated group that filed an agreement under paragraph (g)(2)(i) of this section (the acquired group) becomes a member of another consolidated group (the acquiring group), provided that each member of the acquired group that is an includible corporation (within the meaning of section 1504(b)) in the new consolidated group must be included immediately after the acquisition in a consolidated income tax return filed by the acquiring group. A statement referencing this paragraph (g)(2)(iv)(A)(*5*) must be attached to the timely filed (including extensions) consolidated income tax return of the acquiring group, setting forth the information required in paragraph (g)(2)(i)(B) of this section, the amount of each dual consolidated loss, and the year incurred. The acquiring group also must continue to comply in subsequent years with the reporting requirements in paragraph (g)(2)(vi) of this section for each dual consolidated loss.

* * * * *

(D) Example. The following example illustrates the operation of paragraph (g)(2)(iv)(A)(*5*) of this section.

Example.(i) Facts. C is the common parent of a consolidated group (the "C Group") that includes DRC, a domestic corporation. DRC is a dual resident corporation and incurs a dual consolidated loss in its taxable year ending December 31, Year 1. The C Group complies with paragraph (g)(2)(i) of this section and its associated requirements with respect to the Year 1 dual consolidated loss. The C Group does not incur a dual consolidated loss in Year 2. On December 31, Year 2, stock constituting section 1504(a)(2) ownership of C is acquired by D, an unaffiliated domestic corporation. Immediately after and as a result of the acquisition, the C Group ceases to exist, and all the C Group members, including DRC, become includible members of a consolidated group of which D is the common parent (the "D Group").

(ii) Acquisition not a triggering event. Under paragraph (g)(2)(iv)(A)(*5*) of this section, the acquisition by D of the C Group is not an event requiring the recapture of the Year 1 dual consolidated loss of DRC, or the payment of an interest charge, as described in paragraph (g)(2)(vii) of this section, provided that the D Group files the statement described in paragraph (g)(2)(iv)(A)(*5*) of this section and continues to comply with the reporting requirements of paragraph (g)(2)(vi) of this section.

(iii) Subsequent event. A triggering event occurs on December 31, Year 3, that requires recapture by DRC of the dual consolidated loss it incurred for Year 1 and any dual consolidated loss incurred in Year 3, as well as the payment of an interest charge, as provided in paragraph (g)(2)(vii) of this section. Each member of the D Group, including DRC and the other former members of the C Group, is severally liable under § 1.1502–6 for the additional tax (and the interest charge) due upon the recapture of the dual consolidated loss of DRC.

* * * * *

(h) * * *

(1) * * *

Paragraphs (g)(2)(iv)(A)(*4*) and (*5*) of this section, and paragraphs (g)(2)(iv)(B)(*1*)(*ii*) and (*iii*) of this section, shall apply with respect to transactions otherwise constituting triggering events occurring on or after August 1, 2002.

* * * * *

Robert E.Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 31, 2002, 8:45 a.m., and published in the issue of the Federal Register for August 1, 2002, 67 F.R. 49892)

Notice of Proposed Rulemaking and Notice of Public Hearing

Compensatory Stock Options Under Section 482

REG–106359–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that provide guidance regarding the application of the rules of section 482 governing qualified cost sharing arrangements. These proposed regulations provide guidance regarding the treatment of stock-based compensation for purposes of the rules governing qualified cost sharing arrangements and for purposes of the comparability factors to be considered under the comparable profits method. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by October 28, 2002. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for November 20, 2002, must be received by October 30, 2002.

ADDRESSES: Send submissions to: CC: ITA:RU (REG–106359–02), 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–106359–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Douglas Giblen, (202) 874–1490; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224. Comments on the collection of information should be received by September 27, 2002. Comments are specifically requested concerning:

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

The accuracy of the estimated burden associated with the proposed collection of information (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 collection 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 services to provide information.

The collection of information requirements are in proposed §§ 1.482–7(d)(2)(iii)(B) and 1.482–7(j)(2)(i)(F). This information is required by the IRS to monitor compliance with the federal tax rules for determining stock-based compensation costs related to intangible development to be shared among controlled participants in qualified cost sharing arrangements. The likely respondents are taxpayers who enter into these arrangements. Responses to this collection of information are required to determine these taxpayers' proper shares of stock-based compensation costs incurred with respect to these arrangements.

Section 1.482–7(d)(2)(iii)(B) of the proposed regulations provides that controlled participants may elect an alternative method of measurement of certain stock-based compensation by clearly referring to the election in the written cost sharing agreement required under existing regulations or by amending a cost sharing agreement already in effect to refer to the election. Section 1.482–7(j)(2)(i)(F) requires controlled participants to maintain documentation necessary to establish the amount taken into account as operating expenses attributable to stock-based compensation, including the method of measurement and timing used in computing that amount, and the data, as of the date of grant, used to identify stock-based compensation related to the development of intangibles.

Estimated total annual reporting and/or recordkeeping burden: 2,000 hours.

Estimated average annual burden hours per respondent and/or recordkeeper: The estimated annual burden per respondent varies from 2 hours to 7 hours, depending on individual circumstances, with an estimated average of 4 hours.

Estimated number of respondents and/or recordkeepers: 500.

Estimated frequency of responses: Annually.

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

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

Background

Section 482 of the Internal Revenue Code generally provides that the Secretary may allocate gross income, deductions and credits between or among two or more taxpayers owned or controlled by the same interests in order to prevent evasion of taxes or clearly to reflect income. On July 8, 1994, Treasury and the IRS published in the **Federal Register** (59 FR 34988) final regulations (T.D. 8552, 1994–2 C.B. 93) under section 482 in areas other than cost sharing. On December 20, 1995, Treasury and the IRS published in the **Federal Register** (60 FR 65553) final cost sharing regulations (T.D. 8632, 1996–1 C.B. 85), effective for taxable years beginning on or after January 1, 1996. Amendments to T.D. 8632 were published in the **Federal Register** on May 13, 1996, at 61 FR 21955 (T.D. 8670, 1996–1 C.B. 99), and on January 3, 2001, at 66 FR 280 (T.D. 8930, 2001–1 C.B. 433).

The 1994 final regulations under section 482 contain general provisions at § 1.482–1 describing the arm's length standard and the best method rule. The final cost sharing regulations at § 1.482–7 generally require that controlled participants in a qualified cost sharing arrangement share intangible development costs in proportion to their shares of the reasonably anticipated benefits attributable to the development of the intangibles covered by the arrangement. These proposed regulations clarify that stock-based compensation is taken into account in determining the operating expenses treated as a controlled participant's intangible development costs for purposes of the cost sharing provisions; provide rules for measuring the cost associated with stock-based compensation; clarify that the utilization and treatment of stock-based compensation is appropriately taken into account as a comparability factor for purposes of the comparable profits method under § 1.482–5; and clarify the coordination of the cost sharing rules of § 1.482–7 with the arm's length standard as set forth in § 1.482–1.

Explanation of Provisions

Overview

The Tax Reform Act of 1986, Public Law 99–514, 100 Stat. 2085, 2561 *et seq.* (reprinted at 1986–3 C.B. (Vol 1) 1, 478) (the Act), amended section 482 to require that consideration for intangible property transferred in a controlled transaction be commensurate with the income attributable to the intangible. The legislative history of the Act indicated that in adding this commensurate with income standard to section 482, Congress did not intend to preclude the use of *bona fide* research and development cost sharing arrangements as an appropriate method of allocating income attributable to intangibles among related parties, "if and to the extent such agreements are consistent with the purpose of this provision that the income allocated among the parties reasonably reflect the actual economic activity undertaken by each. Under such a *bona fide* cost-sharing arrangement, the cost-sharer would be expected to bear its portion of all research and development costs. . . ." H.R. Rep. No. 99–841, at II–638 (1986) (the Conference Report).

The Conference Report recommended that the IRS conduct a comprehensive study and consider whether the regulations under section 482 (issued in 1968) should be modified in any respect. In response to this directive, on October 18, 1988, Treasury and the IRS issued a study of intercompany pricing (the White Paper), published as Notice 88–123, 1988–2 C.B. 458. With respect to cost sharing arrangements, the White Paper observed that Congress intended such arrangements to produce results consistent with the purposes of the commensurate with income standard in section 482, and in particular that allocations of income among the par-

ticipants reasonably reflect the participants' respective economic activity. 1988–2 C.B. at 459, 495. The White Paper further observed that Congress intended that Treasury and the IRS apply and interpret the commensurate with income standard consistently with the arm's length standard. 1988–2 C.B. at 458, 477.

Section 1.482–1 of the 1994 final regulations provides that a controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances. A method selected under the best method rule is used to determine whether a controlled transaction produces an arm's length result. The regulations reference §§ 1.482–2 through 1.482–6 as providing specific methods to be used in this determination.

Section 1.482–7 of the 1995 final regulations implements the commensurate with income standard in the context of cost sharing arrangements. The final cost sharing regulations require that controlled participants in a qualified cost sharing arrangement share all costs incurred that are related to the development of intangibles in proportion to their shares of the reasonably anticipated benefits attributable to that development. Section 1.482–7(d)(1) defines these intangible development costs as including operating expenses as defined in § 1.482–5(d)(3), other than depreciation or amortization, plus an arm's length rental charge determined under § 1.482–2(c) for the use of any tangible property made available to the qualified cost sharing arrangement. Section 1.482–5(d)(3) defines operating expenses, for purposes of the comparable profits method under section 482, as including all expenses not included in cost of goods sold except for interest expense, foreign and domestic income taxes, and any other expenses not related to the operation of the relevant business activity. In the context of cost sharing, the relevant business activity is the development of intangibles covered by the cost sharing arrangement.

Since the promulgation of the final cost sharing regulations in 1995, the issue has been raised whether operating expenses within the meaning of § 1.482–7(d)(1) include compensation provided by a controlled participant in the form of stock options. Related questions have been posed in this context regarding the interaction between the arm's length standard and the cost sharing regulations.

These proposed regulations amend the final regulations to clarify that stock-based compensation must be taken into account in determining operating expenses under § 1.482–7(d)(1) and to provide rules for measuring stock-based compensation costs. These proposed regulations also clarify that stock-based compensation should be taken into account in comparability determinations pursuant to the comparable profits method under § 1.482–5. Finally, the proposed regulations amend the final regulations to include express provisions to coordinate the cost sharing rules of § 1.482–7 with the arm's length standard as set forth in § 1.482–1.

Inclusion of Stock-Based Compensation in Intangible Development Costs

The proposed regulations provide that in determining a controlled participant's operating expenses within the meaning of § 1.482–7(d)(1), all compensation, including stock-based compensation, must be taken into account. The proposed regulations also provide rules for measuring the operating expenses attributable to stock-based compensation.

The definition of stock-based compensation for purposes of these proposed regulations is broad, comprising any compensation provided by a controlled participant to an employee or independent contractor in the form of equity instruments, stock options, or rights in (or determined by reference to) such instruments or options, regardless of whether the compensation ultimately is settled in the form of cash, stock, or other property. Thus, these proposed regulations are intended to reach such forms of compensation as restricted stock, nonstatutory stock options, statutory stock options (incentive stock options described in section 422(b) and options granted under an employee stock purchase plan described in section 423(b)), stock appreciation rights, and phantom stock. Statutory stock options are within the scope of the definition regardless of whether the employer is entitled to an income tax deduction with respect to those options.

The proposed regulations provide that the determination of whether stock-based compensation is related to the development of intangibles covered by the qualified cost sharing arrangement is to be made as of the date the stock-based compensation is granted. For example, controlled participants must share the costs attributable to stock-based compensation that is granted to an employee who, at the time of grant, is performing research services related to the qualified cost sharing arrangement. Treasury and the IRS believe that this rule appropriately identifies the stock-based compensation to be shared because the grant of compensation generally is the economic event most closely associated in time with the services being compensated. Because a controlled participant may choose whether to provide stock-based or cash compensation, this rule also promotes neutrality of treatment as among various forms of compensation. Finally, because the grant-date identification rule applies irrespective of the method used by the controlled participant to measure or determine the timing of inclusion of stock-based compensation in the intangible development costs to be shared, the rule ensures that the same items of stock-based compensation will be taken into account under any method, thus promoting neutrality in the choice of measurement method afforded by the proposed regulations.

In applying the grant-date identification rule in cases where a stock option is repriced or otherwise modified, the rules of section 424(h) and related regulations will be used to determine whether the grant of a new stock option has occurred.

Treasury and the IRS recognize that tax and other accounting principles permit the cost associated with stock-based compensation to be measured and taken into account as of different points in time and under various methodologies for different purposes. For example, for general income tax purposes, the amount of compensation taxed to an employee and deductible by an employer upon exercise of a stock option not governed by sections 421–424 (commonly referred to as a nonstatutory stock option) generally is measured by the "spread" between the option price and the fair market value of the underlying stock at the date of exercise. See §§ 83(a), 83(h), 1.83–1(a)(1), 1.83–6(a)(1).

For various other tax purposes, however, the IRS has adopted modified versions of economic pricing models, such as the Black-Scholes model, for valuing stock options at specific points in time prior to exercise. See Rev. Proc. 98–34, 1998–1 C.B. 983 (estate and gift tax valuation); Rev. Proc. 2002–13, 2002–8 I.R.B. 549, as modified by Rev. Proc. 2002–45, 2002–27 I.R.B. 40 (measurement of stock-option-based golden parachute payments under sections 280G and 4999). Pricing models also have been adopted in the context of financial accounting. The Financial Accounting Standards Board (FASB) refers to pricing models for measurement of the stock-based compensation expense that a company is required to report at "fair value," either as a charge to income or, at the company's option, in a *pro forma* footnote disclosure. *See* FASB Statement 123, Accounting for Stock-Based Compensation (October 1995).

Generally accepted pricing models can be applied at the date of grant to estimate the economic cost of a stock option to the issuer. General support for the use of economic measures of cost in the transfer pricing context may be found in the legislative history of the commensurate with income standard and in the White Paper, which state that to be consistent with the commensurate with income standard, cost sharing arrangements must "reflect the actual economic activity" of participants. Conference Report at II-638 and White Paper at 1988–2 C.B. 495.

In establishing rules for measurement of the operating expenses attributable to stock-based compensation for cost sharing purposes, Treasury and the IRS believe that due regard must be given to the emphasis placed on economic factors in the legislative history of the commensurate with income standard and in the White Paper. Treasury and the IRS also recognize the importance of providing rules that are administrable.

The proposed regulations prescribe a general rule of measurement based primarily on the amount and timing of the income tax deduction associated with stock-based compensation, while in certain cases permitting controlled participants in a qualified cost sharing arrangement to elect a rule of measurement with respect to stock options based on the amount and timing of the fair value of the option that is required to be computed for purposes of financial accounting in accordance with United States generally accepted accounting principles (U.S. GAAP).

To provide for uniform measurement of the cost associated with both statutory and nonstatutory stock options, the general deduction-based measurement rule is applied as if section 421 did not apply upon the exercise of a statutory stock option. Thus, although section 421 generally disallows compensation deductions with respect to the exercise of statutory stock options except in the case of certain disqualifying dispositions, the proposed regulations treat the exercise of a statutory stock option as giving rise to a deduction for purposes of the deduction-based measurement rule. Consequently, the operating expense with respect to all stock options, whether statutory or nonstatutory, generally will be measured by the "spread" and taken into account as of the date the stock option is exercised.

To place a foreign controlled participant on an equal footing with a United States controlled participant, an amount is treated as deductible by a foreign controlled participant, solely for purposes of the general deduction-based measurement rule, as if the amount were paid or incurred by a United States taxpayer, even if the foreign controlled participant is not subject to United States taxing jurisdiction and so would not otherwise be entitled to a deduction under United States income tax law.

Solely for purposes of the general deduction-based measurement rule, any item of stock-based compensation that is eligible to be exercised and that remains outstanding on the expiration or termination of a qualified cost sharing arrangement will be treated as being exercised immediately before the expiration or termination, provided that the fair market value of the underlying stock at that time exceeds the price at which the stock-based compensation is exercisable. The result of this treatment is that the excess of the fair market value of the underlying stock over the price at which the stock-based compensation is exercisable is taken into account as an operating expense for the taxable year in which the qualified cost sharing arrangement expires or terminates. This special rule would apply, for example, in the case of a currently exercisable statutory stock option or a substantially vested nonstatutory stock option where the fair market value of the underlying stock exceeds the option price at the time the qualified cost sharing arrangement is terminated. The rule ensures that controlled participants take into account for cost sharing purposes all stock-based compensation that is attributable to the development of intangibles and has become exercisable during the term of the cost sharing arrangement. In cases where significant amounts of stock-based compensation have been granted, but are not exercisable at the time of the termination of the arrangement, the IRS anticipates that factual issues regarding the termination of the qualified cost sharing arrangement will arise if the arrangement is reinstated.

A similar rule applies if, during the term of the qualified cost sharing arrangement, a newly granted stock option is determined to result from a repricing or other modification of another stock option and is not related to the development of intangibles at the time of the modification. In this situation, an amount is taken into account for purposes of the general deduction-based measurement rule as if the original stock option had been exercised immediately before the modification.

The proposed regulations permit an elective method of measurement and timing with respect to options on publicly traded stock of companies subject to financial reporting under U.S. GAAP, provided that the stock is traded on a United States securities market.

Under the election, the amount of the operating expense associated with compensatory stock options is their "fair value," generally measured by reference to economic pricing models as of the date of grant, as reflected either as a charge against income or as a footnote disclosure in the company's audited financial statements, in compliance with current U.S. GAAP. Where the election is made with respect to stock in a company that does not take stock-based compensation expense as a charge against income for financial accounting purposes but rather chooses, as permitted by current U.S. GAAP (for example, FASB Statement 123), to disclose such compensation in a footnote to the financial statements, stock-based compensation is taken into account

in the same amount, and as of the same time, as the *pro forma* fair value figures reflected in the footnote.

The election to measure the operating expense associated with compensatory stock options in accordance with financial accounting rules must be clearly referenced in the written cost sharing agreement required under § 1.482–7(b)(4) and must bind all controlled participants. A transition rule permits controlled participants to amend pre-existing cost sharing agreements not later than the latest due date (without regard to extensions) for an income tax return of a controlled participant for the first taxable year beginning after the effective date of final regulations incorporating this rule.

The proposed regulations contain consistency rules to ensure that all controlled participants in a qualified cost sharing arrangement normally will use the same method of measurement for all options on publicly traded stock with respect to that arrangement. Once a method of measurement has been adopted with respect to stock options granted in a taxable year following the effective date of the proposed regulations, the method of measurement may not be changed for those stock options. With respect to subsequently granted stock options to which the transition rule does not apply, the proposed regulations provide that a method of measurement different from that adopted following the effective date of the proposed regulations may be adopted only with the consent of the Commissioner.

To ensure that taxpayers maintain documentation supporting all amounts taken into account as operating expenses attributable to stock-based compensation, these proposed regulations add to the documentation requirements of § 1.482–7(j)(2)(i) an item specifically relating to stock-based compensation.

Treatment of Stock-Based Compensation Under Other Provisions

The treatment of stock-based compensation as a cost or operating expense for purposes of the transfer pricing of services and for purposes of applying the comparable profits method will be considered by Treasury and the IRS in a separate regulation project. Accordingly, these regulations do not propose amendments to the definitions of cost or operating expense in § 1.482–2(b) or § 1.482–5(d)(3). However, these proposed regulations amend § 1.482–5(c)(2)(iv) to clarify that in applying the comparable profits method, material differences among the tested party and uncontrolled comparables with respect to the utilization or treatment of stock-based compensation are an appropriate basis for comparability adjustments.

Coordination of Cost Sharing With the Arm's Length Standard

These proposed regulations add express provisions coordinating the cost sharing rules of § 1.482–7 with the arm's length standard as set forth in § 1.482–1. New § 1.482–7(a)(3) clarifies that in order for a qualified cost sharing arrangement to produce results consistent with an arm's length result within the meaning of § 1.482–1(b)(1), all requirements of § 1.482–7 must be met, including the requirement that each controlled participant's share of intangible development costs equal its share of reasonably anticipated benefits attributable to the development of intangibles. The proposed regulations also make amendments to § 1.482–1 to clarify that § 1.482–7 provides the specific method to be used to evaluate whether a qualified cost sharing arrangement produces results consistent with an arm's length result, and to clarify that under the best method rule, the provisions of § 1.482–7 set forth the applicable method with respect to qualified cost sharing arrangements.

Through these new provisions, Treasury and the IRS intend to clarify that all of the specific rules necessary to the determination of costs, reasonably anticipated benefits and other aspects of qualified cost sharing arrangements are either contained or cross-referenced within § 1.482–7. Thus, for example, regarding buy-in payments with respect to pre-existing intangibles made available to qualified cost sharing arrangements, §§ 1.482–7(a)(2) and 1.482–7(g) cross-reference various other sections of the regulations under section 482. For the determination of reasonably anticipated benefits, § 1.482–7(f)(3) expressly requires that certain comparability factors described in § 1.482–1(c)(2)(ii) under the best method rule be considered. With respect to identification of the costs to be shared, the rules are contained within § 1.482–7(d)(1), which refers to "all" intangible development costs and cross-references the definition of operating expenses in § 1.482–5(d)(3) and the provisions of § 1.482–2(c) governing determination of arm's length rental charges for tangible property. The § 1.482–7(d)(1) definition of intangible development costs is supplemented by the provisions of § 1.482–7(c)(2), which cross-references the provisions of § 1.482–4(f)(3)(iii) to determine arm's length consideration for research assistance performed by a controlled taxpayer that is not a controlled participant.

Proposed Effective Date

These regulations are proposed to apply to stock-based compensation granted in taxable years beginning on or after the date these regulations are published as a Treasury Decision promulgating final regulations in the **Federal Register**. Notwithstanding this prospective effective date, Treasury and the IRS intend that taxpayers may rely on these proposed regulations until the effective date of the final regulations. No inference is intended with respect to the treatment of stock-based compensation granted in taxable years beginning before the effective date of the final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collections 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 few small entities are expected to enter into qualified cost sharing arrangements involving stock-based compensation, and that for those who do, the burdens imposed under §§ 1.482–7(d)(2)(iii)(B) and 1.482–7(j)(2)(i)(F) will be minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f), this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy

of the Small Business Administration for comment on its impact on small business.

Comments and 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) that are submitted timely to the IRS. Treasury and the IRS specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 21, 2002, at 10 a.m., in Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by September 30, 2002. A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Douglas Giblen of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury and the IRS participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1 — INCOME TAXES

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

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

Sections 1.482–1, 1.482–5 and 1.482–7 also issued under 26 U.S.C. 482. * * *

Par. 2. Section 1.482–0 is amended by:

1. Redesignating the entry for § 1.482–7(a)(3) as the caption for § 1.482–7(a)(4).

2. Adding a new entry for § 1.482–7(a)(3).

3. Redesignating the entry for § 1.482–7(d)(2) as the caption for § 1.482–7(d)(3).

4. Adding new entries for § 1.482–7(d)(2).

The additions and revisions read as follows:

§ 1.482–0 Outline of regulations under section 482.

* * * * *

§ 1.482–7 Sharing of costs.

(a) In general.
* * * * *
(3) Coordination with § 1.482–1.
(4) Cross references.
* * * * *
(d) Costs.
* * * * *
(2) Stock-based compensation.
(i) In general.
(ii) Identification of stock-based compensation related to intangible development.
(iii) Measurement and timing of stock-based compensation expense.
(A) In general.
(*1*) Transfers to which section 421 applies.
(*2*) Deductions of foreign controlled participants.
(*3*) Modification of stock option.
(*4*) Expiration or termination of qualified cost sharing arrangement.
(B) Election with respect to options on publicly traded stock.
(C) Consistency.
(3) Examples.
* * * * *

Par. 3. Section 1.482–1 is amended by:

1. Revising the sixth sentence of paragraph (a)(1).

2. Adding a sentence following the sixth sentence of paragraph (a)(1).

3. Adding a sentence at the end of paragraph (b)(2)(i).

4. Adding a sentence at the end of paragraph (c)(1).

5. Adding paragraph (j)(5).

The additions and revisions read as follows:

§ 1.482–1 Allocation of income and deductions among taxpayers.

(a) * * *

(1) * * * Section 1.482–7T sets forth the cost sharing provisions applicable to taxable years beginning on or after October 6, 1994, and before January 1, 1996. Section 1.482–7 sets forth the cost sharing provisions applicable to taxable years beginning on or after January 1, 1996. * * *

* * * * *

(b) * * *

(2) * * *

(i) * * * Section 1.482–7 provides the specific method to be used to evaluate whether a qualified cost sharing arrangement produces results consistent with an arm's length result.

* * * * *

(c) * * *

(1) * * * See § 1.482–7 for the applicable method in the case of a qualified cost sharing arrangement.

* * * * *

(j) * * *

(5) The last sentences of paragraphs (b)(2)(i) and (c)(1) of this section and of paragraph (c)(2)(iv) of § 1.482–5 are effective for taxable years beginning on or after the date of publication of the Treasury Decision incorporating those sentences into final regulations in the **Federal Register**.

Par. 4. Section 1.482–5 is amended by adding a sentence to paragraph (c)(2)(iv) to read as follows:

§ 1.482–5 Comparable profits method.

* * * * *

(c) * * *

(2) * * *

(iv) * * * As another example, it may be appropriate to adjust the operating profit of a party to account for material differences in the utilization of or accounting for stock-based compensation (as defined by § 1.482–7(d)(2)(i)) among the tested party and comparable parties.

* * * * *

Par. 5. Section 1.482–7 is amended by:

1. Redesignating paragraph (a)(3) as paragraph (a)(4).

2. Adding paragraph (a)(3).

3. Redesignating paragraph (d)(2) as paragraph (d)(3).

4. Adding paragraph (d)(2).

5. Removing the word "and" at the end of paragraph (j)(2)(i)(D).

6. Removing the period and adding a semicolon and adding the word "and" at the end of paragraph (j)(2)(i)(E).

7. Adding paragraph (j)(2)(i)(F).

8. Revising paragraph (k).

The additions and revisions read as follows:

§ 1.482–7 Sharing of costs.

(a) * * *

(3) *Coordination with § 1.482–1*. A qualified cost sharing arrangement produces results that are consistent with an arm's length result within the meaning of § 1.482–1(b)(1) if, and only if, each controlled participant's share of the costs (as determined under paragraph (d) of this section) of intangible development under the qualified cost sharing arrangement equals its share of reasonably anticipated benefits attributable to such development (as required by paragraph (a)(2) of this section) and all other requirements of this section are satisfied.

(4) *Cross references*. * * *

* * * * *

(d) * * *

(2) *Stock-based compensation.*—(i) *In general*. For purposes of this section, a controlled participant's operating expenses include all costs attributable to compensation, including stock-based compensation. As used in this section, the term *stock-based compensation* means any compensation provided by a controlled participant to an employee or independent contractor in the form of equity instruments, options to acquire stock (stock options), or rights with respect to (or determined by reference to) equity instruments or stock options, including but not limited to property to which section 83 applies and stock options to which section 421 applies, regardless of whether ultimately settled in the form of cash, stock, or other property.

(ii) *Identification of stock-based compensation related to intangible development*. The determination of whether stock-based compensation is related to the intangible development area within the meaning of paragraph (d)(1) of this section is made as of the date that the stock-based compensation is granted. Accordingly, all stock-based compensation that is granted during the term of the qualified cost sharing arrangement and is related at date of grant to the development of intangibles covered by the arrangement is included as an intangible development cost under paragraph (d)(1) of this section. In the case of a repricing or other modification of a stock option, the determination of whether the repricing or other modification constitutes the grant of a new stock option for purposes of this paragraph (d)(2)(ii) will be made in accordance with the rules of section 424(h) and related regulations.

(iii) *Measurement and timing of stock-based compensation expense.*—(A) *In general*. Except as otherwise provided in this paragraph (d)(2)(iii), the operating expense attributable to stock-based compensation is equal to the amount allowable to the controlled participant as a deduction for federal income tax purposes with respect to that stock-based compensation (for example, under section 83(h)) and is taken into account as an operating expense under this section for the taxable year for which the deduction is allowable.

(*1*) *Transfers to which section 421 applies*. Solely for purposes of this paragraph (d)(2)(iii)(A), section 421 does not apply to the transfer of stock pursuant to the exercise of an option that meets the requirements of section 422(a) or 423(a).

(*2*) *Deductions of foreign controlled participants*. Solely for purposes of this paragraph (d)(2)(iii)(A), an amount is treated as deductible by a foreign controlled participant otherwise not entitled to a deduction under United States income tax law as if the amount were paid or incurred by a United States taxpayer.

(*3*) *Modification of stock option*. Solely for purposes of this paragraph (d)(2)(iii)(A), if the repricing or other modification of a stock option is determined, under paragraph (d)(2)(ii) of this section, to constitute the grant of a new stock option not related to the development of intangibles, the stock option that is repriced or otherwise modified will be treated as being exercised immediately before the modification, provided that the stock option is then substantially vested within the meaning of § 1.83–3(b) (or, in the case of stock options to which section 421 applies, exercisable) and the fair market value of the underlying stock then exceeds the price at which the stock option is exercisable. Accordingly, the amount of the deduction that would be allowable (or treated as allowable under this paragraph (d)(2)(iii)(A)) to the controlled participant upon exercise of the stock option immediately before the modification must be taken into account as an operating expense as of the date of the modification.

(*4*) *Expiration or termination of qualified cost sharing arrangement*. Solely for purposes of this paragraph (d)(2)(iii)(A), if an item of stock-based compensation related to the development of intangibles is not exercised during the term of a qualified cost sharing arrangement, that item of stock-based compensation will be treated as being exercised immediately before the expiration or termination of the qualified cost sharing arrangement, provided that the stock-based compensation is then substantially vested within the meaning of § 1.83–3(b) (or, in the case of stock options to which section 421 applies, exercisable) and the fair market value of the underlying stock then exceeds the price at which the stock-based compensation is exercisable. Accordingly, the amount of the deduction that would be allowable (or treated as allowable under this paragraph (d)(2)(iii)(A)) to the controlled participant upon exercise of the stock-based compensation must be taken into account as an operating expense as of the date of the expiration or termination of the qualified cost sharing arrangement.

(B) *Election with respect to options on publicly traded stock*. With respect to stock-based compensation in the form of options on publicly traded stock, the controlled participants in a qualified cost sharing arrangement may elect to take into account all operating expenses attributable to those stock options in the same amount, and as of the same time, as the fair value of the stock options reflected as a charge against income in audited financial statements or disclosed in footnotes to such financial statements, prepared in accordance with United States generally accepted accounting principles by or on behalf of the company issuing the publicly traded stock. As used in this section, the term *publicly traded stock* means stock that is regularly traded on an established United States securities market and is issued by a company whose financial statements are prepared in

accordance with United States generally accepted accounting principles for the taxable year. The election described in this paragraph (d)(2)(iii)(B) is made by an explicit reference to the election in the written cost sharing agreement required by paragraph (b)(4) of this section or in a written amendment to the cost sharing agreement entered into with the consent of the Commissioner pursuant to paragraph (d)(2)(iii)(C) of this section. In the case of a qualified cost sharing arrangement in existence on the effective date of this paragraph (d)(2)(iii)(B), the election must be made by written amendment to the cost sharing agreement not later than the latest due date (without regard to extensions) of a federal income tax return of any controlled participant for the first taxable year beginning after the effective date of this paragraph, and the consent of the Commissioner is not required.

(C) *Consistency*. Generally, all controlled participants in a qualified cost sharing arrangement taking options on publicly traded stock into account under paragraph (d)(2)(iii)(A) or (d)(2)(iii)(B) of this section must use that same method of measurement and timing for all options on publicly traded stock with respect to that qualified cost sharing arrangement. Controlled participants may change their method only with the consent of the Commissioner and only with respect to stock options granted during taxable years subsequent to the taxable year in which the Commissioner's consent is obtained. All controlled participants in the qualified cost sharing arrangement must join in requests for the Commissioner's consent under this paragraph. Thus, for example, if the controlled participants make the election described in paragraph (d)(2)(iii)(B) of this section upon the formation of the qualified cost sharing arrangement, the election may be revoked only with the consent of the Commissioner, and the consent will apply only to stock options granted in taxable years subsequent to the taxable year in which consent is obtained. Similarly, if controlled participants already have granted stock options that have been or will be taken into account under the general rule of paragraph (d)(2)(iii)(A) of this section, then except in cases specified in the last sentence of paragraph (d)(2)(iii)(B) of this section, the controlled participants may make the election described in paragraph (d)(2)(iii)(B) of this section only with the consent of the Commissioner, and the consent will apply only to stock options granted in taxable years subsequent to the taxable year in which consent is obtained.

(3) Examples. * * *

* * * * *

(j) * * *

(2) * * *

(i) * * *

(F) The amount taken into account as operating expenses attributable to stock-based compensation, including the method of measurement and timing used with respect to that amount as well as the data, as of date of grant, used to identify stock-based compensation related to the development of intangibles covered by the qualified cost sharing arrangement.

* * * * *

(k) *Effective date*. This section is generally effective for taxable years beginning on or after January 1, 1996. However, paragraphs (a)(3), (d)(2), and (j)(2)(i)(F) of this section are effective for taxable years beginning on or after the date of publication of the Treasury Decision adopting those rules as final regulations in the **Federal Register**.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 26, 2002, 8:45 a.m., and published in the issue of the Federal Register for July 29, 2002, 67 F.R. 48997)

Notice of Proposed Rulemaking; Notice of Public Hearing; and Withdrawal of Previously Proposed Rulemaking

Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens

REG–133254–02; REG–126100–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; notice of public hearing; and withdrawal of previously proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance on the reporting requirements for interest on deposits maintained at U.S. offices of certain financial institutions and paid to nonresident alien individuals that are residents of certain specified countries. These proposed regulations affect persons making payments of interest with respect to such deposits. This document also provides a notice of public hearing on these proposed regulations and withdraws the notice of proposed rulemaking (REG–126100–00, 2001–1 C.B. 862 [66 FR 3925]) published on January 17, 2001.

DATES: Written or electronic comments must be received by November 14, 2002. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for 10 a.m. on December 5, 2002, must be received by November 14, 2002. The proposed rules published on January 17, 2001, (66 FR 3925) and corrected on March 21, 2001 (66 FR 15820) and March 22, 2001 (66 FR 16019) is withdrawn as of August 2, 2002.

ADDRESSES: Send submissions to: CC: DOM:ITA:RU (REG–133254–02), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions also may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to:

CC:DOM:ITA:RU (REG–133254–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Alexandra K. Helou, (202) 622–3840 (not a toll-free number); concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Treena Garrett, (202) 622–7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224. Comments on the collections of information should be received by October 1, 2002. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper operation 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 collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

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

The collection of information in these proposed regulations is in §§ 1.6049–4(b)(5)(i) and 1.6049–6(e)(4)(i) and (ii). This information is required to determine if taxpayers have properly reported amounts received as income. The collection of information is mandatory. The likely respondents are businesses and other for-profit institutions.

The estimated average annual burden per respondent and/or recordkeeper required by §§ 1.6049–4(b)(5)(i) and 1.6049–6(e)(4)(i) and (ii) will be reflected in the burdens of Forms 1042, 1042–S and the income tax return of a foreign person.

Further, the estimated average annual burden per respondent and/or recordkeeper for the statement required by § 1.6049–6(e)(4)(i) is as follows:

Estimated total annual reporting burden: 500 hours.

Estimated average annual burden per respondent: 15 minutes.

Estimated number of respondents: 2000.

Estimated annual frequency of responses: annually.

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 control number assigned by the Office of Management and Budget.

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

Background and Explanation of Provisions

On January 17, 2001, the IRS and Treasury published a notice of proposed rulemaking (REG–126100–00) in the **Federal Register** (66 FR 3925, corrected by REG–126100–00, 2001–1 C.B. 862 [66 FR 15820] and Ann. 2001–50, 2001–1 C.B. 1184 [66 FR 16019]) under Section 6049 (the 2001 proposed regulations), which would provide that U.S. bank deposit interest paid to any nonresident alien individual must be reported annually to the IRS. Under regulations currently in effect, reporting of U.S. bank deposit interest is required only if the interest is paid to a U.S. person or a nonresident alien individual who is a resident of Canada.

The IRS and Treasury requested comments on the 2001 proposed regulations, and a public hearing regarding the 2001 proposed regulations was held on June 21, 2001. The IRS and Treasury received numerous comments on the proposed regulations, and several commentators spoke at the public hearing on the 2001 proposed regulations. After careful consideration of all the comments received, the IRS and Treasury have concluded that the 2001 proposed regulations should be withdrawn and a new notice of proposed rulemaking should be issued on this subject. Accordingly, this document withdraws the 2001 proposed regulations and provides new proposed regulations (the 2002 proposed regulations).

Most of the comments received on the 2001 proposed regulations were highly critical of the regulations. In particular, many commentators expressed the view that the administrative burden imposed by the 2001 proposed regulations would significantly outweigh any benefits obtained by the IRS from the additional information collected. Some commentators also stated that the 2001 proposed regulations could have a severe negative impact on U.S. banks, particularly U.S. banks with a deposit base that included a significant number of nonresident alien individuals, some of whom had expressed concerns that the information collected under the 2001 proposed regulations might be misused. Other commentators raised certain technical concerns regarding the 2001 proposed regulations, particularly with respect to the reporting requirements for bank deposit interest paid to joint account holders.

After consideration of the comments received, the IRS and Treasury have concluded that the 2001 proposed regulations were overly broad in requiring annual information reporting with respect to U.S. bank deposit interest paid to any nonresident alien. The IRS and Treasury have decided instead that reporting should be required only for nonresident alien individuals that are residents of certain designated countries. The IRS and Treasury believe that limiting reporting to residents of these countries will facilitate the goals

of improving compliance with U.S. tax laws and permitting appropriate information exchange without imposing an undue administrative burden on U.S. banks. Accordingly, the 2002 proposed regulations would modify the current regulations (which require reporting of U.S. bank deposit interest only if paid to Canadian residents) by requiring in addition reporting of U.S. bank deposit interest paid to residents of Australia, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, and the United Kingdom. Payors may, however, at their option, choose to report bank deposit interest paid to all nonresident aliens or to any nonresident alien who is a resident of a country other than the countries listed above. If the IRS and Treasury determine that this list of countries should be modified in the future, regulations providing such a modification will be proposed and comments will be requested on those proposed regulations.

In other respects, the 2002 proposed regulations generally follow the approach set forth in the 2001 proposed regulations. Thus, the 2002 proposed regulations provide that, if a nonresident alien who is a recipient of U.S. bank deposit interest is a resident of a country for which reporting of such interest is required, a copy of Form 1042–S, "*Foreign Person's U.S. Source Income Subject to Withholding*", must be furnished to the nonresident alien. Like the 2001 proposed regulations, the 2002 proposed regulations provide that the payor or middleman can satisfy this requirement by furnishing a copy of Form 1042–S either in person or to the last known address of the nonresident alien.

In addition, to conform to the changes made in the 2002 proposed regulations, the Form 1042–S requirements have been modified with respect to joint accounts. For example, the 2001 proposed regulations provide that, if a joint account holder is a U.S. non-exempt recipient, the payor or middleman must report the entire payment to that person. If all joint account holders are foreign persons, the 2001 proposed regulations require the payor or middleman to report the payment to the nonresident alien individual that is a resident of a country with which the United States has an income tax treaty or a tax information exchange agreement (TIEA). The 2002 proposed regulations retain the requirement that the entire payment be reported to a U.S. non-exempt recipient if there is a U.S. non-exempt recipient that is a joint account holder. However, the 2002 proposed regulations modify the 2001 proposed regulations by providing that, if all joint account holders are foreign persons, reporting is required to any one of the joint account holders that is a resident of one of the listed countries.

Section 1.6049–8(a) currently provides, for purposes of the requirement that U.S. bank deposit interest paid to individuals who are Canadian residents must be reported, that the payor or middleman may rely on the permanent address found on an applicable withholding certificate described in § 1.1441–1(c)(16) (Form W–8) to make the determination of whether the nonresident alien individual resides in Canada. However, the regulation also provides that a payor or middleman may rely on its actual knowledge of the individual's residence address in Canada, even if a valid Form W–8 has not been provided, to make such a determination. The 2002 proposed regulations, like the 2001 proposed regulations, eliminate this "actual knowledge of the individual's residence address" rule because it creates a result that is contrary to the presumption rules contained in § 1.1441–1(b)(3)(iii) (and made applicable to reportable payments by § 1.6049–5(d)(2)). In this regard, the presumption rules generally provide that interest on a U.S. bank deposit that cannot be reliably associated with a valid Form W–8 or Form W–9, "*Request for Taxpayer Identification Number and Certification*", must be presumed to be paid to an undocumented U.S. non-exempt recipient. Accordingly, the 2002 proposed regulations clarify that a payor of interest on such a deposit must report the payment on a Form 1099 as made to a U.S. non-exempt recipient in accordance with the presumption rules. Further, such payment is subject to backup withholding under section 3406.

Proposed Effective Date

These regulations are proposed to apply to payments made after December 31 of the year in which they are published as final regulations in the **Federal Register**.

Special Analyses

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

Comments and 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) that are submitted timely (in the manner described in the "ADDRESSES" portion of this preamble) to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for December 5, 2002, beginning at 10 a.m. in Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the main entrance, located at 1111 Constitution Avenue, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by November 14,

2002. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for reviewing outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of the regulations is Alexandra K. Helou, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

Withdrawal of Proposed Amendments

Accordingly, under the authority of 26 U.S.C. 7805, the proposed amendment to 26 CFR parts 1 and 31 that was published in the **Federal Register** on Wednesday, January 17, 2001 (66 FR 3925, corrected by 66 FR 15820 and 66 FR 16019) is withdrawn.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 31 are proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. In § 1.6049–4, paragraph (b)(5) is revised to read as follows:

§ 1.6049–4 Return of information as to interest paid and original issue discount includible in gross income after December 31, 1982.

* * * * *

(b) * * *

(5) *Interest payments to nonresident alien individuals*—(i) *General rule*. In the case of interest aggregating $10 or more paid to a nonresident alien individual (as defined in section 7701(b)(1)(B)) that is reportable under § 1.6049–8(a), the payor shall make an information return on Form 1042–S, "*Foreign Person's U.S. Source Income Subject to Withholding*", for the calendar year in which the interest is paid. The payor or middleman shall prepare and file Form 1042–S at the time and in the manner prescribed by section 1461 and the regulations under that section and by the form and its accompanying instructions. See § 1.6049–6(e)(4) for furnishing a copy of the Form 1042–S to the payee. To determine whether an information return is required for original issue discount, see §§ 1.6049–5(f) and 1.6049–8(a).

(ii) *Effective dates*. Paragraph (b)(5)(i) of this section shall apply for payments made after December 31 of the year in which the final regulations are published in the **Federal Register** with respect to an applicable withholding certificate described in § 1.1441–1(c)(16) (Form W–8) furnished to the payor or middleman after that date. (For interest paid to a Canadian nonresident alien individual on or before December 31 of the year in which final regulations are published in the **Federal Register**, see § 1.6049–4(b)(5) in effect prior to (effective date of final rules) (see 26 CFR part 1 revised April 1, 2002.)

* * * * *

Par. 3. Section 1.6049–6 is amended as follows:

1. Paragraph (e)(4) is revised.

2. In paragraph (e)(5), the first sentence is revised and a new sentence is added at the end of the paragraph.

The addition and revisions read as follows:

§ 1.6049–6 Statements to recipients of interest payments and holders of obligations for attributed original issue discount.

* * * * *

(e) * * *

(4) *Special rule for amounts described in § 1.6049–8(a)*—(i) *In general*. In the case of amounts described in § 1.6049–8(a) (relating to certain payments of deposit interest to nonresident alien individuals) paid after December 31 of the year in which the final regulations are published in the **Federal Register**, any person who files a Form 1042–S, "*Foreign Person's U.S. Source Income Subject to Withholding*", under section 6049(a) and § 1.6049–4(b)(5) shall furnish a statement to the recipient of the interest either in person or by first-class mail to the recipient's last known address. The statement shall include a copy of the Form 1042-S required to be prepared pursuant to § 1.6049–4(b)(5) and a statement to the effect that the information on the form is being furnished to the United States Internal Revenue Service and may be furnished to the government of the foreign country where the recipient resides.

(ii) *Joint account holders*. In the case of joint account holders, a payor or middleman must report the entire amount of interest as paid to any one of the joint account holders that provides a valid Form W–9, "*Request for Taxpayer Identification Number and Certification*," or, if any account holder has not furnished an applicable withholding certificate described in § 1.1441–1(c)(16) (Form W–8) or Form W–9, any one of the joint account holders that is presumed to be a U.S. nonexempt recipient under §§ 1.6049–5(d)(2) and 1.1441–1(b)(3)(iii). If all of the joint account holders have furnished valid Forms W–8 certifying their status as foreign persons and any joint account holder is a resident of one of the countries specified in § 1.6049–8(a), then the payor or middleman must report the payment to any one of the joint account holders that is a resident of one of the countries specified in § 1.6049–8(a) (selected account holder). If, however, any joint account holder, including the selected account holder, requests its own Form 1042–S and provides information regarding the correct amount to be reported to him, the payor or middleman must furnish a Form 1042–S to such account holder and make a corresponding reduction to the amount reported to the selected account holder. If the selected account holder makes such request, the payor or middleman must report the corrected amount to the selected account holder and report the remaining amount to any other joint account holder that is a resident of one of the countries specified in § 1.6049–8(a).

(5) *Effective dates*. Paragraph (e)(4) of this section applies for payee statements due with respect to payments made after December 31 of the year in which the final regulations are published in the **Federal Register**, without regard to extensions. * * * (For interest paid to a Canadian nonresident alien individual on or before December 31 of the year in which final regulations are published in the **Federal Register**, see § 1.6049–6(e)(4) in effect prior to (effective date of final rules) (see 26 CFR part 1 revised April 1, 2002.))

* * * * *

Par. 4. In § 1.6049–8, the section heading and paragraph (a) are revised to read as follows:

§ 1.6049–8 Certain Interest and original issue discount paid to nonresident alien individuals.

(a) *Interest subject to reporting requirement*. For purposes of §§ 1.6049–4, 1.6049–6, and this section and except as provided in paragraph (b) of this section, the term *interest* means interest described in section 871(i)(2)(A) with respect to a deposit maintained at an office within the United States by a nonresident alien individual who is a resident of any of the following countries: Australia, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, and the United Kingdom. For purposes of the regulations under section 6049, a nonresident alien individual is a person described in section 7701(b)(1)(B). The payor or middleman may rely upon an applicable withholding certificate described in § 1.1441–1(c)(16) (Form W–8) that is valid to determine whether the payment is made to a nonresident alien individual who is a resident of one of the countries for which reporting is required. Generally, amounts described in this paragraph (a) are not subject to backup withholding under section 3406. See § 31. 3406(g)–1(d) of this chapter. However, if the payor or middleman does not have either a valid Form W–8 or valid Form W–9, "*Request for Taxpayer Identification Number and Certification*", the payor or middleman must report the payment as made to a U.S. non-exempt recipient if it must so treat the payee under the presumption rules of §§ 1.6049–5(d)(2) and 1.1441–1(b)(3)(iii) and must also backup withhold under section 3406. (For interest paid to a Canadian nonresident alien individual on or before December 31 of the year in which final regulations are published in the **Federal Register**, see § 1.6049–8(a) in effect prior to (effective date of final rules) (see 26 CFR part 1 revised April 1, 2002.)

* * * * *

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

Par. 5. The authority citation for part 31 continues to read in part as follows:

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

Par. 6. In § 31.3406(g)–1, paragraph (d) is revised to read as follows:

§ 31.3406(g)–1 Exceptions for payments to certain payees and certain other payment.

* * * * *

(d) *Reportable payments made to nonresident alien individuals*. A payment of interest that is reported on Form 1042-S as paid to a nonresident alien individual under § 1.6049–8(a) of this chapter is not subject to withholding under section 3406. (For interest paid to a Canadian nonresident alien individual on or before December 31 of the year in which final regulations are published in the **Federal Register**, see § 31.3406(g)–1(d) in effect prior to (effective date of final rules) (see 26 CFR part 1 revised April 1, 2002.)

* * * * *

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 30, 2002, 1:35 p.m., and published in the issue of the Federal Register for August 2, 2002, 67 F.R. 50386)

Foundations Status of Certain Organizations

Announcement 2002–75

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

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

12 Gods Benefit, Inc., New York, NY
47 Alumni Association of the Deaf, Inc., New York, NY
126th Street Neighborhood Development Association, Inc., New York, NY
ABS Foundation, Inc., Rye, NY
Abundant Life Missions International, Inc., Coventry, RI
Action Programs, Inc., N. Syracuse, NY
Adoption Works, Inc., Hamden, CT
African Center, Inc., Albany, NY
Albany Latin Festival Association, Albany, NY
Alchemy Theatre Company of Manhattan, Inc., New York, NY
Alive Forever Ministries, Haverstraw, NY
All Bereavement Center, Ltd., Bronx, NY
Alumni of the Negro Ensemble Co., Inc., New York, NY
AMC Child Care Center, Inc., Roosevelt, NY
American Association of Indian Social Workers, Inc., Glen Oaks, NY
American Friends of Kolel Tiferes Yisroel, Brooklyn, NY
American Friends of the Gate Theatre Dublin, Inc., New York, NY
American Friends of Yeshiva Rabbenu Ozer, Inc., Brooklyn, NY
Andr Esprit, Monticello, NY
Animals for Life, Inc., South Britain, CT
Anti-Mine Alliance, Highland, NY
Aquidneck Indian Council, Newport, RI
Armenian Center for Contemporary Experimental Art, Inc., New York, NY
Art New England, Newport, RI
Artists With Disabilities, Inc., Mahotac, NY

Avnei Neizer Sochotshov Trust, Brooklyn, NY
Best Medicine Group, Inc., Astoria, NY
Black Planet Productions, Inc., New York, NY
Black Rhino Expedition, Ltd., New York, NY
Blue Skies Ranches Childrens Services, Inc., Enfield, CT
Boston Healthy Start Initiative, Inc., Boston, MA
Bronx North Association of Resident Councils, Inc., Bronx, NY
Brooklyn Fund for Children and Community, Brooklyn, NY
Brooklyn Initiatives, Inc., Brooklyn, NY
Brooklyn's Helping Hands Ministry, Inc., Brooklyn, NY
Caribbean Carnival Connections, Inc., Hartford, CT
Carleton S. Walker Memorial Youth Sailing Foundation, Old Lyme, CT
Center for Family and Community Restoration, Inc., Newburyport, MA
Center for Family Resources and Support, Cortland, NY
Chabad of Hamden, Inc., Hamden, CT
Chariho Football Boosters, Ashaway, RI
Charles River Public Internet Center, Inc., Waltham, MA
Cheryl Hampton Early Childhood Foundation, Inc., Stamford, CT
Children of Grenada, Inc., Monroe, NY
Childrens Health Foundation Corp., New York, NY
Childrens Outreach International, Inc., Cos Cob, CT
Christiams Brothers Corp., Bronx, NY
Cinewomen NY, Inc., New York, NY
City Wide Emergency Volunteer Ambulance & Rescue Service, Inc., New York, NY
Coalition of Blacks in Nutrition Professions, Inc., Brooklyn, NY
Coalition of Multi-Ethnic Partnership and Support Services, Brooklyn, NY
Committee to Save Dominica, Inc., Brooklyn, NY
Community House Housing Development Fund Company, Inc., Brooklyn, NY
Community Lantern Corporation, New York, NY
Compuquest Institute, Inc., New Fairfield, CT
Congregation Keren Yechezkel Gemilas Chesed, Brooklyn, NY
Coolatore House Artists Retreat, Inc., New York, NY
Cortlandt Youth Football League Touchdown Club, Inc., Buchanan, NY
Coventry Youth Football and Cheerleading Association, Inc., Coventry, CT
Creative Outlet Dance Theatre of Brooklyn, Inc., Brooklyn, NY
Crystal Image Theatre, Brooklyn, NY
Cypress West Housing Development Fund Corporation, Brooklyn, NY
Dramatic Actions, Incorporated, Ronkonkoma, NY
Education Innovations, Inc., New Haven, CT
Educators for Children Youth and Families, Incorporated, Brooklyn, NY
Elderserve Licensed Home Care Services Agency, Inc., Bronx, NY
Enfield Youth Dek & Roller Hockey Association, Inc., Enfield, CT
Eternal Light International, Inc., Great Neck, NY
Fareta Institute of Pan-African Culture, Inc., New York, NY
Fat Publications, Ltd., New York, NY
Federal Hall Restoration Corporation, New York, NY
Feeling the Spirit Foundation, New York, NY
Fellowship Community Development Corporation, Wyandanch, NY
Finbar Devine Memorial Dinner Corp., Brooklyn, NY
Fletcher James Hairston Scholarship Fund, White Plains, NY
Foundation for Prevention & Early Resolution of Conflict, New York, NY
Franklin Projects, Inc., Northport, NY
Free Women in Christ, Inc., Jamaica, NY
Friends of 170, Inc., Unionville, CT
Friends of Greenwich Street, Inc., New York, NY
Friends of Orient-Occident Foundation, Inc., New York, NY
Friends of Wsuf, Inc., Selden, NY
Genesis Community Development Corporation, Meriden, CT
Give Back Community Youth Organization, Inc., Brooklyn, NY
Good Find Thrift Shop-La Buena Compra, Inc., Brooklyn, NY
Great Irish Hunger Memorial, Inc., Brooklyn, NY
Greater Flatbush Community Services Corporation, Brooklyn, NY
Greater Long Island Clean Cities Coalition, Inc., Farmingdale, NY
Haddam-Killingworth Soccer Club, Inc., Higganum, CT
Han Min Charity Mission Corp., Flushing, NY
Helping Hand Foundation, New York, NY
Homecoming Project, Inc., Jackson Heights, NY
Hope for the Gifted Foundation, Inc., Monroe, NY
Hope House Theater, Inc., New York, NY
Incubator, Inc., Brooklyn, NY
Institute for Educational Innovation, Chepachet, RI
Institute for International Vaccine Development, Cambridge, MA
International Book Institute, Inc., Boltou, MA
International Community Taxi Drivers Foundation, New York, NY
International Society for Krishna Consciousness of Greater NY, Inc., Scarsdale, NY
It Takes a Village to Raise a Child, Inc., Freeport, NY
Jackie Robinson Park of Fame, Inc., Stamford, CT
Jazz Cares, Inc., Holtsville, NY
Jewish Recovery Foundation, Inc., New York, NY
Jirut Foundation, Inc., Hempstead, NY
John Drennan Memorial Fund, Inc., Staten Island, NY
Joy of Life Foundation, Inc., Brooklyn, NY
JRL Outreach Program, Inc., Brooklyn, NY
Korean-American Senior Pastors and Elders Assoc. of Greater NY, Inc., Flushing, NY
Korean American Small Business Development Corporation, Flushing, NY
LAO American Foundation, Inc., Danbury, CT
Latino Artists Group, Inc., Waterbury, CT
Levittown Diamond Club, Inc., Levittown, NY
Life and Buddhism, Inc., New York, NY
Long Island Feline Rescue Society Corp., New Hyde Park, NY

Lynbrook Historical and Preservation Society, Lynbrook, NY
Machon Gila, Brooklyn, NY
Magic Street, Inc., Chappaqua, NY
Malcom E. Smith Jr. Foundation, Inc., St. James, NY
Maritime Archaeology Research, Inc., Fairfield, CT
Mayor Mikes Kids Golf Club, Middletown, CT
Metropolitan Peace Museum, New York, NY
Mid-Brooklyn Resources Center, Incorporated, Brooklyn, NY
Mikvah of Rockland County, Inc., Spring Valley, NY
Million Dollar Fund for Acts of Goodness and Kindness, Inc., Brooklyn, NY
Minority Contractors Association of Westchester, Inc., White Plains, NY
Montaukett Indian Nation Tribal Fund, Sag Harbor, NY
Mount Moriah Corporation for Excellence, Hartford, CT
Mulvihill-Lynch School Parents Association, Centerreach, NY
National Asian American League, Inc., Branford, CT
National Institute for Special-Need Audiences, Inc., New York, NY
National Students Theater, Inc., New York, NY
National Voluntary Health Facility 4, Inc., Chicago, IL
Neighbor 2 Neighbor Foundation, Inc., Middle Island, NY
Neighborhood Multi-Service Center, Inc., Far Rockaway, NY
New Center for Acculturation & Placement of New Americans, Inc., Brooklyn, NY
New Jerusalem Community Development Center, Inc., New Britain, CT
New York City Youth Empowerment Center, Inc., Jackson Heights, NY
New York Conference of Italian American State Legislators, Inc., Great Neck, NY
Newpath, Inc., Hartford, CT
Nimat, Inc., Laurelton, NY
Noble Drew Ali Plaza Housing Corporation, Brooklyn, NY
Object Developers Group, Inc., New York, NY
One-On-One Basketball Cultural, Inc., Brooklyn, NY
Organization for the Protection Education & Needs of Children, Inc., White Plains, NY
Orthodox Community Kashrus, Inc., Monroe, NY
Paul Robenson Foundation, Inc., New York, NY
PDP-ARF, Inc., New York, NY
Pelham Parkway Resident Council, Inc., Bronx, NY
Peoplecount, Purchase, NY
P H A S E 1 Transitional Living Facility, Inc., Mineola, NY
Philadelphia Community Services Corporation, New York, NY
Podunk Bluegrass Music Festival, Inc., Vernon, CT
Polo Grounds Sports and Education Foundation, Inc., New York, NY
Poverty Awareness Coalition, Inc., New York, NY
Professional Design Center of New York, Inc., Fresh Meadows, NY
Racers Against Drunk Driving, Inc., Scarsdale, NY
Raza World Services, Inc., N. Bellmore, NY
Riverhead Revitalization & Preservation Corporation, Riverhead, NY
Roxbury Bicentennial Celebration Committee, Inc., Roxbury, CT
Safe Schools Institute, Inc., Rhinebeck, NY
Safehaven Animal Center, Inc., Mastic Beach, NY
Samanthas Friends, Portchester, NY
Saugus Historical Society, Inc., Saugus, MA
Scott Conover Youth Foundation, Freehold, NJ
Sepa Mujer, Inc., Hempstead, NY
Sephardic National Alliance, Inc., Brooklyn, NY
Shiola Baptist Community Development Corp., Meriden, CT
Society for African American Historical Pioneers, Inc., Park Slope, NY
Soho Community Council, Inc., New York, NY
Southend Neighborhood Revitalization Corporation, Waterbury, CT
Spiritual Endeavors, Inc., Naugatuck, CT
Sport Moms, Inc., Islip, NY
St. Frances Animal Rescue, Shirley, NY
St. Vincent De Paul Center of Gouverneur, Inc., Gouverneur, NY
Stanley M. Issacs Park Association, Inc., New York, NY
Sternhold Resources, Inc., Brooklyn, NY
Sunrise Mothers Center, Inc., Bellmore, NY
Sursum Corda Scholarship Fund, New York, NY
Survivors Foundation, Chatham, NJ
Syrian Jewish Organization, Brooklyn, NY
Tennis Against Breast Cancer, Inc., New York, NY
Tony's Kids Fund, Inc., New York, NY
Topos Musicworks, Inc., New York, NY
Total Youth Development, Inc., Sodus, NY
Touch Support Services, Inc., Bronx, NY
TOV V'Chesed, Inc., Brooklyn, NY
Tri-Town Convention, Inc., Cromwell, CT
United States Junior Golf Association Foundation, N. Providence, RI
Unity Fellowship Breaking Ground, Inc., New York, NY
Urban Canine Conservancy, Inc., New York, NY
U S UNFM, Inc., New York, NY
Venice Foundation, Inc., New York, NY
Village of New Square Emergency Services Hatzoloh of New Square, New Square, NY
Village Repertory Theatre, Inc., New York, NY
Vintage Radio and Communications Museum of Connecticut, Inc., E. Hartford, CT
Wannago, Inc., New York, NY
Ways and Means Development, Inc., Freeport, NY
West Bronx Neighborhood Redemption Center, Inc., Bronx, NY
West Warwick Educational Assistance of Volunteers, W. Warwick, RI
Westhampton Beach Performing Arts Center, Inc., West Hampton Beach, NY
White Plains Community Health Fair, Inc., White Plains, NY
White Plains Housing Development Fund Company, Inc., Tarrytown, NY
William J. Powell Scholarship Fund, Inc., Medford, NY
Winsor Music, Incorporated, Boston, MA

Worcester Area Transportation Management Association Incorporation, Worcester, MA
World Peace Bell Association U S A, Inc., New York, NY
Worldwide Supernatural Deliverance Outreach Ministry, Inc., Brooklyn, NY
Yeshiva Oam Eli Melech, Inc., Spring Valley, NY
Youth and Family Justice Center, Inc., New York, NY

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

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

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

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

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

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

Name	Address	Designation	Effective date
McKnight, James A.	Tequesta, FL	Enrolled Agent	April 12, 2001 to October 11, 2002
Donnelly, Edward	Melville, NY	CPA	April 17, 2002 to July 16, 2003

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

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

Name	Address	Designation	Effective Date
Schmeiser, Larry W.	Limon, CO	Attorney	September 1, 2000
Sayre, Charles L.	Ann Arbor, MI	Attorney	January 2, 2001

Name	Address	Designation	Effective Date
Young, Dennis	Lewiston, ID	CPA	January 2, 2001
Buckley, Francis M.	Marlborough, CT	Attorney	January 18, 2001
Dugovich, Frank A.	Middleburg Heights, OH	CPA	January 29, 2001
Kiss, Philip M.	Liberyville, IL	Enrolled Agent	March 1, 2001
Mellner, Michael	Scranton, PA	CPA	June 11, 2001
Davis, Jerry A.	Leonard, TX	CPA	June 13, 2001
Thornton, John L.	Fayetteville, AR	CPA	June 21, 2001
Campbell, David G.	Reading, PA	Attorney	July 10, 2001
Schlabach, John J.	Colbert, WA	CPA	July 16, 2001
Belin, Leon	Southfield, MI	CPA	August 7, 2001
Simpson, James	Elmhurst, IL	Attorney	September 24, 2001
Berg, Richard L.	Vadnais Heights, MN	CPA	October 3, 2001
Riesenmy, David	Joplin, MO	Attorney	October 15, 2001
Andrade, Rodrigo	El Paso, TX	Enrolled Agent	November 20, 2001
Miller, Larry Charles	Philadelphia, PA	Attorney	January 10, 2002
Melton, Andrew I.	Detroit, MI	CPA	February 13, 2002
Daily, J. Michael	Clearwater, FL	CPA	March 29, 2002
Klimkowski, Joseph R.	Florham, NJ	CPA	March 29, 2002
Greene, William M.	Center Sandwich, NH	Attorney	March 29, 2002
Bart, Adrian	Tulsa, OK	CPA	April 17, 2002

Consent Suspensions From Practice Before the Internal Revenue Service

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

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

Name	Address	Designation	Date of Suspension
McDaniel III, Troy J.	Atlanta, GA	CPA	Indefinite from June 6, 2000
Levine, Paul	Los Angeles, CA	CPA	February 1, 2001 to January 31, 2003

Name	Address	Designation	Date of Suspension
Hammons, Patrick B.	Mesa, AZ	Enrolled Agent	February 1, 2001 to January 31, 2004
Price, Russell S.	Washington, DC	CPA	February 17, 2001 to August 16, 2003
Donohue, Robert M.	Ellicott City, MD	CPA	May 15, 2001 to May 14, 2005
Havranek, Ronald J.	Deerfield, IL	CPA	July 30, 2001 to July 29, 2003
Harding III, Leon H.	Roanoke, VA	CPA	Indefinite from August 7, 2001
Noone, Patrick	Orland Park, IL	CPA	August 23, 2001 to February 22, 2004
Sefton, David L.	Austin, TX	CPA	August 31, 2001 to February 27, 2003
Zuccarelli, Silvio	Coconut Creek, FL	Enrolled Agent	September 18, 2001 to December 17, 2004
DeFazio, James P.	Sacramento, CA	CPA	October 1, 2001 to March 31, 2003
Levenson, Martin J.	New York, NY	CPA	October 15, 2001 to April 14, 2004
Donchatz, Charles	Columbia, SC	CPA	October 25, 2001 to October 24, 2004
Smith, Virga A.	Rochester, IN	CPA	November 1, 2001 to October 31, 2003

Name	Address	Designation	Date of Suspension
Fuller, Don B.	Minneapolis, MN	Attorney	November 15, 2001 to November 14, 2004
Retzlaff, Gene A.	Hortonville, WI	Enrolled Agent	Indefinite from December 27, 2001
Kime, Robert L.	Collinsville, IL	CPA	December 6, 2001 to December 5, 2003
King, John C.	Wichita, KS	Attorney	January 1, 2002 to June 30, 2003
Carter, Lloyd C.	St. George, UT	CPA	January 15, 2002 to October 14, 2002
Dennis, Paul J.	Milwaukee, WI	Enrolled Agent	January 28, 2002 to January 27, 2005
Jones, Ricky A.	Greenfield, OH	CPA	March 15, 2002 to March 14, 2003
Price, Richard A.	Novato, CA	CPA	May 1, 2002 to April 30, 2005
Burnett, Bradley P.	Wheat Ridge, CO	Attorney	May 1, 2002 to April 30, 2004
Leone, Anthony	Des Plaines, IL	CPA	April 1, 2002 to September 30, 2003
Groskin, Lawrence J.	Tuxedo Park, NY	Attorney	May 1, 2002 to April 30, 2003
Homnick, Cory	San Diego, CA	CPA	June 1, 2002 to May 31, 2003

Name	Address	Designation	Date of Suspension
Herring, Chester L.	University Park, IL	CPA	June 1, 2002 to November 30, 2003
Cutcher, Edward W.	Clinton, OH	CPA	June 1, 2002 to February 28, 2003
Gisser, Arthur S.	Glenwood Landing, NY	CPA	July 1, 2002 to December 31, 2002
Garlikov, Mark B.	Dayton, OH	Attorney	July 1, 2002 to October 30, 2005
Foust, John Franklin	Des Moines, IA	CPA	July 1, 2002 to June 30, 2003
Byock, Matthew I.	Red Bank, NJ	CPA	August 1, 2002 to March 31, 2003

Expedited Suspensions From Practice Before the Internal Revenue Service

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

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

Name	Address	Designation	Date of Suspension
Brenner, William A.	Grahamsville, NY	Attorney	Indefinite from February 2, 2001
Pope, Ray P.	Pensacola, FL	Attorney	Indefinite from February 23, 2001
Dudnick, Howard A.	Princeton, NY	CPA	Indefinite from June 25, 2001
Griffiths, Brian D.	North Andover, MA	CPA	Indefinite from June 25, 2001

Name	Address	Designation	Date of Suspension
Yerardi, Michael J.	East Walpole, MA	Attorney	Indefinite from June 25, 2001
Cheesman, Michael S.	Mill Creek, WA	CPA	Indefinite from July 20, 2001
Devereaux, Ross	Jackson, MI	CPA	Indefinite from July 20, 2001
Gaskill, Todd	Lompoc, CA	Attorney	Indefinite from July 20, 2001
Gross, Peter Sam	Kerrville, TX	Attorney	Indefinite from July 20, 2001
Hausman, Stanley	Livingston, NJ	Attorney	Indefinite from July 20, 2001
Jones, Peter C.	Seattle, WA	CPA	Indefinite from July 20, 2001
Koss, Lewis M.	Calabasas, CA	Attorney	Indefinite from July 20, 2001
Maxey, Michael	Mishawaka, IN	CPA	Indefinite from July 20, 2001
Meaney, Richard A.	Harwich Port, MA	Attorney	Indefinite from July 20, 2001
Shaver, Howard D.	Leawood, KS	Attorney	Indefinite from July 20, 2001
Sims, Thomas	Tonka Bay, MN	CPA	Indefinite from July 20, 2001
Wallin, Hans	Arthur, ND	Attorney	Indefinite from July 20, 2001
Freeman, Dale L.	North Royalton, OH	CPA	Indefinite from August 6, 2001
Huffman, Richard E.	Riverside, CA	CPA	Indefinite from August 6, 2001
Lawrence, William E.	Salinas, CA	CPA	Indefinite from August 6, 2001
Marks, William J.	New York, NY	CPA	Indefinite from August 6, 2001
Parker, George	Honolulu, HI	Attorney	Indefinite from August 6, 2001

Name	Address	Designation	Date of Suspension
Pham, Van Luong	Houston, TX	Enrolled Agent	Indefinite from August 6, 2001
Pirro, Jr., Albert J.	Rye, NY	Attorney	Indefinite from August 6, 2001
Pollacheck, Mark E.	Califon, NJ	Enrolled Agent	Indefinite from August 6, 2001
Price, Padget C.	Corona, CA	Attorney	Indefinite from August 6, 2001
Ragusa, Sebastian	Hicksville, NY	Attorney	Indefinite from August 6, 2001
Ranum, Karl M.	Stillwater, MN	Attorney	Indefinite from August 6, 2001
Ross, Daniel P.	Ashtabula, OH	CPA	Indefinite from August 6, 2001
Shea, Michael P.	Myrtle Beach, SC	CPA	Indefinite from August 6, 2001
Tatman, Elizabeth A.	Mission Viejo, CA	CPA	Indefinite from August 6, 2001
Taylor, Murray E.	Houston, TX	CPA	Indefinite from August 6, 2001
Truex, Anthony J.	Port Hueneme, CA	CPA	Indefinite from August 6, 2001
Utterback, Thomas M.	Gerald, MO	Attorney	Indefinite from August 6, 2001
Zauft, Steven J.	San Antonio, TX	Attorney	Indefinite from August 6, 2001
Hancock, George B.	New Bern, NC	CPA	Indefinite from June 24, 2002
Nadale, Richard D.	Petaluma, CA	CPA	Indefinite from June 24, 2002

Resignations of Enrolled Agents

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

The Director of Practice has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Resignation
Fuener, Donald C.	Springfield, IL	Effective December 31, 2001
Clark, Robert A.	Chico, CA	Effective January 1, 2002
Sarmiento, Romulo B.	San Francisco, CA	Effective March 31, 2002
Goetz, Roger H.	Waseca, MN	Effective June 24, 2002

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 current actions on previously published items in Internal Revenue Bulletins 2002–1 through 2002–25 is in Internal Revenue Bulletin 2002–26, dated July 1, 2002.

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