

## HIGHLIGHTS OF THIS ISSUE

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

### INCOME TAX

Ct.D. 2065, page 7.

Treasury Regulation section 1.846-3(c)(3) reasonably interprets that the term "reserve strengthening" is broad enough to embrace all increases in the reserve's amount. *Atlantic Mutual Insurance Company v. Commissioner of Internal Revenue*.

T.D. 8780, page 14.

Final regulations under section 7623 of the Code relate to rewards for information on violations of the internal revenue laws.

Rev. Rul. 98-46, page 10.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning October 1, 1998, will be 7 percent for overpayments, 8 percent for underpayments, and 10 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding \$10,000 is 5.5 percent.

Rev. Rul. 98-47, page 4.

Residential rental property. For purposes of section 142(d) and 145(d) of the Code, the ruling provides that the availability of continual or frequent medical, nursing, or psychiatric services in a facility for the residents of the facility will cause the facility to be other than residential rental property. Other non-housing services available in a facility for the residents of the facility generally will not cause the facility to be other than residential rental property.

Rev. Rul. 98-48, page 6.

LIFO; price indexes; department stores. The July 1998 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, July 31, 1998.

### EMPLOYEE PLANS

Notice 98-48, page 17.

Weighted average interest rate update. The weighted average interest rate for September 1998 and the resulting permissible range of interest rates used to calculate current liability for purposes of the full funding limitation of section 412(c)(7) of the Code are set forth.

### ADMINISTRATIVE

REG-104565-97, page 21.

Proposed regulations under section 6402 of the Code relate to the administration of the Tax Refund Offset Program (TROP).

REG-115393-98, page 34.

Proposed regulations under section 408A of the Code relate to Roth IRAs. A public hearing will be held on December 10, 1998.

REG-118926-97, page 23.

Proposed regulations under section 6038B of the Code relate to information reporting requirements for certain transfers by United States persons to foreign partnerships. A public hearing will be held on November 10, 1998.

REG-118966-97, page 29.

Proposed regulations under section 6038 of the Code relate to information reporting requirements for certain United States persons holding interests in controlled foreign partnerships. A public hearing will be held on November 10, 1998.

REG-209060-86, page 18.

Proposed regulations under section 6046A of the Code relate to information reporting requirements for certain United States persons who acquire or dispose of an interest in a foreign partnership, or whose interest in a foreign partnership changes substantially. A public hearing will be held on November 10, 1998.

Finding Lists begin on page 54.

Announcement of Disbarments and Suspensions begins on page 50.



# Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our prod-

ucts and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness.

## Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

# 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 of a permanent nature 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 proce-

dures 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 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.

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

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 103.—Interest on State and Local Bonds

26 CFR 1.103–8(b): Residential rental property.

For purposes of sections 142(d) and 145(d) of the Code, the ruling provides that the availability of continual or frequent medical, nursing, or psychiatric services in a facility for the residents of the facility will cause the facility to be other than residential rental property. Other non-housing services available in a facility for the residents of the facility generally will not cause the facility to be other than residential rental property. See Rev. Rul. 98–47, page 4.

## Section 142.—Exempt Facility Bond

26 CFR 1.103–8(b): Residential rental property.

For purposes of sections 142(d) and 145(d) of the Code, the ruling provides that the availability of continual or frequent medical, nursing, or psychiatric services in a facility for the residents of the facility will cause the facility to be other than residential rental property. Other non-housing services available in a facility for the residents of the facility generally will not cause the facility to be other than residential rental property. See Rev. Rul. 98–47, page 4.

26 CFR 1.103–8: Interest on bonds to finance certain exempt facilities.  
(Also sections 145 and 103)

**Residential rental property.** For purposes of section 142(d) and 145(d) of the Code, the ruling provides that the availability of continual or frequent medical, nursing, or psychiatric services in a facility for the residents of the facility will cause the facility to be other than residential rental property. Other non-housing services available in a facility for the residents of the facility generally will not cause the facility to be other than residential rental property.

Rev. Rul. 98–47

### ISSUE

Are the buildings described below residential rental property for purposes of § 142(d) and § 145(d) of the Internal Revenue Code?

### FACTS

Complex M provides housing units on a non-transient basis for individuals who are

of retirement age or older. All of the units in Complex M are available to members of the general public. Complex M is comprised of Building X, Building Y, and Building Z, each of which is composed of similarly constructed housing units that have separate and complete facilities for living, sleeping, eating, cooking, bathing, and sanitation. The cooking and eating area contains a small refrigerator, a sink, a pull-down table, and a two-burner stove with an oven. Each unit is designed so that the stove can be replaced with a full-sized microwave oven if the physical or mental frailties of the resident make it imprudent to provide a functioning cooking stove.

Each resident enters into a lease arrangement with Complex M. The amount of the monthly payment under the lease varies according to the level of care provided in the building in which the resident resides, with Building Z commanding the largest payment and Building X the smallest payment. The monthly payment is made in exchange for use of an individual unit, basic services and, with respect to Buildings Y and Z, other services. Under a lifetime lease payment option, residents of Complex M may pay a fixed monthly amount for the time they reside in Complex M. The lifetime lease option guarantees a resident the right to move to a unit in Buildings Y or Z if the resident requires additional care.

The basic services available to the residents in all three buildings include: laundry; housekeeping; regular daily meals in the common dining areas; 24 hour monitored emergency call service using call buttons and two-way communication devices located in each room of a unit; planned social activities; and scheduled transportation to various sites in the vicinity including commercial areas, shopping centers, hospitals, and doctor's offices.

Building X, Building Y, and Building Z each contains a separate common dining area. The dining area in each building will be used exclusively by residents of Complex M and visitors of those residents. The size of the dining area in any building does not exceed that necessary to serve the residents of the building and their guests. The dining area serves the special needs of the residents and provides the staff of Complex M an opportu-

nity to monitor the overall well-being, nutrition, and health of the residents.

Only the basic services are made available to residents of Building X. No other services are included in the monthly payment. Continual or frequent nursing, medical, or psychiatric services are not made available in Building X.

The basic services and the Building Y support services are made available to residents of Building Y. The Building Y support services are as follows: assistance by medication management technicians in medication management and intake; maintenance of detailed medication records; consultation with a nurse as needed about health concerns and medication plans; assistance by non-medically certified aides each day during waking hours in activities of daily living that include getting in and out of bed and chairs, walking, using the toilet, dressing, eating, and bathing; and routine checks by staff members of Building Y to insure the residents' general well-being. Some residents of Building Y have incapacitating infirmities that require continual assistance, but do not require continual or frequent nursing, medical, or psychiatric services. Continual or frequent nursing, medical, or psychiatric services are not made available in Building Y.

The basic services and the Building Y support services are made available to residents of Building Z. In addition, Building Z is staffed in the following manner: registered nurses are on duty for 12 hours each day; licensed practical nurses are on duty for 24 hours each day; and licensed nurses' aides are available 24 hours each day. The nurses and nurses' aides are available to provide nursing care for residents' medical or psychiatric needs. Thus, continual or frequent nursing, medical, or psychiatric services are made available in Building Z.

Residents in Building X are required to move into Buildings Y or Z or another facility outside of Complex M if, because of physical or mental disability, they require additional care beyond that offered by Building X. Residents in Buildings X and Y are required to move into Building Z or another facility outside of Complex M if they require continual or frequent nursing, medical, or psychiatric services.

## LAW AND ANALYSIS

Under the general rule of § 103(a), gross income does not include interest on any state or local bond. Section 103(b)(1), however, provides that the exclusion does not apply to any private activity bond unless it is one of the qualified bonds under § 141(e). Among these qualified bonds are exempt facility bonds and qualified § 501(c)(3) bonds.

Section 142(a) describes an exempt facility bond as any bond issued as part of an issue of bonds if 95 percent or more of the net proceeds of the issue are to be used to provide listed types of projects or facilities. Within the list, in § 142(a)(7), are qualified residential rental projects.

Section 142(d) defines a qualified residential rental project as a project for residential rental property that houses occupants who meet one of the alternative income tests at all times throughout a qualified project period. In the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 519-575 (the "1986 Act"), Congress reorganized § 103 and § 103A of the Internal Revenue Code of 1954 (the "1954 Code") regarding tax-exempt bonds into § 103 and §§ 141 through 150 of the Internal Revenue Code of 1986. Congress intended that to the extent not amended by the 1986 Act, all principles of pre-1986 Act law would continue to apply to the reorganized provisions. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-686 (1986), 1986-3 (Vol. 4) C.B. 686. (Conference Report). Because no Income Tax Regulations have been promulgated under § 142(d), the regulations promulgated pursuant to § 103(b)(4) of the 1954 Code continue to apply to residential rental property except as otherwise modified by the 1986 Act and subsequent law.

Section 145(a) describes a qualified § 501(c)(3) bond as any bond issued as part of an issue of bonds if all of the property to be provided by the net proceeds of the issue is to be owned by a § 501(c)(3) organization or a governmental unit and 95 percent or more of the net proceeds of the issue are used in a manner related to the exempt purpose of the § 501(c)(3) organization. Under § 145(d)(1), however, a bond generally is not a qualified § 501(c)(3) bond if net proceeds of the issue are used directly or indirectly to provide residential rental property for family

units. Section 145(d)(2) provides certain exceptions to § 145(d)(1). The legislative history of § 145(d) indicates that the phrase residential rental property for family units in § 145(d) has the same meaning as residential rental property under § 1.103-8(b) of the Income Tax Regulations.

Under § 1.103-8(b)(4), a residential rental project is residential rental property that meets certain requirements including occupancy requirements by low-income tenants during the period when the units must be continually rented or available for rental. Residential rental property is a building or structure, together with any functionally related and subordinate facilities, containing one or more similarly constructed units that are available to members of the general public and used on other than a transient basis. The regulations also provide that hotels, motels, dormitories, fraternity and sorority houses, rooming houses, hospitals, nursing homes, sanitariums, rest homes, and trailer parks and courts for use on a transient basis are not residential rental projects.

Section 1.103-8(b)(8) defines a "unit" as any accommodation containing separate and complete facilities for living, sleeping, eating, cooking, and sanitation. The regulations note that an example of a unit would be a separate and distinct apartment containing a living area, a sleeping area, bathing and sanitation facilities, and cooking facilities equipped with a cooking range, refrigerator, and sink.

Additional insight into the meaning of residential rental property can be found under § 42, which provides the low-income housing credit. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1983-3 (Vol. 4) C.B. 89, states that the phrase "residential rental property" generally has the same meaning under both § 42 and § 142(d).

Section 1.42-11(b) provides a distinction between residential rental properties and health care facilities by focusing on whether frequent nursing, medical, or psychiatric services are provided to residents. Under that section, if continual or frequent nursing, medical, or psychiatric services are provided to residents, it is presumed that the building is ineligible for the credit as is the case with a hospital or nursing home. The distinction drawn

in the regulations under § 42 regarding the nature of the facility based on the frequency of nursing, medical, or psychiatric services available in the facility is also the appropriate standard for determining whether facilities are residential rental property for purposes of § 142(d) and § 145(d).

For purposes of § 142(d) and § 145(d), if a facility makes available continual or frequent nursing, medical, or psychiatric services, the facility will not be residential rental property under § 142(d) or § 145(d). In the case of a mixed use facility, the allocable portion of the facility in which continual or frequent nursing, medical, or psychiatric services are made available will not be residential rental property under § 142(d) or § 145(d).

As set forth in the facts above, Building X, Building Y, and Building Z each contains complete living units within the meaning of § 1.103-8(b)(8), all of the living units within the respective buildings are available to the general public, and all of the living units are used on a non-transient basis. Since Complex M also provides significant non-housing services to residents of the three buildings (including continual or frequent nursing, medical, or psychiatric services to the residents of Building Z), the analysis must consider the nature and extent of the non-housing services. In the case of Complex M, the analysis must examine whether the buildings of Complex M are hospitals, nursing homes, sanitariums, or rest homes rather than residential rental property. For purposes of § 142(d) and § 145(d), labels are not determinative. The focus of these sections, their legislative histories, and the applicable regulations thereunder, is whether the facilities are, in substance, residences or health care facilities. Therefore, the nature and degree of the services provided by the facility controls.

Significant non-housing services are made available to residents of Building X and Building Y, including meals and various support services. The services available to residents of Building X and Building Y do not include continual or frequent nursing, medical, or psychiatric services although, under the lifetime lease option, certain residents are assured that they will receive continual or frequent nursing, medical, or psychiatric services in Building Z if required. Thus, under the princi-

ples set forth above, Buildings X and Y would be residential rental property.

Continual or frequent nursing, medical, or psychiatric services are made available to residents of Building Z in addition to the same non-housing services that are made available to residents of Building X and Building Y. Thus, under the principles set forth above, Building Z would not be a residential rental property.

**HOLDING**

Building X and Building Y are residential rental property for purposes of § 142(d) and § 145(d). Because continual or frequent nursing, medical, or psychiatric services are made available in Building Z, Building Z is not residential rental property for purposes of § 142(d) and § 145(d).

Neither Building X nor Building Y would fail to be residential rental property under § 142(d) or § 145(d) merely because it was called a hospital, a sanitarium, a rest home, or a nursing home. Similarly, Building Z would not be residential rental property under § 142(d) or § 145(d) merely because it was called an assisted living facility or an elderly care facility.

**DRAFTING INFORMATION**

The principal authors of this revenue

ruling are Harold N. Diamond and Timothy L. Jones of the Office of Associate Chief Counsel (Domestic) and Edwin G. Oswald of the Department of the Treasury. For further information regarding this revenue ruling contact Harold N. Diamond at 202-622-3980 (not a toll-free call).

**Section 145.—Qualified 501(c)(3) Bond**

*26 CFR 1.103-8(b): Residential rental property.*

For purpose of sections 142(d) and 145(d) of the Code, the ruling provides that the availability of continual or frequent medical, nursing, or psychiatric services in a facility for the residents of the facility will cause the facility to be other than residential rental property. Other non-housing services available in a facility for the residents of the facility generally will not cause the facility to be other than residential rental property. See Rev. Rul. 98-47, page 4.

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

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

**LIFO; price indexes; department stores.** The July 1998 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, July 31, 1998.

**Rev. Rul. 98-48**

The following Department Store Inventory Price Indexes for July 1998 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, July 31, 1998.

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	July 1997	July 1998	Percent Change from July 1997 to July 1998 <sup>1</sup>
1. Piece Goods . . . . .	539.8	547.7	1.5
2. Domestic and Draperies . . . . .	656.1	626.7	-4.5
3. Women's and Children's Shoes . . . . .	641.6	642.3	0.1
4. Men's Shoes . . . . .	902.6	906.5	0.4
5. Infants' Wear . . . . .	637.9	606.8	-4.9
6. Women's Underwear . . . . .	543.5	573.1	5.4
7. Women's Hosiery . . . . .	297.8	307.6	3.3
8. Women's and Girls' Accessories . . . . .	544.5	539.3	-1.0
9. Women's Outerwear and Girls' Wear . . . . .	395.0	389.3	-1.4
10. Men's Clothing . . . . .	621.6	613.4	-1.3
11. Men's Furnishings . . . . .	585.9	589.3	0.6
12. Boys' Clothing and Furnishings . . . . .	495.9	489.4	-1.3
13. Jewelry . . . . .	1003.9	981.5	-2.2
14. Notions . . . . .	797.5	767.3	-3.8
15. Toilet Articles and Drugs . . . . .	905.7	947.6	4.6
16. Furniture and Bedding . . . . .	662.8	683.7	3.2

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

Groups	July 1997	July 1998	Percent Change from July 1997 to July 1998 <sup>1</sup>
17. Floor Coverings .....	598.2	602.1	0.7
18. Housewares .....	807.2	825.5	2.3
19. Major Appliances .....	243.1	238.3	-2.0
20. Radio and Television .....	75.9	71.6	-5.7
21. Recreation and Education <sup>2</sup> .....	109.8	104.3	-5.0
22. Home Improvements <sup>2</sup> .....	132.7	131.2	-1.1
23. Auto Accessories <sup>2</sup> .....	108.6	107.5	-1.0
Groups 1 - 15: Soft Goods .....	594.9	592.1	-0.5
Groups 16 - 20: Durable Goods .....	464.2	464.9	0.2
Groups 21 - 23: Misc. Goods <sup>2</sup> .....	112.5	108.4	-3.6
Store Total <sup>3</sup> .....	549.8	545.9	-0.7

<sup>1</sup>Absence of a minus sign before percentage change in this column signifies price increase.

<sup>2</sup>Indexes on a January 1986=100 base.

<sup>3</sup>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 Stan Michaels of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Michaels on (202) 622-4970 (not a toll-free call).

**Section 846— Discounted  
Unpaid Losses Defined**

Ct.D. 2065

**SUPREME COURT  
OF THE UNITED STATES**

No. 97-147

ATLANTIC MUTUAL INSURANCE  
CO. v. COMMISSIONER OF  
INTERNAL REVENUE

523 U.S. — (1998)

CERTIORARI TO THE UNITED  
STATES COURT OF APPEALS FOR  
THE THIRD CIRCUIT

April 21, 1998

Syllabus

Before enactment of the Tax Reform

Act of 1986, the Internal Revenue Code gave property and casualty (PC) insurers a full deduction for “loss reserves: “ estimated amounts of losses reported but not yet paid, losses incurred but not yet reported, and administrative costs of resolving claims. In each taxable year, not only losses paid, but the full amount of the loss reserves, reduced by the amount of the loss reserves claimed for the prior taxable year, were treated as a business expense. Section 1023 of the 1986 Act required PC insurers, beginning with the 1987 taxable year, to discount unpaid losses to present value when claiming them as a deduction. Requiring insurers to subtract undiscounted year-end 1986 reserves from discounted year-end 1987 reserves in computing 1987 losses would produce artificially low deductions, so the Act included a transitional rule requiring insurers to discount 1986 reserves as well. This rule changed the “method of accounting” for computing taxable income. To avoid requiring PC insurers to recognize as income the difference between undiscounted and discounted year-end 1986 loss reserves, the Act afforded them a “fresh start,” to-wit, an exclusion from taxable income of the difference between undiscounted and discounted year-end 1023(e)(3)(A). It foreclosed the possibil-

ity that they would inflate reserves to manipulate the “fresh start” by excepting “reserve strengthening” from the exclusion. Sec. 1023(e)(3)(B). Treasury Regulation Sec. 1.846-3(c)(3)(ii) defines “reserve strengthening” to include any net additions to reserves. Respondent Commissioner determined that petitioner, Atlantic Mutual Insurance Co., and its subsidiary, a PC insurer, made net additions to loss reserves in 1986, reducing the “fresh start” entitlement and resulting in a tax deficiency. The Tax Court disagreed, holding that “reserve strengthening” refers to only those increases that result from changes in computation methods or assumptions. In reversing, the Third Circuit concluded that the Treasury regulation’s definition of “reserve strengthening” is based on a permissible statutory construction.

*Held:* The Treasury regulation represents a reasonable interpretation of the term “reserve strengthening.” Neither prior legislation nor industry use establishes the plain meaning Atlantic ascribes to that term: reserve increases attributable to changes in methods or assumptions. Since the term is ambiguous, the question is not whether the Treasury regulation represents the best interpretation of the statute, but whether it represents a reason-

able one. See *Cottage Savings Assn. v. Conunissioner*, 499 U.S. 554, 560–561. As a purely linguistic matter, the phrase is broad enough to embrace all increases in the reserve’s amount, for whatever reason and from whatever source. The provision at issue is a limitation upon an extraordinary deduction accorded to PC insurers. There was no need for the deduction to be microscopically fair, and the interpretation adopted in the Treasury regulation seems to be a reasonable accommodation of the competing interests of fairness, administrability, and avoidance of abuse. Given the hundreds (or, more likely, thousands) of claims involved, claims resolved for less than estimated reserves will tend to offset claims that settle for more than estimated reserves. Any discrepancy would not approach the unrealistic proportions claimed by Atlantic. Pp.—

111 F.3d 1056, affirmed.

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

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**SUPREME COURT  
OF THE UNITED STATES**

No. 97–147

ATLANTIC MUTUAL INSURANCE  
CO. v. COMMISSIONER OF  
INTERNAL REVENUE

CERTIORARI TO THE UNITED  
STATES COURT OF APPEALS FOR  
THE THIRD CIRCUIT

April 21, 1998

JUSTICE SCALIA delivered the opinion of the Court.

Property and casualty insurance companies maintain accounting reserves for “unpaid losses.” Under the Tax Reform Act of 1986, increases in loss reserves that constitute “reserve strengthening” do not qualify for a certain one-time tax benefit. We must decide whether the term “reserve strengthening” reasonably encompasses any increase in reserves, or only increases that result from changes in the methods or assumptions used to compute them.

I

Atlantic Mutual Insurance Co. is the common parent of an affiliated group of

corporations, including Centennial Insurance Co., a property and casualty (PC) insurer. From 1985 to 1993, the two corporations (Atlantic) maintained what insurers call “loss reserves.” Loss reserves are estimates of amounts insurers will have to pay for losses that have been reported but not yet paid, for losses that have been incurred but not yet reported, and for administrative costs of resolving claims.

Before enactment of the Tax Reform Act of 1986, Pub.L. 99–514, 100 Stat. 2085, the Internal Revenue Code gave PC insurers a fall deduction for loss reserves as “losses incurred.” In each taxable year, not only losses paid, but the full amount of the loss reserves, reduced by the amount of the loss reserves claimed for the prior taxable year, would be treated as a business expense. 26 U.S.C. Secs. 832(b)(5) and (c)(4) (1982 ed.). This designation enabled the PC insurer to take, in effect, a current deduction for future loss payments without adjusting for the “time value of money” — the fact that “[a] dollar today is worth more than a dollar tomorrow,” D. Herwitz & M. Barrett, *Accounting for Lawyers* 221 (2d ed. 1997). Section 1023 of the 1986 Act amended the Code to require PC insurers, for taxable years beginning after December 31, 1986, to discount unpaid losses to present value when claiming them as a deduction. 100 Stat. 2399, 2404, 26 U.S.C. Secs. 832(b)(5)(A), 846 (1982 ed., Supp. V). Absent a transitional rule, PC insurers would have been left to subtract undiscounted year-end 1986 reserves from discounted year-end 1987 reserves for purposes of computing losses incurred for taxable year 1987 — producing artificially low deductions. The 1986 Act softened this consequence by requiring PC insurers, for purposes of that 1987 tax computation, to discount 1986 reserves as well. 100 Stat. 2404, note following 26 U.S.C. Sec. 846.

Because the requirement that PC insurers discount 1986 reserves changed the “method of accounting” for computing taxable income, PC insurers, absent another transitional rule, would have been required to recognize as income the difference between undiscounted and discounted year-end 1986 loss reserves. See 26 U.S.C. Sec. 481(a) (1988 ed.). To avoid this consequence, Sec. 1023(e)-

(3)(A) of the 1986 Act afforded PC insurers a “fresh start,” to-wit, an exclusion from taxable income of the difference between undiscounted and discounted year-end 1986 loss reserves. 100 Stat. 2404, note following 26 U.S.C. Sec. 846. Of course, the greater the 1986 reserves, the greater the exclusion. Section 1023(e)-(3)(B) of the 1986 Act foreclosed the possibility that insurers would inflate reserves to manipulate the “fresh start” by excepting “reserve strengthening” from the exclusion:

“(B) RESERVE STRENGTHENING IN YEARS AFTER 1985. — Subparagraph (A) [the fresh-start provision] shall not apply to any reserve strengthening in a taxable year beginning in 1986, and such strengthening shall be treated as occurring in the taxpayer’s 1st taxable year beginning after December 31, 1986.” 100 Stat. 2404, note following 26 U.S.C. Sec. 846.

Regulations promulgated by the Treasury Department set forth rules for determining the amount of “reserve strengthening”:

“(1) *In general.* The amount of reserve strengthening (weakening) is the amount that is determined under paragraph (c)(2) or (3) to have been added to (subtracted from) an unpaid loss reserve in a taxable year beginning in 1986. For purposes of section 1023 (e)(3)(B) of the 1986 Act, the amount of reserve strengthening (weakening) must be determined separately for each unpaid loss reserve by applying the rules of this paragraph (c). This determination is made without regard to the reasonableness of the amount of the unpaid loss reserve and without regard to the taxpayer’s discretion, or lack thereof, in establishing the amount of the unpaid loss reserve. . . .

\* \* \* \*

“(3) Accident years before 1986 — (i) *In general.* For each taxable year beginning in 1986, the amount of reserve strengthening (weakening) for an unpaid loss reserve for an accident year before 1986 is the amount by which the reserve at the end of that taxable year exceeds (is less than) —

(A) The reserve at the end of the immediately preceding taxable year; reduced by



(B) Claims paid and loss adjustment expenses paid (“loss payments”) in the taxable year beginning in 1986 with respect to losses that are attributable to the reserve. . . . Treas. Reg. 1.846–3(c), 26 CFR Sec. 1.846–3(c) (1997).

In short, any net additions to reserves (with two exceptions not here at issue, Sec. 1.846–3(c)(3)(ii)) constitute “reserve strengthening” under the regulation.

The Commissioner of Internal Revenue determined that Atlantic made net additions to reserves — “reserve strengthening” — during 1986, reducing the “fresh start” entitlement by an amount that resulted in a tax deficiency of \$519,987. The Tax Court disagreed, holding that Atlantic had not strengthened its reserves. “Reserve strengthening,” the Tax Court held, refers only to increases in reserves that result from changes in the methods or assumptions used to compute them. (Atlantic’s reserve increases, there is no dispute, did not result from any such change.) The United States Court of Appeals for the Third Circuit reversed the Tax Court, concluding that the Treasury regulation’s definition of “reserve strengthening” to include any net additions to reserves is based on a permissible construction of the statute. 111 F.3d 1056 (1997). (It expressly disagreed with the Eighth Circuit’s conclusion in *Western National Mutual Insurance Co. v. Commissioner*, 65 F.3d 90 (1995), that the Treasury regulation is invalid.) We granted certiorari. 522 U.S. — (1997).

## II

The 1986 Act does not define “reserve strengthening.” Atlantic contends that the term has a plain meaning under the statute: reserve increases attributable to changes in methods or assumptions. If that is what the term plainly means, Atlantic must prevail, “for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.” *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842–843 (1984).

Atlantic contends that the plain meaning of “reserve strengthening” can be discerned, first, from its use in the PC insurance industry. It presented at trial two expert reports which, by “constructing a working definition of the term” that requires “a material change in methodology

and/or assumptions,” App. 68, 74, purport to demonstrate that Atlantic “did not strengthen reserves,” *id.* at 99. Our task, of course, is to determine not what the term ought to mean, but what it does mean. Atlantic’s first expert, before “constructing” a definition, expressly acknowledged that “reserve strengthening” is “not a well defined PC insurance or actuarial term of art to be found in PC actuarial, accounting, or insurance regulatory literature.” *Id.* at 60. On this point, she was in agreement with the Commissioner’s experts: “In the property-casualty industry, the term ‘reserve strengthening’ has various meanings, rather than a single universal meaning,” *id.* at 124. If the expert reports establish anything, it is that “reserve strengthening” does not have an established meaning in the PC insurance industry.

Atlantic next contends that a plain meaning can be discerned from prior use of the term in life insurance tax legislation. According to Atlantic, the term has its roots in the Life Insurance Company Income Tax Act of 1959, which provided tax consequences for changes in the “basis” for determining life insurance reserves. 73 Stat. 125, 26 U.S.C. Sec. 810(d) (1958 ed., Supp. 1). But that provision does not define, or for that matter even use, the term “reserve strengthening.” Though the regulation that implemented the provision uses the term “reserve strengthening” in a caption, Treas. Reg. Sec. 1.810–3(a), 26 CFR Sec. 1.810–3(a) (1997), its text does not mention the term, and one of its Examples speaks only of “reserve strengthening attributable to the change in basis which occurred in 1959,” Sec. 1.810–3(b), Ex. 2. If, as Atlantic argues, “basis” and “assumptions or methodologies” are interchangeable terms, Brief for Petitioner 17, n. 8, and a change in basis is necessary for “reserve strengthening,” it is redundant to say “reserve strengthening attributable to the change in basis which occurred in 1959,” much as it would be to say “a sunburn attributable to the sun in 1959.” On Atlantic’s assumptions, the more natural formulation would have been simply “reserve strengthening in 1959.” Thus, the 1959 Act and implementing regulation suggest, if anything, that a change in basis is a sufficient, but not a necessary, condition for “reserve strengthening.”

Atlantic further contends that the term “reserve strengthening” draws a plain meaning from a provision of the Tax Reform Act of 1984 that accorded a “fresh start” adjustment to life insurance reserves. Div. A., 98 Stat. 758, note following 26 U.S.C. Sec. 801 (1984 Act). That provision, like the “fresh start” adjustment for PC insurers in the 1986 Act, said that the “fresh start” would not apply to reserve strengthening, specifically, “to any reserve strengthening reported for Federal income tax purposes after September 27, 1983, for a taxable year ending before January 1, 1984.” 98 Stat. 759. Unlike the 1986 Act, however, the 1984 Act expressly provided that “reserve strengthening” would not be excluded from the “fresh start” if the insurer “employs the reserve practice used for purposes of the most recent annual statement filed before September 27, 1983. . . . *Ibid.* If, as Atlantic contends, reserve strengthening encompasses only reserve increases that result from a change in reserve practices (viz., change in methods or assumptions), the saving clause is superfluous. Thus, to the extent the definition of “reserve strengthening” in the life insurance context is relevant to its meaning here (which is questionable, see 111 F.3d at 1061–1062), the 1984 Act, like the regulations under the 1959 Act, tends to contradict, rather than support, petitioner’s interpretation. We conclude that neither prior legislation nor industry use establishes the plain meaning Atlantic ascribes to “reserve strengthening.”

## III

Since the term “reserve strengthening” is ambiguous, the task that confronts us is to decide not whether the Treasury regulation represents the best interpretation of the statute, but whether it represents a reasonable one. See *Cottage Savings Assn. v. Commissioner*, 499 U.S. 554, 560–561 (1991). We conclude that it does.

As a purely linguistic matter, the phrase is certainly broad enough to embrace all increases in (all “strengthening of”) the amount of the reserve, for whatever reason and from whatever source. Atlantic contends that this interpretation is unreasonable because, in theory, it produces absurd results, as the following example supposedly illustrates: assume that, in 1985, a PC insurer had four case reserves

of \$500 each (total reserves of \$2,000). If two cases settled in 1986 for \$750 each (\$1,500 total), the remaining loss reserve would be \$1,000. Under the regulation, according to Atlantic, the Commissioner would find “reserve strengthening” of \$500 (1986 loss reserves (\$1,000) less (first year reserves (\$2,000) less second year payments (\$1,500))), even though reserves did not increase. The Commissioner denies this consequence, contending that, under the stipulation in this case, the increase in the reserve would be “reduced to zero” by an offsetting adjustment when the payment is made, and that adjustments in the IBNR reserve (reserve for claims “incurred but not reported”) may result from payments in excess of prior reserve amounts, offsetting changes in other reserves. Brief for Respondent 36–39.

We need not resolve that dispute, because we agree with the Commissioner that Atlantic’s horrific example is, in any event, unrealistic. The property and casualty insurer that had only four cases would not be in business very long, with or without the benefit of the tax adjustment — or, if he would, his talents could be put to better use in Las Vegas. The whole point of the insurance business is to spread the insured risk over a large number of cases, where experience and the law of probabilities can be relied upon. And where hundreds (or more likely thousands) of claims are involved, claims resolved for less than estimated reserves will tend to offset claims that settle for more than estimated reserves. See Notice of Proposed Rulemaking Discounted Unpaid Losses, FI-139-86, 1991-2 Cum. Bull. 946, 947 (“For most unpaid loss reserves . . . , any potential inaccuracies are likely to offset each other in the aggregate”). There may, to be sure, be some discrepancy in one direction or the other, but it would not approach the relative proportions claimed by Atlantic. It should be borne in mind that the provision at issue here is a limitation upon an extraordinary deduction accorded to PC insurers. There was certainly no need for that deduction to be microscopically fair, and the interpretation adopted by the Treasury Regulation seems to us a reasonable accommodation — and one that the statute very likely intended — of the competing interests of fairness, administrability, and avoidance of abuse.

\* \* \*

Because the Treasury regulation represents a reasonable interpretation of the term “reserve strengthening,” we affirm the judgment of the Court of Appeals.

*It is so ordered.*

## Section 6621.— Determination of Interest Rate

26 CFR 301.6621-1: Interest rate.

**Interest rates; underpayments and overpayments.** The rate of interest determined under section 6621 of the Code for the calendar quarter beginning October 1, 1998, will be 7 percent for overpayments, 8 percent for underpayments, and 10 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding \$10,000 is 5.5 percent.

### Rev. Rul. 98-46

Section 6621 of the Internal Revenue Code establishes different rates for interest on tax overpayments and interest on tax underpayments. Under § 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 2 percentage points, except the rate for the portion of a corporate overpayment of tax exceeding \$10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under § 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under § 6601 on any large corporate underpayment, the underpayment rate under § 6621(a)(2) is determined by substituting “5 percentage points” for “3 percentage points.” See § 6621(c) and § 301.6621-3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and § 301.6621-3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under § 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of  $\frac{1}{2}$  of 1 percent, the rate is increased to the next highest full percent).

Notice 88-59, 1988-1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under § 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with § 6621 which, pursuant to § 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of July 1998 is 5 percent. Accordingly, an overpayment rate of 7 percent and an underpayment rate of 8 percent are established for the calendar quarter beginning October 1, 1998. The overpayment rate for the portion of a corporate overpayment exceeding \$10,000 for the calendar quarter beginning October 1, 1998, is 5.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning October 1, 1998, is 10 percent. These rates apply to amounts bearing interest during that calendar quarter.

Interest factors for daily compound interest for annual rates of 5.5 percent, 7 percent, 8 percent, and 10 percent are published in Tables 16, 19, 21, and 25 of Rev. Proc. 95-17, 1995-1 C.B. 556, 570, 573, 575, and 579.

Annual interest rates to be compounded daily pursuant to § 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

### DRAFTING INFORMATION

The principal author of this revenue ruling is Raymond Bailey of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Bailey on (202) 622-6226 (not a toll-free call).

TABLE OF INTEREST RATES  
PERIODS BEFORE JUL. 1, 1975 - PERIODS ENDING DEC. 31, 1986  
OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	DAILY RATE TABLE IN 1995-1 C.B.
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25, pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES  
FROM JAN. 1, 1987 - PRESENT

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	TABLE PG	1995-1 C.B.	RATE	TABLE PG	1995-1 C.B.
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623

TABLE OF INTEREST RATES (Continued)

FROM JAN. 1, 1987 - PRESENT

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE TABLE PG			RATE TABLE PG		
	1995-1 C.B.			1995-1 C.B.		
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES FOR  
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 - PRESENT

	RATE TABLE PG		
	1995-1 C.B.		
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577

TABLE OF INTEREST RATES FOR  
LARGE CORPORATE UNDERPAYMENTS (Continued)  
FROM JANUARY 1, 1991 - PRESENT

	RATE TABLE PG 1995-1 C.B.		
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579

TABLE OF INTEREST RATES FOR CORPORATE  
OVERPAYMENTS EXCEEDING \$10,000  
FROM JANUARY 1, 1995 - PRESENT

	RATE TABLE PG 1995-1 C.B.		
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1, 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570

## Section 7623—Expenses of Detection of Underpayments and Fraud, Etc.

26 CFR 301.7623-1: Rewards for information relating to violations of internal revenue laws.

T.D. 8780

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

Rewards for Information  
Relating to Violations of Internal  
Revenue Laws

AGENCY: Internal Revenue Service  
(IRS), Treasury.

ACTION: Final and temporary regula-  
tions.

SUMMARY: This document contains  
final regulations relating to rewards for  
information that relates to violations of  
the internal revenue laws. The regula-  
tions reflect changes to the law made by  
the Taxpayer Bill of Rights 2 and affect  
persons that are eligible to receive an in-  
formant reward.

DATES: *Effective date:* These regula-  
tions are effective August 21, 1998.

*Applicability date:* For dates of applic-  
ability, see §301.7623-1(g).

FOR FURTHER INFORMATION CON-  
TACT: Judith A. Lintz (202) 622-4940  
(not a toll-free number).

SUPPLEMENTARY INFORMATION:

### *Paperwork Reduction Act*

The collections of information con-  
tained in these final regulations have been  
reviewed and approved by the Office of  
Management and Budget in accordance  
with the Paperwork Reduction Act (44  
U.S.C. 3507) under control number  
1545-1534. Responses to these collec-  
tions of information are voluntary with re-  
spect to the provision of information re-  
lating to violations of the internal revenue  
laws, but are required to obtain a benefit  
with respect to filing a claim for reward.

An agency may not conduct or sponsor,  
and a person is not required to respond to,

a collection of information unless it dis-  
plays a valid control number.

The estimated annual burden per re-  
spondent varies from 2 to 4 hours, de-  
pending on individual circumstances,  
with an estimated average of 3 hours.

Comments concerning the accuracy of  
this burden estimate and suggestions for  
reducing this burden should be sent to the  
**Internal Revenue Service**, Attn: IRS Re-  
ports Clearance Officer, OP:FS:FP, Wash-  
ington, DC 20224, and to the **Office of  
Management and Budget**, Attn: Desk  
Officer for the Department of the Trea-  
sury, Office of Information and Regula-  
tory Affairs, Washington, DC 20503.

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

### *Background*

This document contains amendments to  
the Regulations on Procedure and Admin-  
istration (26 CFR Part 301) under section  
7623 relating to rewards for information  
that relates to violations of the internal  
revenue laws. This section was amended  
by section 1209 of the Taxpayer Bill of  
Rights 2 (TBOR 2) (Public Law 104-168,  
110 Stat. 1452 (1996)).

On October 14, 1997, final and tempo-  
rary regulations (TD 8737) relating to in-  
formant rewards under section 7623 were  
published in the **Federal Register** (62  
F.R. 53230). A notice of proposed rule-  
making (REG-252936-96) cross-refer-  
encing the temporary regulations was  
published in the **Federal Register** for the  
same day (62 F.R. 53274).

No written comments responding to the  
notice were received. No public hearing  
was requested or held. The proposed reg-  
ulations under section 7623 are adopted  
as revised by this Treasury decision, and  
the corresponding temporary regulations  
are removed. The revisions are discussed  
below.

### *Explanation of Provisions*

The amendments made by TBOR 2 to  
section 7623 provide that the Secretary  
may pay rewards for information that  
leads to the detection and bringing to trial

and punishment persons guilty of violat-  
ing the internal revenue laws or conniving  
at the same, and for information that leads  
to the detection of underpayments of tax.  
In addition, the amendments to section  
7623 provide that rewards will be paid  
from the proceeds of amounts (other than  
interest) collected by reason of the infor-  
mation provided.

Following the publication of the pro-  
posed regulations, it was determined that  
the regulations should clarify that rewards  
may also be paid in situations where in-  
formation leads to the denial of a claim  
for refund. Therefore, the final regula-  
tions provide that proceeds of amounts  
(other than interest) collected by reason of  
the information provided include both ad-  
ditional amounts collected because of the  
information provided and amounts col-  
lected prior to receipt of the information if  
the information leads to the denial of a  
claim for refund that otherwise would  
have been paid.

### *Special Analyses*

It has been determined that this Trea-  
sury decision is not a significant regula-  
tory action as defined in EO 12866.  
Therefore, a regulatory assessment is not  
required. It has also been determined that  
section 553(b) of the Administrative Pro-  
cedure Act (5 U.S.C. chapter 5) does not  
apply to these regulations.

It is hereby certified that the regulations  
in this document will not have a significant  
economic impact on a substantial number  
of small entities. This certification is based  
on a determination that in the past approx-  
imately 10,000 persons have filed claims  
for reward on an annual basis. Of these  
persons, almost all have been individuals.  
Accordingly, a regulatory flexibility analy-  
sis under the Regulatory Flexibility Act (5  
U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Inter-  
nal Revenue Code, the notice of proposed  
rulemaking preceding these regulations  
was submitted to the Small Business Ad-  
ministration for comment on its impact on  
small businesses.

### *Drafting Information*

The principal author of these regula-  
tions is Judith A. Lintz, Office of Assis-  
tant Chief Counsel (Income Tax and Ac-  
counting). However, other personnel

from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

*Adoption of Amendments to the Regulations*

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

**PART 301—PROCEDURE AND ADMINISTRATION**

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

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

Par. 2. Section 301.7623-1 is revised to read as follows:

*§301.7623-1 Rewards for information relating to violations of internal revenue laws.*

(a) *In general.* In cases where rewards are not otherwise provided for by law, a district or service center director may approve a reward, in a suitable amount, for information that leads to the detection of underpayments of tax, or the detection and bringing to trial and punishment of persons guilty of violating the internal revenue laws or conniving at the same. The rewards provided for by section 7623 and this section will be paid from the proceeds of amounts (other than interest) collected by reason of the information provided. For purposes of section 7623 and this section, proceeds of amounts (other than interest) collected by reason of the information provided include both additional amounts collected because of the information provided and amounts collected prior to receipt of the information if the information leads to the denial of a claim for refund that otherwise would have been paid.

(b) *Eligibility to file claim for reward—*

(1) *In general.* Any person, other than certain present or former federal employees described in paragraph (b)(2) of this section, that submits, in the manner described in paragraph (d) of this section, information relating to the violation of an internal revenue law is eligible to file a claim for reward under section 7623 and this section.

(2) *Federal employees.* No person who was an officer or employee of the Department of the Treasury at the time the indi-

vidual came into possession of information relating to violations of the internal revenue laws, or at the time the individual divulged such information, is eligible for a reward under section 7623 and this section. Any other current or former federal employee is eligible to file a claim for reward if the information provided came to the individual's knowledge other than in the course of the individual's official duties.

(3) *Deceased informants.* A claim for reward may be filed by an executor, administrator, or other legal representative on behalf of a deceased informant if, prior to the informant's death, the informant was eligible to file a claim for such reward under section 7623 and this section. Certified copies of the letters testamentary, letters of administration, or other similar evidence must be attached to the claim for reward on behalf of a deceased informant in order to show the authority of the legal representative to file the claim.

(c) *Amount and payment of reward.* All relevant factors, including the value of the information furnished in relation to the facts developed by the investigation of the violation, will be taken into account by a district or service center director in determining whether a reward will be paid, and, if so, the amount of the reward. The amount of a reward will represent what the district or service center director deems to be adequate compensation in the particular case, generally not to exceed fifteen percent of the amounts (other than interest) collected by reason of the information. Payment of a reward will be made as promptly as the circumstances of the case permit, but not until the taxes, penalties, or fines involved have been collected. However, if the informant waives any claim for reward with respect to an uncollected portion of the taxes, penalties, or fines involved, the claim may be immediately processed. Partial reward payments, without waiver of the uncollected portion of the taxes, penalties, or fines involved, may be made when a criminal fine has been collected prior to completion of the civil aspects of a case, and also when there are multiple tax years involved and the deficiency for one or more of the years has been paid in full. No person is authorized under this section to make any offer, or promise, or otherwise

to bind a district or service center director with respect to the payment of any reward or the amount of the reward.

(d) *Submission of information.* A person that desires to claim a reward under section 7623 and this section may submit information relating to violations of the internal revenue laws, in person, to the office of a district director, preferably to a representative of the Criminal Investigation Division. Such information may also be submitted in writing to the Commissioner of Internal Revenue, Attention: Assistant Commissioner (Criminal Investigation), 1111 Constitution Avenue, NW., Washington, DC 20224, to any district director, Attention: Chief, Criminal Investigation Division, or to any service center director. If the information is submitted in person, either orally or in writing, the name and official title of the person to whom it is submitted and the date on which it is submitted must be included in the formal claim for reward.

(e) *Identification of informant.* No unauthorized person will be advised of the identity of an informant.

(f) *Filing claim for reward.* An informant that intends to claim a reward under section 7623 and this section should notify the person to whom the information is submitted of such intention, and must file a formal claim on Form 211, Application for Reward for Original Information, signed by the informant in the informant's true name, as soon as practicable after the submission of the information. If other than the informant's true name was used in furnishing the information, satisfactory proof of identity as that of the informant must be included with the claim for reward.

(g) *Effective date.* This section is applicable with respect to rewards paid after January 29, 1997.

**§301.7623-1T [Removed]**

Par. 3. Section 301.7623-1T is removed.

**PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (c) is amended by removing the entry for

301.7623-1T from the table and by revising the entry for 301.7623-1 to read as follows:

§602.101 OMB Control numbers.

\* \* \* \* \*

(c) \* \* \*

CFR part or section where identified and described	Current OMB control No.
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\* \* \* \* \*

301.7623-1 . . . . .	1545-0409 1545-1534
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\* \* \* \* \*

Michael P. Dolan,  
*Deputy Commissioner of Internal Revenue.*

Approved July 20, 1998.

Donald C. Lubick,  
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on August 20, 1998, 8:45 a.m., and published in the issue of the Federal Register for August 21, 1998, 63 F.R. 44777)



## Part III. Administrative, Procedural, and Miscellaneous

### Weighted Average Interest Rate Update

#### Notice 98-48

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of

interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103-465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for August 1998 is 5.54 percent.

The following rates were determined for the plan years beginning in the month shown below.

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Month	Year	Weighted Average	90% to 106% Permissible Range	90% to 110% Permissible Range
September	1998	6.46	5.82 to 6.85	5.82 to 7.11

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### Drafting Information

The principal author of this notice is Donna Prestia of the Employee Plans Di-

vision. For further information regarding this notice, call (202) 622-6076 between 2:30 and 3:30 p.m. Eastern time (not a

toll-free number). Ms. Prestia's number is (202) 622-7473 (also not a toll-free number).

## Part IV. Items of General Interest

### Notice of Proposed Rulemaking and Notice of Public Hearing

### Return Requirement for United States Persons Owning Interests in Foreign Partnerships

REG-209060-86

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 6046A of the Internal Revenue Code relating to return requirements for certain United States persons who acquire or dispose of an interest in a foreign partnership, or whose interest in a foreign partnership changes substantially. These proposed regulations would provide guidance to United States persons who must file such a return. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by November 9, 1998. Outlines of topics to be discussed at the public hearing scheduled for November 10, 1998, at 10 a.m., must be received by October 20, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-209060-86), 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:DOM:CORP:R (REG-209060-86), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html).

A public hearing has been scheduled to be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Christopher Kelley, 202-622-3860; concerning the hearing and submissions of written comments, Michael Slaughter, 202-622-7190 (not toll-free calls).

### 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**, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attention: IRS Reports Clearance Officer OP:FS:FP, Washington, DC 20224. Comments on the collection of information must be received by November 9, 1998. Comments are specifically requested on:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, 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 the capital or start-up costs of operation, maintenance, and purchase of services to provide information.

The collection of information in these regulations is in §1.6046A-1. This information is required by the IRS to identify United States persons with significant interests in foreign partnerships and to ensure the correct reporting of items with re-

spect to these interests. The collection of information is mandatory. The likely respondents will be individuals and businesses or other for-profit organizations.

The burden of complying with the proposed collection of information required to be reported on Form 8865 is reflected in the burden for Form 8865.

The burden of complying with the proposed collection of information in §1.6046A-1(f)(1)(ii) is as follows:

Estimated total annual reporting burden: 250 hours.

Estimated annual burden per respondent: .25 hours to 1 hour, with an average of .5 hours.

Estimated number of respondents: 500.

Estimated 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*

##### *Taxpayer Relief Act of 1997*

In the Taxpayer Relief Act of 1997 (TRA 1997), Public Law 105-34 (111 Stat. 983 (1997)), Congress significantly modified the information reporting requirements with respect to foreign partnerships under sections 6038, 6038B and 6046A (and also amended section 6501(c)(8) to provide that the statute of limitations on the assessment of tax under section 6038, 6038B and 6046A does not expire until three years after the information required under those sections is reported). These regulations under section 6046A are being proposed along with regulations under sections 6038 (reporting with respect to certain foreign partnerships) and 6038B (reporting of certain transfers to foreign partnerships). The IRS is also developing a comprehensive

form (Form 8865) for reporting under all of these provisions. A draft version of the form will be issued for public comment while the proposed regulations are outstanding.

#### *Section 6046A*

Section 6046A was added to the Internal Revenue Code (Code) by section 405 of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Public Law 97-248 (96 Stat. 669 (1982)), and, prior to amendment by TRA 1997, required reporting of acquisitions and dispositions of interests in foreign partnerships as well as of substantial changes in proportional interests in such partnerships. Section 1143 of TRA 1997, Public Law 105-34 (111 Stat. 983 (1997)), amended section 6046A, to provide that reporting is required only when the interest acquired, disposed of, or substantially changed is at least a 10-percent interest in the partnership.

#### *Explanation of Provisions*

##### *Filing Requirement*

The proposed regulations require a United States person to report the information required under section 6046A with respect to a "reportable event" on Form 8865, "Information Return of U.S. Persons With Respect To Certain Foreign Partnerships". The proposed regulations follow the statute and define a reportable event to mean (1) an acquisition by a United States person of at least a 10-percent interest in a foreign partnership, (2) a disposition by a United States person of at least a 10-percent interest in a foreign partnership, or (3) a change in a United States person's proportional interest in a foreign partnership that is equivalent to at least a 10-percent interest in the partnership. However, the proposed regulations exclude from the definition of a reportable event any acquisition of an interest in, or change in proportional interest in a foreign partnership resulting from a transfer by a partner also subject to the reporting requirements under section 6038B.

Under section 6046A(d), a 10-percent interest is defined by cross-reference to section 6038(e)(3)(C) and regulations issued under that provision, and means direct or indirect ownership of an interest

equal to 10 percent of the capital interest or profits interest in a partnership, and an interest to which 10 percent of the deductions or losses of a partnership are allocated.

#### *Partnerships Excluded From Application of Subchapter K*

The reporting requirements of this section shall not apply in respect of any foreign partnership which is an eligible partnership described in §1.761-2(a) that has validly elected pursuant to §1.761-2(b)(2)(i) to be wholly excluded from the application of subchapter K. Nor shall the reporting requirements of these proposed regulations apply to any foreign partnership validly deemed to have wholly elected out of the provisions of subchapter K as specified in §1.761-2(b)(2)(ii). Taxpayers are reminded, however, that a precondition to being an "electing-out" partnership is that, as provided in §1.761-2(a)(1), "[t]he members of such organization must be able to compute their income without the necessity of computing partnership taxable income." The IRS and Treasury are concerned that in certain cases the necessary books and records are not being maintained to allow verification that such computations can indeed be made without regard to the partnership. If it appears that, in the absence of a reporting requirement under this section, the members of the "electing-out" partnership cannot make such separate computations, this exception to the reporting requirements will be reconsidered.

#### *Exception for Certain International Satellite Partnerships*

The proposed regulations contain an exception to the filing requirement for certain international satellite partnerships. Section 406 of TEFRA provides that section 6031 and 6046A do not apply to the International Telecommunications Satellite Organization, the International Maritime Satellite Organization, or any organization which is a successor of either organization. Although the International Maritime Satellite Organization has been subsequently renamed the International Mobile Satellite Organization, no legislation has been enacted that would eliminate the exception provided by section 406 of TEFRA.

#### *Time and Place for Filing Return*

Section 6046A(c) provides that any return required by section 6046A(a) must be filed on or before the 90th day after the day on which the United States person becomes liable to file it, or on or before a later day prescribed in regulations. After section 6046A was enacted, the IRS announced that the regulations would provide that any return would be considered timely filed if filed on or before the 90th day following the date of publication of the regulations, even if the date of filing was more than 90 days after a reportable event. Announcement 83-5 (1983-2 I.R.B. 31). Thus, no returns under section 6046A have been required to be filed to date.

Rather than require a return to be made within a specified period after a reportable event, under the proposed regulations a return under section 6046A would generally be required to be filed with the United States person's income tax return for the taxable year during which a reportable event occurs (or on the Form 8865 for the foreign partnership's taxable year in which the reportable event occurs (filed in accordance with §§1.6038-3(e) and (h)) if the United States person is also required to report under proposed regulation §1.6038-3(a)). However, a return for a reportable event would not be required to be filed before the 90th day after the event. A reportable event occurring within 90 days of the due date for a taxpayer's return may be reported on a Form 8865 filed with that return, or may be reported on a separate Form 8865 filed with the taxpayer's return for the next taxable year. If required by the instructions to Form 8865, a duplicate return under section 6046A must also be filed.

In certain circumstances, the proposed regulations would also eliminate the need for two or more United States persons to file Form 8865 with respect to the same reportable event in the case of attribution of ownership.

#### *Effective Dates*

The proposed regulations are generally effective for reportable events occurring on or after January 1, 1998. The proposed regulations would relieve a United States person from having to file a return under

section 6046A for reportable events occurring prior to January 1, 1998. Furthermore, the return period for reportable events occurring on or before the date that final regulations are published in the **Federal Register** would generally be extended for one taxable year.

### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 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 proposed regulations. It is hereby certified that the collection of information contained in these proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time required to complete the form and file the information required under these regulations is brief and will not have a significant impact on those small entities that are required to provide notification. Furthermore, the number of small entities that will be required to file the form is not significant. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these 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*

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 Internal Revenue Service. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for Tuesday, November 10, 1998, at 10 a.m., in room 2615, 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 15 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 written comments and an outline of the topics to be discussed (preferably a signed original and eight (8) copies) by October 20, 1998.

A period of 10 minutes will be allotted for each person 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 Christopher Kelley 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 \* \* \*

*Section 1.6046A-1 also issued under 26 U.S.C. 6046A. \* \* \**

Par. 2. Section 1.6046A-1 is added to read as follows:

*§1.6046A-1 Return requirement for United States persons owning interests in foreign partnerships.*

(a) *Return requirement*—(1) *General rule.* If a reportable event occurs with respect to the interest of a United States person in a foreign partnership, the United States person is required to report the event on Form 8865, "Information Return of U.S. Persons With Respect To Certain Foreign Partnerships", except as provided in paragraphs (b)(1)(ii), (e), (g) or (h) of this section.

(2) *Separate return for each partnership.* If a United States person is required under section 6046A and this section to report an event with respect to an interest

in more than one foreign partnership, the United States person must file a separate return for each partnership.

(b) *Definitions*—(1) *Reportable event*—(i) *General rule.* For purposes of section 6046A and this section, a *reportable event* means—

(A) An acquisition by a United States person of at least a 10-percent interest in a foreign partnership;

(B) A disposition by a United States person of at least a 10-percent interest in a foreign partnership; or

(C) Any change in a United States person's proportional interest in a foreign partnership that is equivalent to at least a 10-percent interest in the partnership.

(ii) *Exception.* If a United States person acquires an interest in a foreign partnership (or the amount of such interest changes) as a result of a transfer subject to the reporting requirements under section 6038B, the United States person will not be required to also report the acquisition (or change) under section 6046A(a).

(2) *10-percent interest.* Under section 6046A and this section, a *10-percent interest* in a partnership is an interest described in section 6038(e)(3)(C) and the regulations thereunder.

(3) *United States person.* *United States person* means a person described in section 7701(a)(30).

(4) *Foreign partnership.* *Foreign partnership* means any partnership that is a foreign partnership under sections 7701(a)(2) and (5).

(c) *Content of return.* In respect of acquisitions and dispositions of, and changes in interest described in section 6046A(a), the return must contain information in such form or manner as Form 8865 (and its accompanying instructions) prescribes with respect to reportable events, including—

(1) The name, address, and taxpayer identification number of the United States person required to file the return;

(2) The name, address, and taxpayer identification number, if any, of the foreign partnership;

(3) The name of the country under the laws of which the foreign partnership was organized, and the date of formation;

(4) For each reportable event, the date of the event, the type of event (acquisition, disposition, or change in partnership interest), and the United States person's

percentage interest in the foreign partnership before and after the event; and

(5) For an acquisition, disposition or change affecting the United States person's interest in partnership capital, profits, losses, or deductions, the fair market value of the interest acquired, disposed of, or changed.

(d) *Time and manner for filing returns*—(1) *General rule.* Except as provided in paragraph (d)(2) of this section, the Form 8865 must be filed with the income tax return (including a partnership return of income) of the United States person for the taxable year in which the reportable event occurs, and must be filed by the due date (including extensions) of the income tax return.

(2) *Exceptions*—(i) *United States person also required to file under §1.6038-3(a).* If the United States person required to file under this section is also required to file under §1.6038-3(a) for the period in which the reportable event occurred, then the United States person must report under this section on the Form 8865 for the foreign partnership's annual accounting period in which the reportable event occurred (not its own taxable year) and file with its income tax return for that year as provided in §1.6038-3(e) and (h).

(ii) *Reportable event less than 90 days before the due date of the United States person's income tax return.* If the date of a reportable event is less than 90 days before the due date of the United States person's income tax return for the taxable year in which the reportable event occurred, the United States person may file the Form 8865 in respect of that reportable event with its income tax return for that taxable year, or may file a separate Form 8865 in respect of that reportable event with its income tax return for the next taxable year.

(3) *Duplicate returns.* If required by the instructions to Form 8865, a duplicate Form 8865 (including attachments and schedules) must also be filed.

(e) *Persons excepted from filing return*—(1) *Requirements.* A United States person otherwise required to file a return under this section with respect to a foreign partnership need not file a return provided all of the following conditions are met—

(i) The person does not directly own an interest in the foreign partnership;

(ii) The person is required to file a return solely by reason of attribution of ownership from a United States person (as determined under the rules of section 6038(e)(3) and the regulations thereunder); and

(iii) A person from whom ownership is attributed furnishes all of the information required under this section with respect to the reportable event.

(2) *Statement required.* A United States person who does not furnish an information return under the provisions of paragraph (e)(1) of this section must file a statement with the person's income tax return—

(i) Indicating that the filing requirement has been or will be satisfied;

(ii) Identifying the person who has or will file the return;

(iii) Identifying the IRS Service Center where the return was or will be filed; and

(iv) Providing any additional information as Form 8865 and the accompanying instructions may require.

(f) *Method of Reporting.* Except as otherwise provided on Form 8865, or the accompanying instructions, any amounts required to be reported under section 6046A and this section must be expressed in United States dollars, with a statement of the exchange rates used. All statements required on or with Form 8865 pursuant to this section must be in the English language.

(g) *Reporting under this section not required of partnerships excluded from the application of subchapter K*—(1) *Election to be wholly excluded.* The reporting requirements of this section will not apply to any United States person in respect of an eligible partnership as described in §1.761-2(a) in which that United States person is a partner, if such partnership has validly elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in the manner specified in §1.761-2(b)(2)(i).

(2) *Deemed excluded.* The reporting requirements of this section will not apply to any United States person in respect of an eligible partnership as described in §1.761-2(a) in which that United States person is a partner, if such partnership is validly deemed to have elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in accordance with the provisions of §1.761-2(b)(2)(ii).

(h) *Exclusion for satellite organizations.* The return requirement of section 6046A does not apply to the International Telecommunications Satellite Organization (or a successor organization) or the International Mobile Satellite Organization (or any other organization that is a successor to the International Maritime Satellite Organization).

(i) *Failure to comply with reporting requirements*—(1) *Failure to comply.* A failure to comply with the requirements of section 6046A includes—

(i) The failure to report at the proper time and in the proper manner any information required to be reported under the rules of this section; and

(ii) The provision of false or inaccurate information in purported compliance with the requirements of this section.

(2) *Penalties.* For penalties for failure to comply with the reporting requirements of section 6046A and this section, see sections 6679 and 7203.

(3) *Statute of limitations.* For exceptions to the limitations on assessment and collection in the event of a failure to provide information under section 6046A, see section 6501(c)(8).

(j) *Effective date*—(1) *General rule.* This section applies to reportable events occurring on or after January 1, 1998.

(2) *Reportable event prior to issuance of final regulations.* If a reportable event occurs on or before the date final regulations on this subject are published in the **Federal Register**, the Form 8865 may be filed with the United States person's timely filed (including extensions) income tax return for the taxable year immediately following the taxable year in which the reportable event occurs.

Michael P. Dolan,  
Deputy Commissioner of  
Internal Revenue.

(Filed by the Office of the Federal Register on September 8, 1998, 8:45 a.m., and published in the issue of the Federal Register for September 9, 1998, 63 F.R. 48154)

Notice of Proposed Rulemaking  
Revision of the Tax Refund  
Offset Program

REG-104565-97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the administration of the Tax Refund Offset Program (TROP). This action is necessary because TROP, which is currently administered by the IRS, is being merged into the centralized administrative offset program known as the Treasury Offset Program (TOP), which is administered by the Financial Management Service (FMS). These regulations will affect State and Federal agencies that participate in TROP.

DATES: Written comments and requests for a public hearing must be received by November 30, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-04565-97), 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:DOM:CORP:R (REG-104565-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html).

FOR FURTHER INFORMATION CONTACT: John J. McGreevy, (202) 622-4910 (not toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to section 6402(c) and (d). The proposed regulations contain revised effective dates for the regulations under section 6402(c) and (d).

##### *Explanation of Provisions*

Section 6402(c) provides, in general, that the amount of any overpayment to be

refunded to the person making the overpayment must be reduced by the amount of any past-due support (as defined in section 464(c) of the Social Security Act) owed by that person of which the Secretary has been notified by a State in accordance with section 464 of the Social Security Act.

Section 6402(d) provides, in general, that upon receiving notice from any Federal agency that a named person owes a past-due, legally enforceable debt to that agency, the Secretary must reduce the amount of any overpayment payable to that person by the amount of the debt, pay the amount by which the overpayment is reduced to the agency, and notify the person making the overpayment that the overpayment has been reduced.

The IRS currently makes offsets pursuant to section 6402(c) and (d) according to regulations prescribed under those sections. See §§301.6402-5 and 301.6402-6 of the Regulations on Procedure and Administration.

Section 31001(v)(2) and (w) of the Debt Collection Improvement Act of 1996 (110 Stat. 1321-375), amended 42 U.S.C. 664(a)(2)(A) and 31 U.S.C. 3720A(h), respectively, to clarify that the disbursing agency of the Treasury Department may conduct tax refund offsets. The disbursing agency of the Treasury Department is the FMS.

The IRS and FMS have agreed that the Tax Refund Offset Program (TROP), which is currently administered by the IRS, will be merged into the centralized administrative offset program known as the Treasury Offset Program (TOP), which is administered by the FMS. The merger of the two programs is intended to maximize and improve the Treasury Department's government-wide collection of nontax debts, including those subject to offset against the debtor's Federal tax refund. The full merger of TROP with TOP is expected to occur by January 1, 1999.

Interim rules concerning the manner in which the FMS will administer the collection of nontax federal debts after the merger of TROP with TOP were published by the FMS in the **Federal Register** on June 25, 1997 (62 F.R. 34175) (codified at 31 CFR Part 285) effective for refunds payable after January 1, 1998. The regulations proposed in this document provide an ending effective date for §301.6402-6

to accommodate the beginning effective date of the FMS regulations. Accordingly, §301.6402-6 will not apply to refunds payable after January 1, 1998.

A notice of proposed rulemaking concerning the manner in which the FMS will administer the collection of past-due child support payments was published by the FMS in the **Federal Register** on August 4, 1998 (63 F.R. 41688) (which when finalized will be codified at 31 CFR Part 285), effective for refunds payable after January 1, 1999. The regulations in this document provide an ending effective date for §301.6402-5 to accommodate the expected beginning date for the full merger of TROP with TOP. Accordingly, it is expected that §301.6402-5 will not apply to refunds payable after January 1, 1999.

##### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this 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 Requests for a Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies of written comments) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

*Drafting Information*

The principal author of these regulations is John J. McGreevy, Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and the Treasury Department participated in the development of the regulations.

\* \* \* \* \*

*Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

**PART 301—PROCEDURE AND ADMINISTRATION**

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

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

Par. 2. Section 301.6402-5 is amended by adding paragraph (h) to read as follows:

*§301.6402-5 Offset of past-due support against overpayments.*

\* \* \* \* \*

(h) *Effective dates.* This section applies to refunds payable on or before January 1, 1999. For the rules applicable after January 1, 1999, see 31 CFR part 285.

Par. 3. Section 301.6402-6 is amended by revising paragraph (n) to read as follows:

*§301.6402-6 Offset of past-due, legally enforceable debt against overpayment.*

\* \* \* \* \*

(n) *Effective dates.* This section applies to refunds payable under section 6402 after April 15, 1992, and on or before January 1, 1998. For the rules applicable after January 1, 1998, see 31 CFR part 285.

Michael P. Dolan,  
*Deputy Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on August 28, 1998, 8:45 a.m., and published in the issue of the Federal Register for August 31, 1998, 63 F.R. 46205)

Notice of Proposed Rulemaking and Notice of Public Hearing

Notice of Certain Transfers to Foreign Partnerships and Foreign Corporations

REG-118926-97

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 6038B of the Internal Revenue Code on information reporting requirements for certain transfers by United States persons to foreign partnerships. The proposed regulations would implement the amendments made by the Taxpayer Relief Act of 1997 that require a United States person who transfers property to a foreign partnership to furnish certain information with respect to such transfers. This document also contains proposed regulations that would amend the information reporting requirements for certain transfers by United States persons to foreign corporations to require the reporting of the transfer of cash. The proposed regulations would provide guidance to United States persons who must furnish this information. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by November 9, 1998. Outlines of topics to be discussed at the public hearing scheduled for November 10, 1998, at 10 a.m., must be received by October 20, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-118926-97), 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:DOM:CORP:R (REG-118926-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly

to the IRS Internet site at: [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html).

A public hearing has been scheduled to be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning transfers of cash to foreign corporations, Philip L. Tretiak, and concerning transfers to foreign partnerships, Christopher Kelley, 202-622-3860; concerning the hearing and submissions of written comments, Michael Slaughter, 202-622-7190 (not toll-free calls).

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**, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attention: IRS Reports Clearance Officer OP:FS:FP, Washington, DC 20224. Comments on the collection of information must be received by November 9, 1998. Comments are specifically requested on:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, 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 the capital or start-up costs of operation, maintenance, and purchase of services to provide information.

The collection of information in these regulations is in §§1.6038B-1(b) and 1.6038B-2. This information is required by the IRS to identify United States persons who contribute property to foreign partnerships and to ensure the correct reporting of items with respect to those partnerships. The collection of information is mandatory. The likely respondents will be individuals and businesses or other for-profit organizations.

The burden of complying with the proposed collection of information required to be reported on Form 8865 is reflected in the burden for Form 8865.

The burden of complying with the proposed collection of information required to be reported on Form 926 is reflected in the burden for Form 926.

The burden of complying with the proposed collection of information in §1.6038B-2(f)(2) is as follows:

Estimated total annual reporting burden: 250 hours.

Estimated annual burden per respondent: 0.25 hours to 1 hour, with an average of 0.5 hours.

Estimated number of respondents: 500.

Estimated frequency of responses: Once per year.

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*

### *Taxpayer Relief Act of 1997*

In the Taxpayer Relief Act of 1997 (TRA 1997), Public Law 105-34 (111 Stat. 983 (1997)), Congress significantly modified the information reporting requirements with respect to foreign partnerships under sections 6038, 6038B and 6046A (and also amended section 6501(c)(8) to provide that the statute of limitations on the assessment of tax under section 6038, 6038B and 6046A does not expire until three years after the information required under those sections is re-

ported). Certain of these modifications also affect reporting requirements with respect to foreign corporations. These regulations under section 6038B are being proposed along with regulations under sections 6038 (reporting with respect to certain foreign partnerships) and 6046A (reporting of certain ownership interests in foreign partnerships). The IRS is also developing a comprehensive form (Form 8865) for reporting under all of these provisions. A draft version of the form will be issued for public comment while the proposed regulations are outstanding.

### *Section 6038B and Transfers to Foreign Corporations*

Section 6038B, as enacted in 1984, provided that United States persons that made certain transfers of property to foreign corporations were required to report those transfers in the manner prescribed by regulations. Prior to the enactment of TRA 1997, section 6038B imposed a penalty for failure to comply with the regulations equal to 25 percent of the gain realized on the exchange, unless the failure was due to reasonable cause and not to willful neglect. Thus, in the case of a transfer of cash or other unappreciated property to a foreign corporation, no penalty was imposed under section 6038B if the transfer was not reported.

Section 1144(c) of TRA 1997 modified the penalty applicable to the failure to furnish information required to be reported under section 6038B. The modified penalty is equal to 10 percent of the fair market value of the property at the time of the transfer.

In response to TRA 1997, Treasury and the IRS issued final regulations under section 6038B (TD 8770 at 63 F.R. 33568; June 19, 1998), in conjunction with regulations under section 367(a), to clarify that transfers to corporations of unappreciated property other than cash that occur on or after July 20, 1998, generally are required to be reported in accordance with §1.6038B-1(b). The preamble to the final regulations stated that rules regarding transfers of cash to foreign corporations would be provided in future regulations.

### *Section 6038B and Transfers to Foreign Partnerships*

Prior to the enactment of TRA 1997, section 1491 imposed an excise tax on

certain transfers of property by United States persons to foreign corporations, partnerships, estates, or trusts. The tax was equal to 35 percent of the fair market value of the property transferred in excess of adjusted basis and any gain recognized on the transfer (built-in gain). Section 1494(c), effective for transfers made after August 20, 1996, imposed a further penalty for a failure to report.

Section 1131(a) of TRA 1997 repealed sections 1491 through 1494. Section 1144 of TRA 1997 amended section 6038B to require a United States person who transfers property to a foreign partnership to report the transfer in the time and manner provided in regulations. The 1997 amendments apply to transfers of property made after August 5, 1997. Notice 98-17 (1998-11 C.B. 6) provided the manner of reporting a transfer under section 6038B made after August 5, 1997, and before January 1, 1998.

### *Explanation of Provisions*

#### *Reporting of Cash Transfers to Foreign Corporations*

These proposed regulations provide that transfers of cash to foreign corporations are required to be reported if the U.S. transferor holds, immediately after the transfer, directly or indirectly, a 10-percent interest in the foreign corporation, or the amount of the cash transferred by the transferor or any related person to such foreign corporation or a related foreign corporation during the 12-month period ending on the date of the transfer exceeds \$100,000. The transfer of cash to a foreign corporation will not be required to be reported unless made in a taxable year beginning after the date that final regulations requiring reporting are published in the **Federal Register**.

The IRS and Treasury invite comments on these requirements and the corresponding requirement for foreign partnerships, including a description of the types of transfers which could appropriately be excepted (for example, capital contributions and returns of cash made as part of the normal course of business operations).

#### *Reporting of Transfers to Foreign Partnerships*

The proposed regulations would implement the rules of section 6038B by gener-



ally requiring that a United States person that transfers property (including cash) to a foreign partnership in a contribution described in section 721 in exchange for a partnership interest, file a return on Form 8865 "Information Return of U.S. Persons With Respect To Certain Foreign Partnerships", reporting the transfer. Under the statutory exceptions in section 6038B(b)(1), a United States person must report such a contribution only if (1) the United States person holds (immediately after the transfer), directly or indirectly, at least a 10-percent interest in the partnership, or (2) the value of the property transferred (when added to the value of the property transferred by such person to the partnership within the preceding 12 months) exceeds \$100,000 (including the value of property transferred in any transfer not described in section 721, a principal purpose of which is the avoidance of the reporting requirements of these regulations). The proposed regulations would also require a transferor, if still a partner, to notify the IRS when a foreign partnership disposes of appreciated property contributed by the transferor. This information will help in determining whether built-in gain has been properly allocated to and recognized by the U.S. transferor. The proposed regulations provide that certain indirect transferors need not report under this section if certain conditions are met.

A 10-percent interest is defined by cross-reference to section 6046A(d), which in turn cross-references section 6038(e)(3)(C) and regulations issued under that provision. The term means direct or indirect ownership of an interest equal to 10 percent of the capital interest or profits interest in a partnership, and an interest to which 10 percent of the deductions or losses of a partnership are allocated.

#### *Partnerships Excluded From Application of Subchapter K*

The reporting requirements of this section shall not apply in respect of any foreign partnership which is an eligible partnership described in §1.761-2(a) that has validly elected pursuant to §1.761-2(b)-(2)(i) to be wholly excluded from the application of subchapter K. Nor shall the reporting requirements of these proposed regulations apply to any foreign partner-

ship validly deemed to have wholly elected out of the provisions of subchapter K as specified in §1.761-2(b)(2)(ii). Taxpayers are reminded, however, that a precondition to being an "electing-out" partnership is that, as provided in §1.761-2(a)(1), "[t]he members of such organization must be able to compute their income without the necessity of computing partnership taxable income." The IRS and Treasury are concerned that in certain cases the necessary books and records are not being maintained to allow verification that such computations can indeed be made without regard to the partnership. If it appears that, in the absence of a reporting requirement under this section, the members of the "electing-out" partnership cannot make such separate computations, this exception to the reporting requirements will be reconsidered.

#### *Reporting of Cash Transfers to Foreign Partnerships*

The proposed regulations require the reporting of a cash transfer to a foreign partnership in a contribution otherwise required to be reported under section 6038B and these regulations. Such transfers were required to be reported under Notice 98-17. Reporting of cash transfers will help to ensure that any earnings and appreciation attributable to the cash are reported by the U.S. transferor, and help to prevent United States persons from avoiding the rules applicable to foreign trusts. As noted above with respect to cash contributions to foreign corporations, Treasury and the IRS are interested in receiving comments on specific issues in addition to general comments on this requirement.

#### *Information Required*

The proposed regulations would require a United States person to provide certain information with respect to property transferred in a reportable contribution. Appreciated property and intangible property must be listed item by item on the Form 8865. Other items of property may be aggregated and listed according to the following categories: (1) inventory; (2) other tangible trade or business property; (3) cash; (4) securities; and (5) other property.

The proposed regulations provide that a United States person reporting a transfer

to a foreign partnership under section 6038B must identify the other partners in the partnership. This allows the IRS, for example, to determine whether built-in gain is being properly allocated to and recognized by the U.S. transferor under section 704(c). The proposed regulations except from this rule a United States person only required to report because of a transfer of cash, if the transferor holds less than a 10-percent interest in the partnership immediately following the transfer.

#### *Time and Place for Filing*

The proposed regulations would require Form 8865 to be filed with the United States person's income tax return (including a partnership return of income) for the year in which the reportable contribution occurs. However, if the transferor is also required to report under proposed regulation §1.6038-3(a), then the transfer must be reported on the Form 8865 (and filed in accordance with §§1.6038-3(e) and (h)) for the foreign partnership's taxable year in which the reportable contribution occurs. Additionally, if required by the instructions to Form 8865, a duplicate Form 8865 must also be filed. The proposed regulations would provide alternative filing deadlines with respect to reportable contributions that occur on or before the date final regulations on this subject are published in the **Federal Register** (see **Effective Dates** portion of this preamble).

#### *Failure to Provide Information*

Section 6038B(c)(1) and the proposed regulations provide that a failure by the transferor to properly report a transfer that is required to be reported under section 6038B and these regulations is subject to a penalty equal to 10 percent of the fair market value of the property transferred. This penalty is subject to a \$100,000 limit under section 6038B(c)(3), unless the failure is due to intentional disregard. In addition, the transferor must recognize gain (reduced by gain recognized, with respect to that property, by the transferor after the transfer) as if the property had been sold for its fair market value at the time of the transfer. In addition, section 6501(c)(8) keeps the statute of limitations open with respect to the transferor in the case of a failure to report. Any adjust-

ments to the basis of the partnership or any partner (direct or indirect) as a result of the gain recognized under this provision, shall be made as though the gain was recognized in the year in which the failure to report was finally determined. Section 6038B(c)(2) and the proposed regulations provide a reasonable cause exception to the penalty and gain recognition provisions.

#### Effective Dates

The amendments to the regulations on the reporting of cash transfers to foreign corporations apply to taxable years beginning after these regulations are published as final regulations in the **Federal Register**.

The proposed regulations on the reporting of transfers to foreign partnerships apply to transfers made on or after January 1, 1998. Notice 98-17 (1998-11 I.R.B. 6) provides reporting requirements for transfers made after August 5, 1997, and before January 1, 1998. The proposed regulations would permit United States persons who made transfers in that period to rely on either Notice 98-17 or the final regulations.

#### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 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 proposed regulations. It is hereby certified that the collection of information contained in these proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time required to complete the form and file the information required under these regulations is brief and will not have a significant impact on those small entities that are required to provide notification. Furthermore, the number of small entities that will be required to file the form is not significant. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue

Code, these 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

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. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for Tuesday, November 10, 1998, at 10 a.m., in room 2615, 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 15 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 written comments and an outline of the topics to be discussed (preferably a signed original and eight (8) copies) by October 20, 1998.

A period of 10 minutes will be allotted for each person 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 proposed regulations are Christopher Kelley and Philip Tretiak 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 \* \* \*  
Section 1.6038B-1 also issued under 26

U.S.C. 6038B.

Section 1.6038B-2 also issued under 26 U.S.C. 6038B. \* \* \*

Par. 2. Section 1.6038B-1 is amended as follows:

1. The section heading is revised.

2. Paragraph (b)(1)(i), first sentence, is revised.

3. The text of paragraph (b)(3) is added.

4. Paragraph (c), first sentence, is revised

5. Paragraph (g) is revised.

The additions and revisions read as follows:

#### §1.6038B-1 Reporting of certain transfers to foreign corporations.

\* \* \* \* \*

(b) *Time and manner of reporting*—(1) *In general*—(i) *Reporting procedure*. Except for stock or securities qualifying under the special reporting rule of paragraph (b)(2) of this section, or cash, which is subject to special rules contained in paragraph (b)(3) of this section, any U.S. person that makes a transfer described in section 6038B(a)(1)(A), 367(d) or (e)(1) is required to report pursuant to section 6038B and the rules of this section and must attach the required information to Form 926 “Return by Transferor of Property to a Foreign Corporation”. \* \* \*

\* \* \* \* \*

(3) *Special rule for transfers of cash*. A U.S. person that transfers cash must report the transfer of cash to a foreign corporation if—

(i) Such U.S. person holds (immediately after the transfer) directly or indirectly (determined under the rules of sections 318(a) and 6038(e)(2)) at least 10 percent of the total voting power or the total value of the foreign corporation; or

(ii) The amount of cash transferred by such person or any related person (determined under section 267(b)) to such foreign corporation or a related foreign corporation during the 12-month period ending on the date of the transfer exceeds \$100,000.

\* \* \* \* \*

(c) *Information required with respect to transfers described in section 6038B(a)(1)(A)*. A U.S. person that transfers property to a foreign corporation in

an exchange described in section 6038B(a)(1)(A) (including cash and other unappreciated property) must provide the following information, in paragraphs labeled to correspond with the number or letter set forth in this paragraph (c) and §1.6038B-1T(c)(1) through

(5). \* \* \*

\* \* \* \* \*

(g) *Effective dates.* This section applies to transfers occurring on or after July 20, 1998, except the first sentence of paragraph (b)(1)(i), paragraph (b)(3), and the first sentence of paragraph (c) apply to taxable years beginning after the date that final regulations are published in the **Federal Register**. See §1.6038B-1T for transfers occurring prior to July 20, 1998.

Par. 6. Section 1.6038B-2 is added to read as follows:

*§1.6038B-2 Reporting of certain transfers to foreign partnerships.*

(a) *Reporting requirements*—(1) *Requirement to report transfers.* Any United States person that makes a transfer to a foreign partnership in a contribution described in section 721 is required to report pursuant to section 6038B and the rules of this section by filing Form 8865 “Information Return of U.S. Persons With Respect To Certain Foreign Partnerships” attached to the transferor’s income tax return (including a partnership return of income) for the taxable year that includes the date of the transfer by the due date (including extensions) for that return, if—

(i) The United States person holds (immediately after the transfer) directly or indirectly at least a 10-percent interest in the partnership; or

(ii) The value of the property transferred, when added to the value of the property transferred by such person or any related person (described in section 267(b) or 707(b)(1)) to such partnership or a related partnership (described in section 707(b)(1)(B)) during the 12-month period ending on the date of the transfer, exceeds \$100,000. For purposes of determining the relevant amounts, there shall also be taken into account the value of any property transferred in a transfer not subject to section 721, where a principal purpose of such transfer was the avoidance of these reporting requirements.

(2) *Requirement to report dispositions*—(i) *In general.* If a United States

person was required to report a transfer to a foreign partnership under paragraph (b)(1) of property with a fair market value in excess of basis (built-in gain property), and the partnership disposes of the property while such United States person remains a partner, that United States person must report the disposition by filing Form 8865. The form must be attached to, and filed by the due date (including extensions) of, the transferor’s income tax return for the year in which the disposition occurred.

(ii) *Disposition of property in nonrecognition transaction.* If a foreign partnership disposes of contributed built-in gain property in a nonrecognition transaction and substituted basis property is received in exchange, and the substituted basis property has built-in gain under §1.704-3(a)(8), the transferor must report the disposition of the substituted basis property in the same manner as provided for the contributed property.

(3) *Returns to be made*—(i) *Separate returns for each partnership.* If a United States person transfers property to more than one foreign partnership in a taxable year, a separate return must be made by the United States for each partnership.

(ii) *Duplicate form to be filed.* If required by the instructions to Form 8865, a duplicate Form 8865 (including attachments and schedules) must also be filed.

(4) *Time for filing when transferor also required to report under §1.6038-3(a).* If the United States person required to file under §1.6038-3(a) for the period in which the transfer occurs, then the United States person must report under this section on the Form 8865 for the foreign partnership’s annual accounting period in which the transfer occurred (not its own taxable year) and file with its income tax return for that year as provided in §§1.6038-3(e) and (h).

(b) *Relief for indirect transferors*—(1) *Requirements.* A United States person otherwise required to file a return under this section with respect to a transfer to a foreign partnership need not file a return if all of the following conditions are met—

(i) The person does not directly own an interest in the foreign partnership;

(ii) The person is required to file a return solely by reason of attribution of ownership from a United States person

(as determined under the rules of section 6038(e)(3) and the regulations thereunder); and

(iii) A United States person from whom the ownership is attributed files all of the information required under section 6038B and this section with respect to the transfer.

(2) *Statement required.* A United States person who does not furnish an information return under the provisions of paragraph (b)(1) of this section must file a statement with the person’s income tax return—

(i) Indicating that the filing requirement has been or will be satisfied;

(ii) Identifying the person who has or will file the return;

(iii) Identifying the IRS Service Center where the return was or will be filed; and

(iv) Providing any additional information as Form 8865 and the accompanying instructions may require.

(c) *Information required with respect to transfers of property.* In respect of transfers described in section 6038B(a)(1)(B), the return must contain information in such form or manner as Form 8865 (and its accompanying instructions) prescribes with respect to reportable events, including—

(1) The name, address, and U.S. taxpayer identification number of the United States person making the transfer;

(2) The name, U.S. taxpayer identification number (if any), and address of the transferee foreign partnership, and the type of entity and country under whose laws the partnership was created or organized;

(3) A general description of the transfer, and of any wider transaction of which it forms a part, including the date of transfer;

(4) The names and addresses of the other partners in the foreign partnership, unless the transfer is solely of cash and the transferor holds less than a 10-percent interest in the transferee foreign partnership immediately after the transfer;

(5) A description of the partnership interest received by the United States person, including a change in partnership interest;

(6) A separate description of each item of contributed property that is appreciated property subject to the allocation rules of section 704(c)(except to the extent that

the property is permitted to be aggregated in making allocations under section 704(c), or is intangible property, including its estimated fair market value and adjusted basis.

(7) A description of other contributed property, not specified in paragraph (c)(6) of this section, aggregated by the following categories (with, in each case, a brief description of the property)—

(i) Stock in trade of the transferor (inventory);

(ii) Tangible property (other than stock in trade) used in a trade or business of the transferor;

(iii) Cash;

(iv) Stock, notes receivable and payable, and other securities; and

(v) Other property.

(d) *Information required with respect to dispositions of property.* In respect of dispositions, the return must contain information in such form or manner as Form 8865 (and its accompanying instructions) prescribes with respect to reportable events, including—

(1) The date and manner of disposition;

(2) The gain and depreciation recapture amounts, if any, realized by the partnership; and

(3) Any such amounts allocated to the United States person.

(e) *Method of reporting.* Except as otherwise provided on Form 8865, or the accompanying instructions, all amounts reported as required under this section must be expressed in United States currency, with a statement of the exchange rates used. All statements required on or with Form 8865 pursuant to this section must be in the English language.

(f) *Reporting under this section not required of partnerships excluded from the application of subchapter K—(1) Election to be wholly excluded.* The reporting requirements of this section will not apply to any United States person in respect of an eligible partnership as described in §1.761-2(a) in which that United States person is a partner, if such partnership has validly elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in the manner specified in §1.761-2(b)(2)(i).

(2) *Deemed excluded.* The reporting requirements of this section will not apply to any United States person in respect of

an eligible partnership as described in §1.761-2(a) in which that United States person is a partner, if such partnership is validly deemed to have elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in accordance with the provisions of §1.761-2(b)(2)(ii).

(g) *Deemed contributions.* If by reason of an adjustment under section 482 or otherwise, a contribution required to be reported under section 6038B(a)(1)(B) and this section is deemed to have been made, the information required to be reported will be furnished timely if filed by the due date (including extensions) of, the taxable year during which the adjustment is made.

(h) *Failure to comply with reporting requirements—(1) Consequences of failure.* If a United States person is required to file a return under paragraph (a) of this section and fails to comply with the reporting requirements of section 6038B and this section, then—

(i) The United States person is subject to a penalty equal to 10 percent of the fair market value of the property at the time of the contribution;

(ii) The United States person will recognize gain (reduced by the amount of any gain recognized, with respect to that property, by the transferor after the transfer) as if the contributed property had been sold for fair market value at the time of the contribution; and

(iii) Adjustments to the basis of the partnership and any relevant partner as a result of gain being recognized under this provision will be made as though the gain was recognized in the year in which the failure to report was finally determined.

(2) *Failure to comply.* A failure to comply with the requirements of section 6038B includes—

(i) The failure to report at the proper time and in the proper manner any information required to be reported under the rules of this section; and

(ii) The provision of false or inaccurate information in purported compliance with the requirements of this section.

(3) *Reasonable cause exception.* Under section 6038B(c)(3) and this section, the provisions of paragraph (h)(1) of this section will not apply if the transferor shows that a failure to comply was due to reasonable cause and not willful neglect. The transferor may attempt to do so by

providing a written statement to the district director having jurisdiction of the taxpayer's return for the year of the transfer, setting forth the reasons for the failure to comply. Whether a failure to comply was due to reasonable cause will be determined by the district director under all facts and circumstances.

(4) *Limitation on penalties.* The penalty under paragraph (h)(1)(i) of this section with respect to any transfer cannot exceed \$100,000, unless the failure to comply with respect to such transfer was due to intentional disregard.

(5) *Statute of limitations.* For exceptions to the limitations on assessment and collection in the event of a failure to provide information under section 6038B, see section 6501(c)(8).

(i) *Definitions—(1) 10-percent interest.* 10-percent interest is defined in sections 6046A(d) and 6038(e)(3)(C) and the regulations thereunder.

(2) *United States person.* United States person is defined in section 7701(a)(30).

(3) *Foreign partnership.* Foreign partnership is defined in section 7701(a)(2) and (5).

(4) *Substituted basis property.* Substituted basis property is defined in section 7701(a)(42).

(5) *Value of the property transferred.* Under section 6038B and this section, the value of the property transferred is the fair market value of the property at the time of its transfer.

(j) *Effective dates—(1) In general.* This section applies to transfers made on or after January 1, 1998. However, for a transfer made prior to the date final regulations are published in the **Federal Register**, Form 8865 will be considered timely filed with respect to a transfer if filed with the taxpayer's income tax return for the first taxable year beginning after the date that final regulations are published in the **Federal Register**.

(2) *Transfers after August 5, 1997 and before January 1, 1998.* A United States person who made a transfer of property required to be reported under section 6038B prior to the effective date of these regulations may satisfy its reporting requirements by reporting in accordance with the provisions of this section.

Michael P. Dolan,  
Deputy Commissioner of  
Internal Revenue.

## Notice of Proposed Rulemaking and Notice of Public Hearing

### Information Reporting With Respect to Certain Foreign Partnerships

REG-118966-97

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 6038 of the Internal Revenue Code providing information reporting requirements for certain United States persons holding interests in controlled foreign partnerships. The proposed regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. These proposed regulations would provide guidance to United States persons who must file such a return. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by November 9, 1998. Outlines of topics to be discussed at the public hearing scheduled for November 10, 1998, at 10 a.m., must be received by October 20, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-118966-97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-118966-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html).

A public hearing has been scheduled to be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Victoria Scotto Balacek, 202-622-3860; concerning submissions and requests for a hearing, Michael Slaughter, 202-622-7190 (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**, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attention: IRS Reports Clearance Officer OP:FS:FP, Washington, DC 20224. Comments on the collection of information must be received by November 9, 1998. Comments are specifically requested on:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, 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 the capital or start-up costs of operation, maintenance, and purchase of services to provide information.

The collection of information in these regulations is in §1.6038-3. This information is required by the IRS to identify

foreign partnerships which are controlled by United States persons and verify amounts reported by the partners. The collection of information is mandatory. The likely respondents will be individuals and businesses or other for-profit organizations.

The burden of complying with the proposed collection of information required to be reported on Form 8865 is reflected in the burden for Form 8865.

The burden of complying with the proposed collection of information in §1.6038-3(c)(3) is as follows:

Estimated total annual reporting burden: 250 hours.

Estimated annual burden per respondent: .25 hours to 1 hour, with an average of .5 hours.

Estimated number of respondents: 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*

##### *Taxpayer Relief Act of 1997*

In the Taxpayer Relief Act of 1997 (TRA 1997), Public Law 105-34 (111 Stat. 983 (1997)), Congress significantly modified the information reporting requirements with respect to foreign partnerships under sections 6038, 6038B and 6046A (and also amended section 6501(c)(8) to provide that the statute of limitations on the assessment of tax under sections 6038, 6038B and 6046A does not expire until three years after the information required under those sections is reported). These regulations under section 6038 are being proposed along with regulations under sections 6038B (reporting of certain transfers to foreign partnerships) and 6046A (reporting of certain ownership interests in foreign partnerships).

The IRS is also developing a comprehensive form (Form 8865) for reporting under all of these provisions. A draft version of the form will be issued for public comment while the proposed regulations are outstanding.

### *Section 6038*

Prior to TRA 1997, reporting in respect of foreign partnerships was governed by section 6031 of the Internal Revenue Code (Code). Regulations had been proposed, but never finalized, that would have required reporting by foreign partnerships where United States persons were allocated 25 percent or more of certain items. Section 1141 of TRA 1997, amended section 6031 to provide that a foreign partnership is required to file an annual return of partnership income (Form 1065) only if the partnership has gross income from sources within the United States, or gross income that is effectively connected with the conduct of a U.S. trade or business. Section 1142 of TRA 1997, amended section 6038 to require information reporting by certain United States persons with direct or indirect interests in controlled foreign partnerships. Thus, these changes moved the statutory authority to require annual reporting on a foreign partnership because of the ownership interests of United States persons from section 6031 to section 6038, and moved the reporting obligation in respect of foreign partnerships from the partnership to the partner level.

### *Explanation of Provisions*

Section 6038 requires certain United States persons that own interests in controlled foreign partnerships to provide information with respect to the interests as prescribed by the Secretary. The proposed regulations implement the statute by requiring taxpayers to furnish the IRS with annual information.

### *Reporting Requirements*

The proposed regulations implement the rules of section 6038 by requiring a United States person that controls a foreign partnership to file an annual information return with respect to the foreign partnership (Form 8865). Pursuant to section 6038(e)(3), the proposed regulations define control as direct or indirect

ownership of more than a 50-percent interest in the partnership. The constructive ownership rules of section 267(c) (other than paragraph (3)) are applied to determine ownership interests (taking into account that such rules refer to corporations and not to partnerships).

A 50-percent interest in a partnership is defined as an interest equal to 50 percent of the capital interest, 50 percent of the profits interest, or, exercising the regulatory authority under section 6038(e)-(3)(A)(ii), an interest to which 50 percent of the deductions or losses are allocated. Defining control by reference to losses or deductions, as well as capital and profits, is appropriate, because a partner with a greater than 50-percent allocation of these items has a level of control sufficient to provide a significant amount of information about the partnership. Furthermore, in the case of such allocations, certain information is required to ensure that the rules of Code provisions such as section 704(b) (determination of distributive share) are being followed.

To relieve taxpayers of unnecessary filing burdens, the regulations provide exceptions from the general rule that a controlling partner must provide information to the IRS on Form 8865. If more than one United States person is required to report as a controlling partner, then one such controlling partner may file the required information in lieu of all such partners having to file separately. However, a controlling partner with respect only to losses or deductions may only satisfy this requirement if there are no controlling partners with respect to capital or profits. The controlling partners not required to file, must file the statement required by the regulations with their tax return indicating that the filing requirement will be met by another person and identifying that person.

Pursuant to section 6038(a)(5), the proposed regulations provide that each United States person that owns at least a 10-percent interest in a foreign partnership that is controlled by United States persons holding at least 10-percent interests must file an annual information return with respect to the partnership. In accordance with the statute, however, such 10-percent partners will not be required to report such information where there is a United States person that is a

controlling partner. The proposed regulations define a 10-percent interest in a partnership as an interest equal to 10 percent of the capital or profits interest, and an interest to which 10 percent of the deductions or losses are allocated.

Because no one United States person controls the partnership, Form 8865 will require less information to be reported than it will for controlling United States partners, and will be more similar to the information contained in Schedule K-1 to Form 1065. If there is a controlling partner (and, thus, any other 10-percent partners are not required to file), the controlling partner must, generally, file the information that would otherwise have been required from such 10-percent partners.

### *Exceptions to Filing Requirements*

The proposed regulations provide that certain United States persons that are indirect partners need not file under section 6038 so long as the United States person from whom ownership is attributed does file the information, and the indirect partner files a statement with its income tax return identifying the United States person that will meet the filing requirements.

The reporting requirements of this section shall not apply in respect of any foreign partnership which is an eligible partnership described in §1.761-2(a) that has validly elected pursuant to §1.761-2(b)(2)(i) to be wholly excluded from the application of subchapter K. Nor shall the reporting requirements of these proposed regulations apply to any foreign partnership validly deemed to have wholly elected out of the provisions of subchapter K as specified in §1.761-2(b)(2)(ii). Taxpayers are reminded, however, that a precondition to being an “electing-out” partnership is that, as provided in §1.761-2(a)(1), “[t]he members of such organization must be able to compute their income without the necessity of computing partnership taxable income.” The IRS and Treasury are concerned that in certain cases the necessary books and records are not being maintained to allow verification that such computations can indeed be made without regard to the partnership. If it appears that, in the absence of a reporting requirement under this section, the members of the “electing-out” partnership cannot make such separate computations, this exception to the

reporting requirements will be reconsidered.

#### *Information Required*

The proposed regulations require certain United States persons to provide information relating to the foreign partnership on Form 8865 (or successor form). The form will require controlling partners of foreign partnerships to report information concerning the income and assets of the partnership, certain transactions with the partnership, the names of the partners in the partnership, and other specified information. The form will require a partner holding at least a 10-percent interest in a controlled foreign partnership (where there is no United States person that is a controlling partner) to report information with respect only to its own interest in the partnership.

#### *Time and Place for Filing*

The proposed regulations require Form 8865 to be filed with the United States person's income tax return (including a partnership return of income) for the taxable year in which the partnership's annual accounting period ends. If required by the instructions to Form 8865, a duplicate Form 8865 must also be filed.

#### *Failure to Provide Information*

As described in section 6038(b), the proposed regulations provide that a failure to comply with the reporting requirements of section 6038 will result in a penalty of \$10,000 for each annual accounting period. Additional penalties apply for failure to comply after notification by the IRS, up to a total of \$50,000 for each annual accounting period. Also, as provided in section 6038(c), the proposed regulations additionally provide a penalty of reducing the United States person's foreign tax credit (also with further penalties for continued failure to report after notification).

#### *Effective Dates*

The proposed regulations would apply for annual accounting periods beginning after the date that these regulations 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 EO 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 proposed regulations. It is hereby certified that the collection of information contained in these proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time required to complete the form and file the information required under these regulations is brief and will not have a significant impact on those small entities that are required to provide notification. Furthermore, the number of small entities that will be required to file the form is not significant. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these 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*

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 Internal Revenue Service. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for Tuesday, November 10, 1998, at 10 a.m., in room 2615, 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 15 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 written comments by November 9, 1998, and an outline of the topics to be discussed (a

signed original and eight (8) copies) by October 20, 1998.

A period of 10 minutes will be allotted for each person 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 this regulation is Victoria Scotto Balacek, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in its 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 as follows:

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

Section 1.6038-3 is also issued under 26 U.S.C. 6038.\* \* \*

Par. 2. Section 1.6038-3 is added to read as follows:

*§1.6038-3 Information returns required of United States persons with respect to foreign partnerships.*

(a) *Persons required to make return—*  
(1) *Controlling partners.* Every United States person that controls a foreign partnership must file an annual information return on Form 8865 "Information Return of U.S. Persons With Respect To Certain Foreign Partnerships" containing so much of the information described in paragraph (f) of this section, and such other information, as the form (or accompanying instructions) may prescribe. The information required to be filed by such controlling partner will include such information regarding any other United States persons that are 10-percent or greater partners in the foreign partnership as Form 8865 may require. (For exceptions to this rule, see paragraph (c) of this section.)

(2) *Certain 10-percent partners.* Every United States person that holds a 10-percent or greater interest in a foreign partnership controlled by United States persons holding at least 10-percent interests must complete and file an annual information return on Form 8865 containing so much of the information described in paragraph (f) of this section, and such other information, as the form (or accompanying instructions) may prescribe. (For exceptions to this rule, see paragraph (c) of this section.) However, no such person will be required to file under this section if a United States person is a controlling partner of such partnership.

(3) *Separate returns for each partnership.* A United States person required to report under this paragraph (a) must file a separate annual information return for each foreign partnership with respect to which the person has a reporting obligation.

(b) *Ownership determinations—(1) Control.* A person (or persons) is deemed to be in control of a partnership if that person (or persons) owns, directly or indirectly, more than a 50-percent interest in the partnership (a controlling partner).

(2) *50-percent interest.* A 50-percent interest in a partnership is an interest equal to 50 percent of the capital interest, 50 percent of the profits interest, or an interest to which 50 percent of the deductions or losses are allocated.

(3) *10-percent interest.* A 10-percent interest in a partnership is an interest equal to 10 percent of the capital interest, 10 percent of the profits interest, or an interest to which 10 percent of the deductions or losses are allocated.

(4) *Attribution rules.* For purposes of determining an interest in a partnership, the rules of section 267(c) (other than section 267(c)(3)) apply (taking into account such rules refer to corporations and not to partnerships).

(5) *Determination of amount of interest.* Whether a person has a 50-percent interest, or a 10-percent interest, as described in paragraphs (b)(2) and (3) of this section, will be determined for each taxable year by reference to the agreement of the partners relating to such interests during the taxable year.

(c) *Exceptions when more than one partner is required to file duplicative information—(1) More than one controlling partner—(i) In general.* If, with re-

spect to the same foreign partnership for the same annual accounting period, more than one United States person is required to file an information return under paragraph (a)(1) of this section by reason of being a controlling partner, then in lieu of all such controlling partners making separate returns, only one return from one of the controlling partners will be required. However, a return by a United States person that is a controlling partner by reason of an interest to which losses or deductions are allocated may only satisfy this exception if there is no United States person that is a controlling partner by reason of an interest in capital or profits.

(ii) *Manner of reporting.* The return must be filed with the income tax return of the person making the return in the manner provided by Form 8865 and the accompanying instructions. The return must contain all of the information which would have been required to be reported by this section if separate information returns had been filed.

(iii) *Controlling partners not required to file.* Those partners not required to file under paragraph (c)(1)(i) of this section must file the statement required by paragraph (c)(3) of this section.

(2) *Certain indirect owners excepted from furnishing information.* Any United States person required to file an information return under this section need not furnish a return, if all of the following conditions are met—

(i) The person does not directly own any interest in the foreign partnership;

(ii) The person is required to file the information return solely by reason of attribution of ownership from a United States person under paragraph (b)(4) of this section; and

(iii) The United States person from whom the ownership interest is attributed files all of the information required under this section.

(3) *Statement required.* A United States person that does not furnish an information return under the provisions of paragraph (c)(1) or (2) of this section must file a statement with the person's income tax return—

(i) Indicating that the filing requirement has been or will be satisfied;

(ii) Identifying the person required to file the return;

(iii) Identifying the IRS Service Center where the return is required to be filed; and

(iv) Providing any additional information as Form 8865 and the accompanying instructions may require.

(d) *Reporting under this section not required of partnerships excluded from the application of subchapter K—(1) Election to be wholly excluded.* The reporting requirements of this section will not apply to any United States person in respect of an eligible partnership as described in §1.761-2(a) in which that United States person is a partner, if such partnership has validly elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in the manner specified in §1.761-2(b)(2)(i).

(2) *Deemed excluded.* The reporting requirements of this section will not apply to any United States person in respect of an eligible partnership as described in §1.761-2(a) in which that United States person is a partner, if such partnership is validly deemed to have elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in accordance with the provisions of §1.761-2(b)(2)(ii).

(e) *Period covered by return.* The information required under this section must be furnished for the annual accounting period of the foreign partnership ending with or within the United States person's taxable year. The partnership's annual accounting period is the annual period on the basis of which it regularly computes its income in keeping its books. (See section 706 for the partnership's taxable year.)

(f) *Contents of return.* The return required to be filed under this section must contain information in such form or manner as Form 8865 (and its accompanying instructions) prescribes with respect to each foreign partnership, including—

(1) The name, address, and employer identification number, if any, of the partnership;

(2) The nature of the partnership's business and principal place where conducted;

(3) The date of organization and country under whose laws the partnership was organized;

(4) A balance sheet showing assets, liability, and capital of the partnership as of the end of the annual accounting period;



(5) A summary of the outstanding ownership interests in the partnership;

(6) A summary showing the total amount of transactions between the partnership and the person required to file the return, any other partnership or corporation controlled by that person, or any United States person owning at the time of the transaction at least a 10-percent interest in the foreign partnership;

(7) The amount of the partnership's foreign income taxes paid or accrued;

(8) A statement of the partnership's income for the annual accounting period;

(9) A statement of the partners' distributive share items of income, gain, losses, deductions and credits; and

(10) A statement of income, gain, losses, deductions and credits allocated to each United States person holding at least a 10-percent interest in the foreign partnership.

(g) *Method of reporting.* Except as otherwise provided on Form 8865 or the accompanying instructions, all amounts required to be furnished on the information return must be expressed in United States dollars with a statement of the exchange rates used. All statements required on or with Form 8865 pursuant to this section must be in the English language.

(h) *Time and place for filing return—*  
(1) *In general.* Form 8865 must be filed with the United States person's income tax return (including a partnership return of income) on or before the due date required by law (including extensions) of that return.

(2) *Duplicate return.* If required by the instructions to Form 8865, a duplicate Form 8865 must also be filed.

(i) *Definition of United States person.* The term United States person is defined in section 7701(a)(30).

(j) *Failure to comply with reporting requirement—*(1) *Dollar amount penalty—*

(i) *In general.* Any United States person required to file an information return under Section 6038 and paragraph (a) of this section that fails to comply (as defined in paragraph (j)(3) of this section) with the applicable reporting requirements of this section, must pay a penalty of \$10,000 for each annual accounting period of each foreign partnership with respect to which the failure occurs.

(ii) *Increase in penalty.* If a failure to

comply with the applicable reporting requirements of section 6038 and this section continues for more than 90 days after the date on which the district director mails notice of the failure to the United States person required to file Form 8865, the person must pay an additional penalty of \$10,000 for each 30-day period (or fraction thereof) during which the failure continues after the 90-day period has expired.

(iii) *Limitation.* The additional penalty imposed on any United States person by section 6038(b)(2) and paragraph (j)(1)(ii) of this section is limited to a maximum of \$50,000 for each partnership for each annual accounting period with respect to which the failure occurs.

(2) *Penalty of reducing foreign tax credit—*(i) *Effect on foreign tax credit.* Failure to comply with the reporting requirements of section 6038 and this section may cause a reduction of foreign tax credits under section 901 (taxes of foreign countries and of possessions of the United States). In applying section 901 to a United States person for any taxable year within which its foreign partnership's annual accounting period ended, the amount of taxes paid (and deemed paid under sections 902 and 960) by the United States person will be reduced by 10 percent if the person fails to comply. However, no tax deemed paid under section 904(c) will be reduced under the provisions of this paragraph (j)(2)(i).

(ii) *Reduction for continued failure.* If a failure to comply with the reporting requirements of section 6038 and this section continues for more than 90 days after the date on which the district director mails notice of the failure to the person required to file Form 8865, then the amount of the reduction in paragraph (j)(2)(i) of this section will be 10 percent, plus an additional 5 percent for each 3-month period (or fraction thereof) during which the failure continues after the 90-day period has expired.

(iii) *Limitation on reduction.* The amount of the reduction under paragraph (j)(2)(ii) of this section for each failure to furnish information required under this section will not exceed the greater of \$10,000, or the income of the foreign partnership for its annual accounting period with respect to which the failure occurs.

(iv) *Offset for dollar amount penalty imposed.* The total amount of the reduction which, but for this paragraph (j)(2)(iv), may be made under this paragraph (j)(2) with respect to any separate failure, may not exceed the maximum amount of the reductions which may be imposed, reduced (but not below zero) by the dollar amount penalty imposed by paragraph (j)(1) of this section with respect to the failure.

(3) *Failure to comply.* A failure to comply is separately determined for each foreign partnership for which a United States person has a reporting obligation. A failure to comply with the requirements of section 6038 includes—

(i) The failure to report at the proper time and in the proper manner any information required to be reported under the rules of this section; or

(ii) The provision of false or inaccurate information in purported compliance with the requirements of this section.

(4) *Reasonable cause limitation.* The time prescribed for furnishing information under paragraph (h) of this section, and the beginning of the 90-day period after the district director mails notice under paragraphs (j)(1)(ii) and (2)(ii) of this section, will be treated as being not earlier than the last day on which reasonable cause existed for failure to furnish the information. The United States person may show reasonable cause by providing a written statement to the district director having jurisdiction of the person's return for the year of the transfer, setting forth the reasons for the failure to comply. Whether a failure to comply was due to reasonable cause will be determined by the district director under all facts and circumstances.

(5) *Statute of limitations.* For exceptions to the limitations on assessment and collection in the event of a failure to provide information under section 6038, see section 6501(c)(8).

(k) *Effective date.* This section applies to annual accounting periods of a partnership beginning on or after the date final regulations on this subject are published in the **Federal Register**.

Michael P. Dolan,  
Deputy Commissioner of  
Internal Revenue.

## Notice of Proposed Rulemaking and Notice of Public Hearing

### Roth IRAs

REG-115393-98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to Roth IRAs. Roth IRAs were created by the Taxpayer Relief Act of 1997 as a new type of IRA that individuals can use beginning in 1998. The proposed regulations reflect changes relating to Roth IRAs contained in the Internal Revenue Service Restructuring and Reform Act of 1998. The proposed regulations affect individuals establishing Roth IRAs, beneficiaries under Roth IRAs, and trustees, custodians or issuers of Roth IRAs. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by December 2, 1998. Outlines of topics to be discussed at the public hearing scheduled for Thursday, December 10, 1998, at 10 a.m. must be received by Thursday, November 19, 1998.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG-115393-98), 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:DOM:CORP:R (REG-106177-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). The public hearing will be held in room 2615, Internal Revenue Building, 1111

Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Cathy A. Vohs, (202) 622-6030; concerning the public hearing, Michael Slaughter (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 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, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by November 2, 1998. Comments are specifically requested concerning:

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

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

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

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

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

The collections of information in these proposed regulations are in §§1.408A-2, 1.408A-4, 1.408A-5, and 1.408A-7. This information is required by the IRS to comply with the provisions of the Taxpayer Relief Act of 1997, and in particular, with section 408A(b), (c), and (d).

This information will be used by individuals and businesses or other for-profit institutions, and not-for-profit institutions, such as trustees, custodians or issuers of Roth IRAs, in establishing Roth IRAs and recharacterizing IRA contributions. This information will also be used by: (1) the IRS and individuals converting traditional IRAs to Roth IRAs to calculate the amount includible in gross income on account of such conversions, (2) the IRS and individuals receiving distributions from Roth IRAs to calculate the amount includible in gross income on account of such distributions, (3) the IRS and individuals recharacterizing IRA contributions to properly account for such recharacterizations, and (4) the IRS and trustees, custodians or issuers of Roth IRAs to properly report (a) the amount of contributions to and distributions from Roth IRAs, and (b) recharacterizations of IRA contributions (including Roth IRA contributions). The collections of information are required to obtain the benefit of having a Roth IRA. The likely respondents and/or recordkeepers are individuals, and trustees, custodians, or issuers of Roth IRAs. The burden for (1) calculating the amount includible in gross income on account of conversions and Roth IRA distributions, and (2) accounting for recharacterizations is reflected in the burden for Form 8606. The burden for electing to continue the 4-year spread of income inclusion (only applicable to certain spousal beneficiaries) is reflected in the burden for either Form 8606 or Form 1040, whichever is applicable. The burden for reporting contributions is reflected in the burden for Form 5498. The burden for reporting distributions is reflected in the burden for Form 1099-R. Estimated total annual reporting/recordkeeping burden: 125,000 hours (50,000 hours for designating an IRA as a Roth IRA, plus 75,000 hours for recharacterizing an IRA contribution). Estimated average annual burden per respondent/recordkeeper: 1 minute for designating an IRA as a Roth IRA and 30 minutes for recharacterizing an IRA contribution. Estimated number of respondents/recordkeepers: 3,150,000 (3,000,000 respondents for designating an IRA as a Roth IRA, plus 150,000 respondents for recharacterizing an IRA contribution).

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*

Section 408A of the Internal Revenue Code (Code), which was added by section 302 of the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788), establishes the Roth IRA as a new type of individual retirement plan, effective for taxable years beginning on or after January 1, 1998. The provisions of section 408A were amended by the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 685).

A Roth IRA generally is treated under the Code like a traditional IRA with several significant exceptions. Similar to traditional IRAs, income on undistributed amounts accumulated under a Roth IRA is exempt from Federal income tax, and contributions to Roth IRAs are subject to specific limitations. Unlike traditional IRAs, contributions to Roth IRAs cannot be deducted from gross income, but qualified distributions from Roth IRAs are excludable from gross income. These proposed regulations set forth specific rules for Roth IRAs in accordance with the provisions of section 408A.

### *Explanation of Provisions*

#### *General Provisions and Establishment of Roth IRAs*

Proposed §1.408A-1 contains general provisions regarding Roth IRAs, and proposed §1.408A-1 contains provisions regarding the establishment of Roth IRAs. As described in proposed §1.408A-1, a Roth IRA is treated for Federal tax purposes in the same manner as an individual retirement plan except as otherwise provided in section 408A and the proposed regulations. Thus, all the rules of section

408 and the regulations under section 408 apply to Roth IRAs to the extent they are not inconsistent with section 408A or these proposed regulations.

Section 408A(b) defines a Roth IRA as an individual retirement plan which is designated at the time of its establishment as a Roth IRA. That section also grants the Secretary of the Treasury authority to prescribe the manner for designating an individual retirement plan as a Roth IRA. Proposed §1.408A-2 provides that a Roth IRA instrument must clearly designate the IRA as a Roth IRA, and that designation cannot later be changed. Thus, a taxpayer may not designate an IRA as a Roth IRA and later redesignate the Roth IRA as a traditional IRA or otherwise treat the Roth IRA as though it were a traditional IRA for Federal tax purposes.

#### *Regular Contributions*

Proposed §1.408A-3 sets forth rules regarding regular (i.e., non-conversion) contributions to a Roth IRA. Unlike contributions to traditional IRAs, contributions to Roth IRAs are not deductible under any circumstances. A taxpayer's regular contributions to all his or her Roth IRAs for a year are limited to the lesser of \$2,000 or the taxpayer's compensation for that year. As with traditional IRAs, a special rule for married taxpayers permits one spouse to treat the other spouse's compensation as his or her own for purposes of the limit on regular contributions. The limit is reduced by any amounts that the taxpayer contributes for that year to an individual retirement plan other than a Roth IRA (although employer contributions, including elective contributions, to a SEP or SIMPLE IRA Plan do not reduce the contribution limit). Additionally, the contribution limit (determined without regard to any reduction for traditional IRA contributions) is phased out for modified adjusted gross income between \$95,000 and \$110,000 for single taxpayers, between \$150,000 and \$160,000 for married taxpayers filing joint returns, and between \$0 and \$10,000 for married taxpayers filing separate returns. Any contribution in excess of the contribution limit is subject to the 6-percent excise tax under section 4973 unless it is distributed to the taxpayer (with allocable net income) under section 408(d)(4) by the Federal income tax return due date

(with extensions) for the year of the contribution.

The proposed regulations define the terms compensation and modified adjusted gross income. The definition of compensation is the same as that applicable under section 219(f)(1) for determining the amount, if any, that a taxpayer may contribute to a traditional IRA. This definition does not include amounts transferred from one individual to another by gift (for example, a gift from a parent to a child). The definition of modified adjusted gross income is based on the definition of adjusted gross income applicable under section 219(g)(3)(A) for determining the amount, if any, that a taxpayer may deduct for a contribution to a traditional IRA where the taxpayer is an active participant in an employee plan. However, the definition of modified adjusted gross income applicable to Roth IRAs provides that any amount includible in gross income because of a Roth IRA conversion is disregarded in determining modified adjusted gross income. Additionally, for taxable years beginning after December 31, 2004, modified adjusted gross income does not include the amount of any required minimum distribution from an IRA for purposes of determining conversion eligibility.

As with traditional IRAs, regular contributions to a Roth IRA may be made as late as the Roth IRA owner's Federal income tax return due date (not including extensions) for the taxable year to which they relate. Thus, Roth IRA contributions may be made by most taxpayers for taxable year 1998 at any time until April 15, 1999. Unlike traditional IRAs, contributions to a Roth IRA may be made after the Roth IRA owner has reached age 70½.

#### *Conversions*

Proposed §1.408A-4 provides rules regarding Roth IRA conversions. In general, a taxpayer whose modified adjusted gross income does not exceed \$100,000 may "convert" an amount held in a non-Roth IRA (i.e., a traditional IRA or SIMPLE IRA) to a Roth IRA. The conversion may be made in one of three ways: (1) a distribution from a non-Roth IRA may be rolled over to a Roth IRA within 60 days; (2) an amount in a non-Roth IRA of one financial institution may be transferred in a trustee-to-trustee transfer to a Roth IRA

of a different financial institution; or (3) an amount in a non-Roth IRA may be transferred to a Roth IRA of the same financial institution. (In the third case, no physical transfer of assets is necessary, but the instrument governing the non-Roth IRA must, of course, be replaced by a Roth IRA instrument.) The conversion amount must be a qualified rollover contribution under section 408A(e) and, therefore, must satisfy section 408(d)(3) (other than the one-rollover-per-year rule of that section). Any amount distributed from a non-Roth IRA prior to the 1998 taxable year may not be contributed to a Roth IRA as a conversion contribution.

In the case of a conversion made by means of a distribution and rollover contribution, the \$100,000 limit applies to the year in which the distribution from the non-Roth IRA is made. For married taxpayers, the \$100,000 limit applies to the joint modified adjusted gross income of the couple, and a married taxpayer filing a separate return is not allowed to convert regardless of modified adjusted gross income (although a taxpayer who has lived apart from his or her spouse for the entire taxable year is treated as not married for these purposes).

The proposed regulations provide that amounts held in a SEP IRA or a SIMPLE IRA may be converted to a Roth IRA. In the case of a SIMPLE IRA, a conversion may be done only after the expiration of the 2-year period described in section 72(t)(6). See Q&A I-2 of Notice 98-4 (1998-2 I.R.B. 25). Once a SEP IRA or SIMPLE IRA has been converted to a Roth IRA, the SEP IRA or the SIMPLE IRA becomes a Roth IRA and ceases to be part of a SEP or a SIMPLE IRA Plan; thus, no SEP or SIMPLE IRA Plan contributions may be made to the Roth IRA. Amounts held in retirement plans other than IRAs—such as section 401(a) qualified plans and section 403(b) annuity contracts—cannot be directly converted to a Roth IRA.

Any amount converted from a non-Roth IRA to a Roth IRA is treated as distributed from the non-Roth IRA and rolled over to the Roth IRA regardless of the actual means by which the conversion is effected. The conversion amount is generally includible in gross income for the year of the conversion under sections 408(d)(1) and 408(d)(2). For this pur-

pose, in the case of a conversion effected by an actual distribution and rollover contribution (rather than a trustee-to-trustee transfer or a transfer between IRAs of the same financial institution), the year of the distribution from the non-Roth IRA is the year that the conversion amount is includible in gross income.

The conversion amount generally is not subject to the 10-percent additional tax under section 72(t). However, section 408A(d)(3)(F) provides that the 10-percent tax applies to a distribution of a conversion amount made within the 5-taxable-year period beginning with the taxable year in which the conversion to which it is attributable was made. Additionally, the proposed regulations provide that a taxpayer's conversion of an amount from a non-Roth IRA from which the taxpayer was receiving a series of substantially equal periodic payments under section 72(t)(2)(A)(iv) will not be treated as a modification of that series under section 72(t)(4) and thus will not trigger recapture of the section 72(t) tax on previous distributions from the non-Roth IRA as long as the series of substantially equal periodic payments is continued under the Roth IRA (or if section 72(t)(4) would otherwise not apply).

Taxpayers making conversions during 1998 are eligible for a 4-year spread under which a conversion amount can be included in income ratably over taxable years 1998 through 2001 rather than solely in 1998. Special rules apply to this 4-year spread if a taxpayer dies before inclusion of the full conversion amount. In such a case, any remaining includible portion of the conversion amount generally must be included in the taxpayer's gross income for the taxable year that includes the date of his or her death. However, if the taxpayer's surviving spouse is the sole beneficiary of all the taxpayer's Roth IRAs (as determined under the aggregation rule of section 408A(d)(4)(A)), the spouse may elect to continue application of the 4-year spread. Finally, the distribution of any amount attributable to a 1998 conversion to which the 4-year spread applies will accelerate the inclusion of any amount otherwise deferred to a later taxable year.

A required minimum distribution may not be converted to a Roth IRA because section 408(d)(3)(E) prohibits the rollover

of any such distribution. Under the proposed regulations, if a non-Roth IRA owner has reached age 70½, any amount distributed (or treated as distributed because of a conversion) from the IRA for that year consists of the required minimum distribution to the extent that an amount equal to the required minimum distribution for that year has not yet been distributed (or treated as distributed). Thus, if a taxpayer who is required to receive a minimum distribution of \$10,000 from his or her non-Roth IRA for a taxable year attempts to convert \$11,000 to a Roth IRA prior to receiving the required minimum distribution, \$10,000 of the conversion amount would be treated as the required minimum distribution and would be ineligible for conversion. This result is not affected by the means through which the taxpayer effects the conversion or by whether an amount greater than or equal to \$10,000 remains in the taxpayer's non-Roth IRA after the conversion.

#### *Recharacterizations of IRA Contributions*

Proposed §1.408A-5 provides special rules for the recharacterization of IRA contributions (including Roth IRA regular and conversion contributions). Section 408A(d)(6) provides that, except as otherwise provided by the Secretary of the Treasury, an IRA contribution that is transferred to another IRA in a trustee-to-trustee transfer on or before the Federal income tax return due date (with extensions) for the taxable year of the contribution is treated as made to the transferee IRA and not the transferor IRA. Section 408A(d)(6) requires that the transfer include allocable net income on the contribution and that no deduction be allowed for the contribution to the transferor IRA. This statutory provision was intended to permit a taxpayer who had converted an amount held in a non-Roth IRA to a Roth IRA and later discovered that his or her modified adjusted gross income for the year of the conversion exceeded \$100,000 to correct the conversion by retransferring the converted amount to a non-Roth IRA. The proposed regulations interpret section 408A(d)(6) liberally to provide broad relief to taxpayers who wish to change the nature of an IRA contribution (and not only to allow taxpayers to correct Roth IRA conversions for which they were in-

eligible). Moreover, the proposed regulations make application of section 408A(d)(6) elective by the taxpayer and permit the taxpayer to recharacterize all or any portion of an IRA contribution.

Under the proposed regulations, a taxpayer may elect whether to recharacterize a contribution made to one type of IRA by having it transferred in a trustee-to-trustee transfer to a different type of IRA. As with a conversion, a recharacterization can be effected simply by transferring IRA assets between two IRAs of a single financial institution. Regardless of how effected, a recharacterization transfer is not considered a rollover for purposes of the one-rollover-per-year rule of section 408(d)(3). The taxpayer makes the election to recharacterize by notifying both the transferor IRA trustee and the transferee IRA trustee and by providing certain information to these trustees (including a direction to make the transfer). Notification to the trustees constitutes the taxpayer's election to apply section 408A(d)(6), and the taxpayer cannot revoke or modify that election after the recharacterization transfer has been made. A recharacterized contribution will be treated for Federal income tax purposes as having been contributed to the transferee IRA (rather than the transferor IRA) on the same date and for the same taxable year that the contribution was initially made to the transferor IRA. In effect, the transferee IRA "steps into the shoes" of the transferor IRA with respect to the taxpayer's original contribution.

The recharacterization transfer must include allocable earnings on the original contribution, and the proposed regulations provide that the rules of Treasury Regulations §1.408-4(c)(2)(ii) apply for determining such allocable earnings. If the original contribution has experienced net losses as of the time of the recharacterization, the transfer of the entire original contribution less such losses will generally constitute a transfer of the entire contribution. The taxpayer must treat the contribution as made to the transferee IRA on his or her Federal income tax return for the year to which the original contribution (to the transferor IRA) relates.

Amounts that cannot be recharacterized include amounts paid into an IRA by tax-free rollover or transfer (other than a rollover or transfer from a traditional IRA

to a SIMPLE IRA) and employer contributions under a SIMPLE IRA Plan or a SEP. The proposed regulations also provide that, once an amount has been contributed to an IRA, any tax-free rollover or transfer of that amount to another IRA may be disregarded in applying the recharacterization rules. Thus, for example, if a taxpayer contributes \$2,000 to a Roth IRA during a taxable year and rolls that contribution over to another Roth IRA during the following taxable year, the rollover between Roth IRAs is disregarded, and the taxpayer may recharacterize the \$2,000 Roth IRA contribution by having it transferred from the second Roth IRA to a traditional IRA in accordance with section 408A(d)(6) and the proposed regulations.

#### *Distributions*

Proposed §1.408A-6 provides rules for the treatment of Roth IRA distributions. Under section 408A(d), qualified distributions from a Roth IRA are not includible in gross income. A qualified distribution is a distribution that is both (1) made after the end of the 5-taxable-year period that begins with the first taxable year for which an individual first makes any regular or conversion contribution to a Roth IRA and (2) made at any time after the Roth IRA owner has reached age 59½, made to a beneficiary (or to the Roth IRA owner's estate) after the Roth IRA owner's death, attributable to the Roth IRA owner's being disabled within the meaning of section 72(m)(7), or made for a first-time home purchase to which section 72(t)(2)(F) applies. The proposed regulations provide that any distribution from a Roth IRA made to the surviving spouse of a Roth IRA owner who has elected to treat the Roth IRA as his or her own in accordance with the terms of the trust instrument or under Q&A-4 of Proposed Treasury Regulations §1.408-8 is not treated as made after the Roth IRA owner's death.

The proposed regulations provide that the 5-taxable-year period for determining whether a distribution is a qualified distribution is not recalculated when a Roth IRA owner dies. Thus, if a Roth IRA owner contributes an amount to a Roth IRA in 1998 and dies in 2004, a distribution made to a beneficiary in 2004 will be

a qualified distribution. Generally, the 5-taxable-year period with respect to a beneficiary's inherited Roth IRA is determined independently of the 5-taxable-year period for any Roth IRA of which the beneficiary is the owner. However, if the beneficiary of a Roth IRA is the surviving spouse of the Roth IRA owner and if the surviving spouse owns his or her own Roth IRA, the 5-taxable-year period for both the Roth IRA of which the surviving spouse is the beneficiary and the Roth IRA of which the surviving spouse is the owner ends with the earlier of the 5-taxable-year periods for the two Roth IRAs.

A Roth IRA distribution other than a qualified distribution is generally includible in the taxpayer's gross income to the extent that the distribution, when added to all prior distributions from the taxpayer's Roth IRAs (whether or not those distributions were qualified distributions) exceeds the taxpayer's total contributions to all his or her Roth IRAs. To the extent includible in gross income, such a distribution will also be subject to the 10-percent additional tax of section 72(t) unless there is an applicable exception under that section. Such a distribution, however, will not be includible in gross income if it is rolled over to another Roth IRA in accordance with section 408(d)(3). Also, a distribution of an excess contribution under section 408(d)(4) is not includible in gross income (although the allocable net income that must be distributed with the excess contribution is includible in gross income for the taxable year of the excess contribution).

The proposed regulations provide aggregation and ordering rules for Roth IRAs in accordance with section 408A(d)(4). Under these rules, a Roth IRA is not aggregated with a non-Roth IRA, but all a taxpayer's Roth IRAs are aggregated with each other. Roth IRA distributions are treated as made first from Roth IRA contributions and second from earnings. Distributions that are treated as made from contributions are treated as made first from regular contributions and then from conversion contributions on a first-in, first-out basis. A distribution allocable to a particular conversion contribution is treated as consisting first of the portion (if any) of the conversion contribution that was includible in gross income by reason of the conversion.

The proposed regulations provide that, in applying these aggregation and ordering rules: all distributions from all of a taxpayer's Roth IRAs during a taxable year are aggregated; all regular contributions made for the same taxable year to all the individual's Roth IRAs are aggregated and added to the undistributed total regular contributions for prior taxable years; all conversion contributions received during the same taxable year by all the individual's Roth IRAs are aggregated (with a special rule for a conversion contribution made by distribution during 1998 and rollover during 1999 to which the 4-year spread applies); and rollovers between Roth IRAs are disregarded. The proposed regulations also provide special rules for applying the aggregation and ordering rules in the case of recharacterizations under section 408A(d)(6). Distributions of excess contributions and allocable net income pursuant to section 408(d)(4) are treated differently under the ordering rules. Specifically, an excess contribution that is distributed under section 408(d)(4) is treated as though it was never contributed, and any allocable net income thereon is includible in gross income for the taxable year of the contribution without regard to whether the taxpayer still has undistributed basis in his or her Roth IRAs. The proposed regulations provide that, for purposes of these ordering rules, different types of contributions are allocated pro rata among multiple Roth IRA beneficiaries after the Roth IRA owner's death.

Unlike traditional IRAs, the pre-death minimum distribution rules of sections 408(a)(6) and 408(b)(3) (which incorporate the rules of section 401(a)(9)) do not apply to Roth IRAs. Under the proposed regulations, on the death of a Roth IRA owner, the rules in Proposed Treasury Regulations §1.408-8 apply as though the Roth IRA owner died before his or her required beginning date. Thus, the entire amount of the Roth IRA must generally be distributed within five years of the Roth IRA owner's death unless it is distributed over the life expectancy of a designated beneficiary beginning prior to the end of the calendar year following the year of the owner's death. The proposed regulations also provide that, where the sole beneficiary of a Roth IRA is the Roth IRA owner's surviving spouse, the spouse

may delay distributions until the Roth IRA owner would have reached age 70½ or may treat the Roth IRA as his or her own. Under the proposed regulations, section 401(a)(9) applies separately to Roth IRAs and other retirement plans; it also applies separately to Roth IRAs inherited by a beneficiary from one decedent and any other Roth IRAs of which the beneficiary is either the beneficiary of another decedent or the owner.

The proposed regulations provide that section 3405 withholding applies to distributions from Roth IRAs and to Roth IRA conversions (although transition relief is provided for 1998 conversions effected by means of direct transfers of funds between IRAs). The proposed regulations provide that the basis of property distributed from a Roth IRA is its fair market value as of the date of the distribution and that any amount distributed from a Roth IRA and contributed to a retirement plan other than a Roth IRA is not a rollover contribution under section 408(d)(3) or a qualified rollover contribution under section 408A(e). The proposed regulations also provide that a transfer of a Roth IRA by gift would constitute an assignment of the Roth IRA, with the effect that the assets of the Roth IRA would be deemed to be distributed to the Roth IRA owner and, accordingly, treated as no longer held in a Roth IRA.

#### *Reporting Requirements*

Proposed 1.408A-7 sets out the reporting requirements applicable to Roth IRAs. In general, Roth IRA trustees (including custodians and issuers) are subject to the same reporting requirements that apply to trustees of traditional IRAs. However, the instructions to applicable Federal tax forms modify the information generally required from Roth IRA trustees (as well as Roth IRA owners) in certain circumstances. For example, conversions require the filing of a Form 1099-R and a Form 8606. The proposed regulations include special rules for reporting of recharacterization transactions. Trustees are permitted to rely on reasonable representations of a Roth IRA owner or distributee in discharging their reporting obligations.

The IRS is issuing additional guidance on the reporting requirements applicable to Roth IRAs and on other changes in the laws relating to IRAs. This guidance will

be in the form of a notice published in the Internal Revenue Bulletin.

#### *Reliance*

Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

#### *Proposed Effective Date*

These regulations are applicable to taxable years beginning on or after January 1, 1998, the effective date for section 408A.

#### *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. Further, it is hereby certified, pursuant to sections 603(a) and 605(b) of the Regulatory Flexibility Act, that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. The cost of the collection information is insignificant because the primary reporting burden is on the individual and not the small entity. Therefore the collection of information will not have a substantial economic impact. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this 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. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Thursday, December 10, 1998, beginning at 10 a.m. in room 2615 of the 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 15 minutes before the hearing starts.

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 (preferably a signed original and eight (8) copies) by Thursday, November 19, 1998.

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 the proposed regulations is Cathy A. Vohs, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

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#### *Proposed Amendments to the Regulations*

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

#### PART 1—INCOME TAXES

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

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

§1.408A-1 also issued under 26 U.S.C. 408A.

§1.408A-2 also issued under 26 U.S.C. 408A.

§1.408A-3 also issued under 26 U.S.C. 408A.

§1.408A-4 also issued under 26 U.S.C. 408A.

§1.408A-5 also issued under 26 U.S.C. 408A.

§1.408A-6 also issued under 26 U.S.C. 408A.

§1.408A-7 also issued under 26 U.S.C. 408A.

§1.408A-8 also issued under 26 U.S.C. 408A.

§1.408A-9 also issued under 26 U.S.C. 408A. \* \* \*

Par. 2. An undesignated centerheading and §§1.408A-0 through 1.408A-9 are added to read as follows:

#### **Roth IRAs; Questions and Answers**

##### *§1.408A-0 Table of contents.*

This table of contents lists the regulations relating to Roth IRAs under section 408A of the Internal Revenue Code as follows:

§1.408A-1 Roth IRAs in general.

§1.408A-2 Establishing a Roth IRA.

§1.408A-3 Contributions to Roth IRAs.

§1.408A-4 Converting amounts to Roth IRAs.

§1.408A-5 Recharacterized contributions.

§1.408A-6 Distributions.

§1.408A-7 Reporting.

§1.408A-8 Definitions.

§1.408A-9 Effective date.

##### *§1.408A-1 Roth IRAs in general.*

###### Q-1 What is a Roth IRA?

A-1. (a) A Roth IRA is a new type of individual retirement plan that individuals can use, beginning in 1998. Roth IRAs are described in section 408A, which was added by the Taxpayer Relief Act of 1997 (TRA 97), Public Law 105-34 (111 Stat. 788).

(b) Roth IRAs are treated like traditional IRAs except where the Internal Revenue Code specifies different treatment. For example, aggregate contributions (other than by a conversion or other rollover) to all an individual's Roth IRAs are not permitted to exceed \$2,000 for a taxable year. Further, income earned on funds held in a Roth IRA is generally not taxable. Similarly, the rules of section 408(e), such as the loss of exemption of the account where the owner engages in a prohibited transaction, apply to Roth IRAs in the same manner as to traditional IRAs.

Q-2. What are the significant differences between traditional IRAs and Roth IRAs?

A-2. There are several significant differences between traditional IRAs and

Roth IRAs under the Internal Revenue Code. For example, eligibility to contribute to a Roth IRA is subject to special modified AGI (adjusted gross income) limits; contributions to a Roth IRA are never deductible; qualified distributions from a Roth IRA are not includible in gross income; the required minimum distribution rules under section 408(a)(6) and (b)(3) (which generally incorporate the provisions of section 401(a)(9)) do not apply to a Roth IRA during the lifetime of the owner; and contributions to a Roth IRA can be made after the owner has attained age 70½.

##### *§1.408A-2 Establishing a Roth IRA.*

###### Q-1. Who can establish a Roth IRA?

A-1. Except as provided in A-3 of this section, only an individual can establish a Roth IRA. In addition, in order to be eligible to contribute to a Roth IRA for a particular year, an individual must satisfy certain compensation requirements and adjusted gross income limits (see §1.408A-3 A-3).

###### Q-2. How is a Roth IRA established?

A-2. A Roth IRA can be established with any bank, insurance company, or other person authorized in accordance with §1.408-2(e) to serve as a trustee with respect to IRAs. The document establishing the Roth IRA must clearly designate the IRA as a Roth IRA, and this designation cannot be changed at a later date. Thus, an IRA that is designated as a Roth IRA cannot later be treated as a traditional IRA. However, see §1.408A-5 of this section for rules for recharacterizing certain IRA contributions.

Q-3. Can an employer or an association of employees establish a Roth IRA to hold contributions of employees or members?

A-3. Yes. Pursuant to section 408(c), an employer or an association of employees can establish a trust to hold contributions of employees or members made under a Roth IRA. Each employee's or member's account in the trust is treated as a separate Roth IRA that is subject to the generally applicable Roth IRA rules. The employer or association of employees may do certain acts otherwise required by an individual, for example, establishing and designating a trust as a Roth IRA.

Q-4. What is the effect of a surviving spouse of a Roth IRA owner treating an IRA as his or her own?

A-4. If the surviving spouse of a Roth IRA owner treats a Roth IRA as his or her own as of a date, from that date forward, the Roth IRA is treated as though it were established for the benefit of the surviving spouse and not the original Roth IRA owner. Thus, for example, the surviving spouse is treated as the Roth IRA owner for purposes of applying the minimum distribution requirements under section 408(a)(6) and (b)(3). Similarly, the surviving spouse is treated as the Roth IRA owner rather than a beneficiary for purposes of determining the amount of any distribution from the Roth IRA that is includible in gross income and whether the distribution is subject to the 10-percent additional tax under section 72(t).

#### *§1.408A-3 Contributions to Roth IRAs.*

Q-1. What types of contributions are permitted to be made to a Roth IRA?

A-1. There are two types of contributions that are permitted to be made to a Roth IRA: regular contributions and qualified rollover contributions (including conversion contributions). The term regular contributions means contributions other than qualified rollover contributions.

Q-2. When are contributions permitted to be made to a Roth IRA?

A-2. (a) The provisions of section 408A are effective for taxable years beginning on or after January 1, 1998. Thus, the first taxable year for which contributions are permitted to be made to a Roth IRA by an individual is the individual's taxable year beginning in 1998.

(b) Regular contributions for a particular taxable year must generally be contributed by the due date (not including extensions) for filing a Federal income tax return for that taxable year. (See §1.408A-5 regarding recharacterization of certain contributions.)

Q-3. What is the maximum aggregate amount of regular contributions an individual is eligible to contribute to a Roth IRA for a taxable year?

A-3. (a) The maximum aggregate amount that an individual is eligible to contribute to all his or her Roth IRAs as a regular contribution for a taxable year is the same as the maximum for traditional IRAs: \$2,000 or, if less, that individual's compensation for the year.

(b) For Roth IRAs, the maximum amount described in paragraph (a) of this

A-3 is phased out between certain levels of modified AGI. For an individual who is not married, the dollar amount is phased out ratably between modified AGI of \$95,000 and \$110,000; for a married individual filing a joint return, between modified AGI of \$150,000 and \$160,000; and for a married individual filing separately, between modified AGI of \$0 and \$10,000. For this purpose, a married individual who has lived apart from his or her spouse for the entire taxable year and who files separately is treated as not married. Under section 408A(c)(3)(A), in applying the phase-out, the maximum amount is rounded up to the next higher multiple of \$10 and is not reduced below \$200 until completely phased out.

(c) If an individual makes regular contributions to both traditional IRAs and Roth IRAs for a taxable year, the maximum limit for the Roth IRA is the lesser of—

(1) The amount described in paragraph (a) of this A-3 reduced by the amount contributed to traditional IRAs for the taxable year; and

(2) The amount described in paragraph (b) of this A-3. Employer contributions, including elective deferrals, made under a SEP or SIMPLE IRA Plan on behalf of an individual (including a self-employed individual) do not reduce the amount of the individual's maximum regular contribution.

(d) The rules in this A-3 are illustrated by the following examples:

*Example 1.* In 1998, unmarried, calendar-year taxpayer B, age 60, has modified AGI of \$40,000 and compensation of \$5,000. For 1998, B can contribute a maximum of \$2,000 to a traditional IRA, a Roth IRA or a combination of traditional and Roth IRAs.

*Example 2.* The facts are the same as in *Example 1*. However, assume that B violates the maximum regular contribution limit by contributing \$2,000 to a traditional IRA and \$2,000 to a Roth IRA for 1998. The \$2,000 to B's Roth IRA would be an excess contribution to B's Roth IRA for 1998 because an individual's contributions are applied first to a traditional IRA, then to a Roth IRA.

*Example 3.* The facts are the same as in *Example 1*, except that B's compensation is \$900. The maximum amount B can contribute to either a traditional IRA or a Roth (or a combination of the two) for 1998 is \$900.

*Example 4.* In 1998, unmarried, calendar-year taxpayer C, age 60, has modified AGI of \$100,000 and compensation of \$5,000. For 1998, C contributes \$800 to a traditional IRA and \$1,200 to a Roth IRA. Because C's \$1,200 Roth IRA contribution does not exceed the phased-out maximum Roth

IRA contribution of \$1,340 and because C's total IRA contributions do not exceed \$2,000, C's Roth IRA contribution does not exceed the maximum permissible contribution.

Q-4. How is compensation defined for purposes of the Roth IRA contribution limit?

A-4. For purposes of the contribution limit described in A-3 of this section, an individual's compensation is the same as that used to determine the maximum contribution an individual can make to a traditional IRA. This amount is defined in section 219(f)(1) to include wages, commissions, professional fees, tips, and other amounts received for personal services, as well as taxable alimony and separate maintenance payments received under a decree of divorce or separate maintenance. Compensation also includes earned income as defined in section 401(c)(2), but does not include any amount received as a pension or annuity or as deferred compensation. In addition, under section 219(c), a married individual filing a joint return is permitted to make an IRA contribution by treating his or her spouse's higher compensation as his or her own, but only to the extent that the spouse's compensation is not being used for purposes of the spouse making a contribution to a Roth IRA or a deductible contribution to a traditional IRA.

Q-5. What is the significance of modified AGI and how is it determined?

A-5. Modified AGI is used for purposes of the phase-out rules described in A-3 of this section and for purposes of the \$100,000 modified AGI limitation described in §1.408A-4 A-2(a) (relating to eligibility for conversion). As defined in section 408A(c)(3)(C)(i), modified AGI is the same as adjusted gross income under section 219(g)(3)(A) (used to determine the amount of deductible contributions that can be made to a traditional IRA by an individual who is an active participant in an employer-sponsored retirement plan), except that any conversion is disregarded in determining modified AGI. For example, the deduction for contributions to an IRA is not taken into account for purposes of determining adjusted gross income under section 219 and thus does not apply in determining modified AGI for Roth IRA purposes.

Q-6. Is a required minimum distribution from an IRA for a year included in in-



come for purposes of determining modified AGI?

A-6. (a) Yes. For taxable years beginning before January 1, 2005, any required minimum distribution from an IRA under section 408(a)(6) and (b)(3) (which generally incorporate the provisions of section 401(a)(9)) is included in income for purposes of determining modified AGI.

(b) For taxable years beginning after December 31, 2004, and solely for purposes of the \$100,000 limitation applicable to conversions, modified AGI does not include any required minimum distributions from an IRA under section 408(a)(6) and (b)(3).

Q-7. Does an excise tax apply if an individual exceeds the aggregate regular contribution limits for Roth IRAs?

A-7. Yes. Section 4973 imposes an annual 6-percent excise tax on aggregate amounts contributed to Roth IRAs that exceed the maximum contribution limits described in A-3 of this section. Any contribution that is distributed, together with net income, from a Roth IRA on or before the tax return due date (plus extensions) for the taxable year of the contribution is treated as not contributed. Net income described in the previous sentence is includible in gross income for the taxable year in which the contribution is made. Section 4973 applies separately to an individual's Roth IRAs and other IRAs.

#### *§1.408A-4 Converting amounts to Roth IRAs.*

Q-1. Can an individual convert an amount in his or her traditional IRA to a Roth IRA?

A-1. (a) Yes. An amount in a traditional IRA may be converted to an amount in a Roth IRA if two requirements are satisfied. First, the IRA owner must satisfy the modified AGI limitation described in A-2(a) of this section and, if married, the joint filing requirement described in A-2(b) of this section. Second, the amount contributed to the Roth IRA must satisfy the definition of a qualified rollover contribution in section 408A(e) (i.e., it must satisfy the requirements for a rollover contribution as defined in section 408(d)(3), except that the one-rollover-per-year limitation in section 408(d)(3)-(B) does not apply).

(b) An amount can be converted by any of three methods—

(1) An amount distributed from a traditional IRA is contributed (rolled over) to a Roth IRA within 60 days after the distribution;

(2) An amount in a traditional IRA is transferred in a trustee-to-trustee transfer from the trustee of the traditional IRA to the trustee of the Roth IRA; or

(3) An amount in a traditional IRA is transferred to a Roth IRA maintained by the same trustee.

(c) Any converted amount is treated as a distribution from the traditional IRA and a qualified rollover contribution to the Roth IRA for purposes of section 408 and section 408A, even if the conversion is accomplished by means of a trustee-to-trustee transfer or a transfer between IRAs of the same trustee.

Q-2. What are the modified AGI limitation and joint filing requirements for conversions?

A-2. (a) An individual with modified AGI in excess of \$100,000 for a taxable year is not permitted to convert an amount to a Roth IRA during that taxable year. This \$100,000 limitation applies to the taxable year that the funds are paid from the traditional IRA, rather than the year they are contributed to the Roth IRA.

(b) If the individual is married, he or she is permitted to convert an amount to a Roth IRA during a taxable year only if the individual and the individual's spouse file a joint return for the taxable year that the funds are paid from the traditional IRA. In this case, the modified AGI subject to the \$100,000 limit is the modified AGI derived from the joint return using the couple's combined income. The only exception to this joint filing requirement is for an individual who has lived apart from his or her spouse for the entire taxable year. If the married individual has lived apart from his or her spouse for the entire taxable year, then such individual can treat himself or herself as not married for purposes of this paragraph, file a separate return and be subject to the \$100,000 limit on his or her separate modified AGI. In all other cases, a married individual filing a separate return is not permitted to convert an amount to a Roth IRA, regardless of the individual's modified AGI.

Q-3. Is a remedy available to an individual who, intending to make a conversion, contributes amounts from a traditional IRA to a Roth IRA, but who is

ineligible to make a conversion (a failed conversion)?

A-3. (a) Yes. See §1.408A-5 for rules permitting a failed conversion amount to be recharacterized as a contribution to a traditional IRA. If the requirements in §1.408A-5 are satisfied, the failed conversion amount will be treated as having been contributed to the traditional IRA and not to the Roth IRA.

(b) If the contribution is not recharacterized in accordance with §1.408A-5, the contribution will be treated as a regular contribution to the Roth IRA and, thus, an excess contribution subject to the excise tax under section 4973 to the extent that it exceeds the individual's regular contribution limit. Additionally, the distribution from the traditional IRA will not be eligible for the 4-year spread and will be subject to the additional tax under section 72(t) (unless an exception under that section applies).

Q-4. Do any special rules apply to a conversion of an amount in an individual's SEP IRA or SIMPLE IRA to a Roth IRA?

A-4. (a) An amount in an individual's SEP IRA can be converted to a Roth IRA on the same terms as an amount in any other traditional IRA.

(b) An amount in an individual's SIMPLE IRA can be converted to a Roth IRA on the same terms as a conversion from a traditional IRA, except that an amount distributed from a SIMPLE IRA during the 2-year period described in section 72(t)(6), which begins on the date that the individual first participated in any SIMPLE IRA Plan maintained by the individual's employer, cannot be converted to a Roth IRA. Pursuant to section 408(d)(3)(G), a distribution of an amount from an individual's SIMPLE IRA during this 2-year period is not eligible to be rolled over into an IRA that is not a SIMPLE IRA and thus cannot be a qualified rollover contribution. This 2-year period of section 408(d)(3)(G) applies separately to the contributions of each of an individual's employers maintaining a SIMPLE IRA Plan.

(c) Once an amount in a SEP IRA or SIMPLE IRA has been converted to a Roth IRA, it is treated as a contribution to a Roth IRA for all purposes. Future contributions under the SEP or under the SIMPLE IRA Plan may not be made to the Roth IRA.

Q-5. Can amounts in other kinds of retirement plans be converted to a Roth IRA?

A-5. No. Only amounts in another IRA can be converted to a Roth IRA. For example, amounts in a qualified plan or annuity plan described in section 401(a) or 403(a) cannot be converted directly to a Roth IRA. Also, amounts held in an annuity contract or account described in section 403(b) cannot be converted directly to a Roth IRA.

Q-6. Can an individual who has attained at least age 70½ by the end of a calendar year convert an amount distributed from a traditional IRA during that year to a Roth IRA before receiving his or her required minimum distribution with respect to the traditional IRA for the year of the conversion?

A-6. (a) No. In order to be eligible for a conversion, an amount first must be eligible to be rolled over. Section 408(d)(3) prohibits the rollover of a required minimum distribution. If a minimum distribution is required for a year with respect to an IRA, the first dollars distributed during that year are treated as consisting of the required minimum distribution until an amount equal to the required minimum distribution for that year has been distributed.

(b) As provided in A-1(c) of this section, any amount converted is treated as a distribution from a traditional IRA and a rollover contribution to a Roth IRA and not as a trustee-to-trustee transfer for purposes of section 408 and section 408A. Thus, in a year for which a minimum distribution is required (including the calendar year in which the individual attains age 70½), an individual may not convert the assets of an IRA (or any portion of those assets) to a Roth IRA to the extent that the required minimum distribution for the traditional IRA for the year has not been distributed.

(c) If a required minimum distribution is contributed to a Roth IRA, it is treated as having been distributed, subject to the normal rules under section 408(d)(1) and (2), and then contributed as a regular contribution to a Roth IRA. The amount of the required minimum distribution is not a conversion contribution.

Q-7. What are the tax consequences when an amount is converted to a Roth IRA?

A-7. (a) Any amount that is converted to a Roth IRA is includible in gross income as a distribution according to the rules of section 408(d)(1) and (2) for the taxable year in which the amount is distributed or transferred from the traditional IRA. Thus, any portion of the distribution or transfer that is treated as a return of basis under section 408(d)(1) and (2) is not includible in gross income as a result of the conversion.

(b) The 10-percent additional tax under section 72(t) generally does not apply to the taxable conversion amount. But see §1.408A-6 A-5 for circumstances under which the taxable conversion amount would be subject to the additional tax under section 72(t).

(c) Pursuant to section 408A(e), a conversion is not treated as a rollover for purposes of the one-rollover-per-year rule of section 408(d)(3)(B).

Q-8. Is there an exception to the income-inclusion rule described in A-7 of this section for 1998 conversions?

A-8. Yes. In the case of a distribution (including a trustee-to-trustee transfer) from a traditional IRA on or before December 31, 1998, that is converted to a Roth IRA, instead of having the entire taxable conversion amount includible in income in 1998, an individual includes in gross income for 1998 only one quarter of that amount and one quarter of that amount for each of the next 3 years. This 4-year spread also applies if the conversion amount was distributed in 1998 and contributed to the Roth IRA within 60 days, but after December 31, 1998. However, see §1.408A-6 A-6 for special rules requiring acceleration of inclusion if an amount subject to the 4-year spread is distributed from the Roth IRA before 2001.

Q-9. Is the taxable conversion amount included in income for all purposes?

A-9. Except as provided below, any taxable conversion amount includible in gross income for a year as a result of the conversion (regardless of whether the individual is using a 4-year spread) is included in income for all purposes. Thus, for example, it is counted for purposes of determining the taxable portion of social security payments under section 86 and for purposes of determining the phase-out of the \$25,000 exemption under section 469(i) relating to the disallowance of passive activity losses from rental real estate

activities. However, as provided in §1.408A-3 A-5, the taxable conversion amount (and any resulting change in other elements of adjusted gross income) is disregarded for purposes of determining modified AGI for section 408A.

Q-10. Can an individual who makes a 1998 conversion elect not to have the 4-year spread apply and instead have the full taxable conversion amount includible in gross income for 1998?

A-10. Yes. Instead of having the taxable conversion amount for a 1998 conversion included over 4 years as provided under A-8 of this section, an individual can elect to include the full taxable conversion amount in income for 1998. The election is made on Form 8606 and cannot be made or changed after the due date (including extensions) for filing the 1998 Federal income tax return.

Q-11. What happens when an individual who is using the 4-year spread dies before the full taxable conversion amount has been included in gross income?

A-11. (a) If an individual who is using the 4-year spread described in A-8 of this section dies before the full taxable conversion amount has been included in gross income, then the remainder must be included in the individual's gross income for the taxable year that includes the date of death.

(b) However, if the sole beneficiary of all the decedent's Roth IRAs is the decedent's spouse, then the spouse can elect to continue the 4-year spread. Thus, the spouse can elect to include in gross income the same amount that the decedent would have included in each of the remaining years of the 4-year period. Where the spouse makes such an election, the amount includible under the 4-year spread for the taxable year that includes the date of the decedent's death remains includible in the decedent's gross income and is reported on the decedent's final Federal income tax return. The election is made on either Form 8606 or Form 1040, in accordance with the instructions to the applicable form, for the taxable year that includes the decedent's date of death and cannot be changed after the due date (including extensions) for filing the Federal income tax return for the spouse's taxable year that includes the decedent's date of death.

Q-12. Can an individual convert a traditional IRA to a Roth IRA if he or she is

receiving substantially equal periodic payments within the meaning of section 72(t)(2)(A)(iv) from that traditional IRA?

A. Yes. Not only is the conversion amount itself not subject to the early distribution tax under section 72(t), but the conversion amount is also not treated as a distribution for purposes of determining whether a modification within the meaning of section 72(t)(4)(A) has occurred. However, if the original series of substantially equal periodic payments does not continue to be distributed in substantially equal periodic payments from the Roth IRA after the conversion, the series of payments will have been modified and, if this modification occurs within 5 years of the first payment or prior to the individual becoming disabled or attaining age 59½, the taxpayer will be subject to the recapture tax of section 72(t)(4)(A).

Q-13. Can a 1997 distribution from a traditional IRA be converted to a Roth IRA in 1998?

A-13. No. An amount distributed from a traditional IRA in 1997 that is contributed to a Roth IRA in 1998 would not be a conversion contribution. See A-3 of this section regarding the remedy for a failed conversion.

#### *§1.408A-5 Recharacterized contributions.*

Q-1. Can an IRA owner recharacterize certain contributions (i.e., treat a contribution made to one type of IRA as made to a different type of IRA) for a taxable year?

A-1. (a) Yes. In accordance with section 408A(d)(6), except as otherwise provided in this section, if an individual makes a contribution to an IRA (the FIRST IRA) for a taxable year and then transfers the contribution (or a portion of the contribution) in a trustee-to-trustee transfer from the trustee of the FIRST IRA to the trustee of another IRA (the SECOND IRA), the individual can elect to treat the contribution as having been made to the SECOND IRA, instead of to the FIRST IRA, for Federal tax purposes. A transfer between the FIRST IRA and the SECOND IRA will not fail to be a trustee-to-trustee transfer merely because both IRAs are maintained by the same trustee.

(b) This recharacterization election can be made only if the trustee-to-trustee

transfer from the FIRST IRA to the SECOND IRA is made on or before the due date (including extensions) for filing the individual's Federal income tax return for the taxable year for which the contribution was made to the FIRST IRA. For purposes of this section, a conversion that is accomplished through a rollover of a distribution from a traditional IRA in a taxable year that, within 60 days after the distribution, is contributed to a Roth IRA in the next taxable year is treated as a contribution for the earlier taxable year.

Q-2. What is the proper treatment of the net income attributable to the contribution that is being recharacterized?

A-2. (a) The net income attributable to the contribution that is being recharacterized must be transferred to the SECOND IRA along with the contribution.

(b) If the amount of the contribution being recharacterized was contributed to a separate IRA and no distributions or additional contributions have been made from or to that IRA at any time, then the contribution is recharacterized by the trustee of the FIRST IRA transferring the entire account balance of the FIRST IRA to the trustee of the SECOND IRA. In this case, the net income (or loss) attributable to the contribution being recharacterized is the difference between the amount of the original contribution and the amount transferred.

(c) If paragraph (b) of this A-2 does not apply, then the net income attributable to the contribution is calculated in the manner prescribed by §1.408-4(c)(2)(ii).

Q-3. What is the effect of recharacterizing a contribution made to the FIRST IRA as a contribution made to the SECOND IRA?

A-3. The contribution that is being recharacterized as a contribution to the SECOND IRA is treated as having been originally contributed to the SECOND IRA on the same date and (in the case of a regular contribution) for the same taxable year that the contribution was made to the FIRST IRA. Thus, for example, no deduction would be allowed for a contribution to the FIRST IRA, and any net income transferred with the recharacterized contribution is treated as earned in the SECOND IRA, and not the FIRST IRA.

Q-4. Can an amount contributed to an IRA in a tax-free transfer be recharacterized under A-1 of this section?

A-4. No. If an amount is contributed to the FIRST IRA in a tax-free transfer, the amount cannot be recharacterized as a contribution to the SECOND IRA under A-1 of this section. However, if an amount is erroneously rolled over or transferred from a traditional IRA to a SIMPLE IRA, the contribution can subsequently be recharacterized as a contribution to another traditional IRA.

Q-5. Can an amount contributed by an employer under a SIMPLE IRA Plan or a SEP be recharacterized under A-1 of this section?

A-5. No. Employer contributions (including elective deferrals) under a SIMPLE IRA Plan or a SEP cannot be recharacterized as contributions to another IRA under A-1 of this section.

Q-6. How does a taxpayer make the election to recharacterize a contribution to an IRA for a taxable year?

A-6. (a) An individual makes the election described in this section by notifying, on or before the date of the transfer, both the trustee of the FIRST IRA and the trustee of the SECOND IRA, that the individual has elected to treat the contribution as having been made to the SECOND IRA, instead of the FIRST IRA, for Federal tax purposes. The notification of the election must include the following information: the type and amount of the contribution to the FIRST IRA that is to be recharacterized; the date on which the contribution was made to the FIRST IRA and the year for which it was made; a direction to the trustee of the FIRST IRA to transfer, in a trustee-to-trustee transfer, the amount of the contribution and net income allocable to the contribution to the trustee of the SECOND IRA; and the name of the trustee of the FIRST IRA and the trustee of the SECOND IRA and any additional information needed to make the transfer.

(b) The election and the trustee-to-trustee transfer must occur on or before the due date (including extensions) for filing the individual's Federal income tax return for the taxable year for which the recharacterized contribution was made to the FIRST IRA, and the election cannot be revoked after the transfer. An individual who makes this election must report the recharacterization, and must treat the contribution as having been made to the SECOND IRA, instead of the FIRST

IRA, on the individual's Federal income tax return for the taxable year described in the preceding sentence in accordance with the applicable Federal tax forms and instructions.

Q-7. If an amount is initially contributed to an IRA for a taxable year, then is moved (with net income attributable to the contribution) in a tax-free transfer to another IRA (the FIRST IRA for purposes of A-1 of this section), can the tax-free transfer be disregarded, so that the initial contribution that is transferred from the FIRST IRA to the SECOND IRA is treated as a recharacterization of that initial contribution?

A-7. Yes. In applying section 408A(d)(6), tax-free transfers between IRAs are disregarded. Thus, if a contribution to an IRA for a year is followed by one or more tax-free transfers between IRAs prior to the recharacterization, then for purposes of section 408A(d)(6), the contribution is treated as if it remained in the initial IRA. Consequently, an individual may elect to recharacterize an initial contribution made to the initial IRA that was involved in a series of tax-free transfers by making a trustee-to-trustee transfer from the last IRA in the series to the SECOND IRA. In this case the contribution to the SECOND IRA is treated as made on the same date (and for the same taxable year) as the date the contribution being recharacterized was made to the initial IRA.

Q-8. If a contribution is recharacterized, is the recharacterization treated as a rollover for purposes of the one-rollover-per-year limitation of section 408(d)(3)(B)?

A-8. No, recharacterizing a contribution under A-1 of this section is never treated as a rollover for purpose of the one-rollover-per-year limitation of section 408(d)(3)(B), even if the contribution would have been treated as a rollover contribution by the SECOND IRA if it had been made directly to the SECOND IRA, rather than as a result of a recharacterization of a contribution to the FIRST IRA.

Q-9. Are there examples to illustrate the rules in this section?

A-9. The rules in this section are illustrated by the following examples:

*Example 1.* In 1998, Individual C converts the entire amount in his traditional IRA to a Roth IRA. Individual C thereafter determines that his modified

AGI for 1998 exceeded \$100,000 so that he was ineligible to have made a conversion in that year. Accordingly, prior to the due date (plus extensions) for filing the individual's Federal income tax return for 1998, he decides to recharacterize the conversion contribution. He instructs the trustee of the Roth IRA (FIRST IRA) to transfer in a trustee-to-trustee transfer the amount of the contribution, plus net income, to the trustee of a new traditional IRA (SECOND IRA). The individual notifies the trustee of the FIRST IRA and the trustee of the SECOND IRA that he is recharacterizing his IRA contribution (and provides the other information described in A-6 of this section). On the individual's Federal income tax return for 1998, he treats the original amount of the conversion as having been contributed to the SECOND IRA and not the Roth IRA. As a result, for Federal tax purposes, the contribution is treated as having been made to the SECOND IRA and not to the Roth IRA. The result would be the same if the conversion amount had been transferred in a tax-free transfer to another Roth IRA prior to the recharacterization.

*Example 2.* In 1998, an individual makes a \$2,000 regular contribution for 1998 to his traditional IRA (FIRST IRA). Prior to the due date (plus extensions) for filing the individual's Federal income tax return for 1998, he decides that he would prefer to contribute to a Roth IRA instead. The individual instructs the trustee of the FIRST IRA to transfer in a trustee-to-trustee transfer the amount of the contribution, plus attributable net income, to the trustee of a Roth IRA (SECOND IRA). The individual notifies the trustee of the FIRST IRA and the trustee of the SECOND IRA that he is recharacterizing his \$2,000 contribution for 1998 (and provides the other information described in A-6 of this section). On the individual's Federal income tax return for 1998, he treats the \$2,000 as having been contributed to the Roth IRA for 1998 and not to the traditional IRA. As a result, for Federal tax purposes, the contribution is treated as having been made to the Roth IRA for 1998 and not to the traditional IRA. The result would be the same if the conversion amount had been transferred in a tax-free transfer to another traditional IRA prior to the recharacterization.

*Example 3.* The facts are the same as in *Example 2*, except that the \$2,000 regular contribution is initially made to a Roth IRA and the recharacterizing transfer is made to a traditional IRA. On the individual's Federal income tax return for 1998, he treats the \$2,000 as having been contributed to the traditional IRA for 1998 and not the Roth IRA. As a result, for Federal tax purposes, the contribution is treated as having been made to the traditional IRA for 1998 and not the Roth IRA. The result would be the same if the contribution had been transferred in a tax-free transfer to another Roth IRA prior to the recharacterization, except that the only Roth IRA trustee the individual must notify is the one actually making the recharacterization transfer.

*Example 4.* In 1998, an individual receives a distribution from traditional IRA 1 and contributes the entire amount to traditional IRA 2 in a rollover contribution described in section 408(d)(3). In this case, the individual cannot elect to recharacterize the contribution by transferring the contribution amount, plus net income, to a Roth IRA, because an amount contributed to an IRA in a tax-free transfer cannot be recharacterized. However, the individual

may convert (other than by recharacterization) the amount in traditional IRA 2 to a Roth IRA at any time, provided the requirements of §1.408A-4 A-1 are satisfied.

#### *§1.408A-6 Distributions.*

Q-1. How are distributions from Roth IRAs taxed?

A-1. (a) The taxability of a distribution from a Roth IRA generally depends on whether or not the distribution is a qualified distribution. This A-1 provides rules for qualified distributions and certain other nontaxable distributions. A-4 of this section provides rules for the taxability of distributions that are not qualified distributions.

(b) A distribution from a Roth IRA is not includible in the owner's gross income if it is a qualified distribution or to the extent that it is a return of the owner's contributions to the Roth IRA (determined in accordance with A-8 of this section). A qualified distribution is one that is both—

(1) Made after a 5-taxable-year period (defined in A-2 of this section); and

(2) Made on or after the date on which the owner attains age 59½, made to a beneficiary or the estate of the owner on or after the date of the owner's death, attributable to the owner's being disabled within the meaning of section 72(m)(7), or to which section 72(t)(2)(F) applies (exception for first-time home purchase).

(c) An amount distributed from a Roth IRA will not be included in gross income to the extent it is rolled over to another Roth IRA on a tax-free basis under the rules of sections 408(d)(3) and 408A(e).

(d) Excess contributions that are returned to the Roth IRA owner in accordance with section 408(d)(4) (corrective distributions) are not includible in gross income, but any net income required to be distributed under section 408(d)(4) together with the excess contribution is includible in gross income for the taxable year in which the excess contribution was made.

Q-2. When does the 5-taxable-year period described in A-1 of this section (relating to qualified distributions) begin and end?

A-2. The 5-taxable-year period described in A-1 of this section begins on the first day of the individual's taxable year for which the first regular contribu-

tion is made to any Roth IRA of the individual or, if earlier, the first day of the individual's taxable year in which the first conversion contribution is made to any Roth IRA of the individual. The 5-taxable-year period ends on the last day of the individual's fifth consecutive taxable year beginning with the taxable year described in the preceding sentence. For example, if an individual whose taxable year is the calendar year makes a first-time regular Roth IRA contribution any time between January 1, 1998, and April 15, 1999, for 1998, the 5-taxable-year period begins on January 1, 1998. Thus, each Roth IRA owner has only one 5-taxable-year period described in A-1 of this section for all the Roth IRAs of which he or she is the owner. Further, because of the requirement of the 5-taxable-year period, no qualified distributions can occur before taxable years beginning in 2003.

Q-3. If a distribution is made to an individual who is the sole beneficiary of his or her deceased spouse's Roth IRA and the individual is treating the Roth IRA as his or her own, can the distribution be a qualified distribution based on being made to a beneficiary on or after the owner's death?

A-3. No. If a distribution is made to an individual who is the sole beneficiary of his or her deceased spouse's Roth IRA and the individual is treating the Roth IRA as his or her own, then, in accordance with §1.408A-2 A-4, the distribution is treated as coming from the individual's own Roth IRA and not the deceased spouse's Roth IRA. Therefore, for purposes of determining whether the distribution is a qualified distribution, it is not treated as made to a beneficiary on or after the owner's death.

Q-4. How is a distribution from a Roth IRA taxed if it is not a qualified distribution?

A-4. A distribution that is not a qualified distribution, and is neither contributed to another Roth IRA in a qualified rollover contribution nor constitutes a corrective distribution, is includible in the owner's gross income to the extent that the amount of the distribution, when added to the amount of all previous distributions from the owner's Roth IRAs (whether or not they were qualified distributions), exceeds the owner's contributions to all his or her Roth IRAs. For pur-

poses of this A-4, any amount distributed as a corrective distribution is treated as if it was never contributed.

Q-5. Will the additional tax under 72(t) apply to the amount of a distribution that is not a qualified distribution?

A-5. (a) The 10-percent additional tax under section 72(t) will apply (unless the distribution is excepted under section 72(t)) to any distribution from a Roth IRA includible in gross income.

(b) The 10-percent additional tax under section 72(t) also applies to a nonqualified distribution, even if it is not then includible in gross income, to the extent it is allocable to a conversion contribution, if the distribution is made within the 5-taxable-year period beginning with the first day of the individual's taxable year in which the conversion contribution was made. The 5-taxable-year period ends on the last day of the individual's fifth consecutive taxable year beginning with the taxable year described in the preceding sentence. For purposes of applying the tax, only the amount of the conversion includible in gross income as a result of the conversion is taken into account. The exceptions under section 72(t) also apply to such a distribution.

(c) The 5-taxable-year period described in this A-5 for purposes of determining whether section 72(t) applies to a distribution allocable to a conversion contribution is separately determined for each conversion contribution, and need not be the same as the 5-taxable-year period used for purposes of determining whether a distribution is a qualified distribution under A-1(b) of this section. For example, if a calendar-year taxpayer who received a distribution from a traditional IRA on December 31, 1998, makes a conversion contribution by contributing the distributed amount to a Roth IRA on February 25, 1999 in a qualifying rollover contribution and makes a regular contribution for 1998 on the same date, the 5-taxable-year period for purposes of this A-5 begins on January 1, 1999, while the 5-taxable-year period for purposes of A-1(b) of this section begins on January 1, 1998.

Q-6. Is there a special rule for taxing distributions allocable to a 1998 conversion?

A-6. Yes. In the case of a distribution from a Roth IRA in 1998, 1999 or 2000 of amounts allocable to a 1998 conversion

with respect to which the 4-year spread for the resultant income inclusion applies (see §1.408A-4 A-8), any income deferred as a result of the election to years after the year of the distribution is accelerated so that it is includible in gross income in the year of the distribution up to the amount of the distribution allocable to the 1998 conversion (determined under A-8 of this section). This amount is in addition to the amount otherwise includible in the owner's gross income for that taxable year as a result of the conversion. However, this rule will not require the inclusion of any amount to the extent it exceeds the total amount of income required to be included over the 4-year period. The acceleration of income inclusion described in this A-6 applies in the case of a surviving spouse who elects to continue the 4-year spread in accordance with §1.408A-4 A-11(b).

Q-7. Is the 5-taxable-year period described in A-1 of this section redetermined when a Roth IRA owner dies?

A-7. (a) No. The beginning of the 5-taxable-year period described in A-1 of this section is not redetermined when the Roth IRA owner dies. Thus, in determining the 5-taxable-year period, the period the Roth IRA is held in the name of a beneficiary, or in the name of a surviving spouse who treats the decedent's Roth IRA as his or her own, includes the period it was held by the decedent.

(b) The 5-taxable-year period for a Roth IRA held by an individual as a beneficiary of a deceased Roth IRA owner is determined independently of the 5-taxable-year period for the beneficiary's own Roth IRA. However, if a surviving spouse treats the Roth IRA as his or her own, the 5-taxable-year period with respect to any of the surviving spouse's Roth IRAs (including the one that the surviving spouse treats as his or her own) ends at the earlier of the end of either the 5-taxable-year period for the decedent or the 5-taxable-year period applicable to the spouse's own Roth IRAs.

Q-8. How is it determined whether an amount distributed from a Roth IRA is allocated to regular contributions, conversion contributions, or earnings?

A-8. (a) Any amount distributed from an individual's Roth IRA is treated as made in the following order (determined as of the end of a taxable year and ex-

hausting each category before moving to the following category)—

- (1) From regular contributions;
- (2) From conversion contributions, on a first-in-first-out basis; and
- (3) from earnings.

(b) To the extent a distribution is treated as made from a particular conversion contribution, it is treated as made first from the portion, if any, that was includible in gross income as a result of the conversion.

Q-9. Are there special rules for determining the source of distributions under A-8 of this section?

A-9. Yes. For purposes of determining the source of distributions, the following rules apply:

(a) All distributions from all an individual's Roth IRAs made during a taxable year are aggregated.

(b) All regular contributions made for the same taxable year to all the individual's Roth IRAs are aggregated and added to the undistributed total regular contributions for prior taxable years. Regular contributions for a year include contributions made in the following taxable year that are identified as made for the taxable year. For example, a regular contribution made in 1999 for 1998 is aggregated with the contributions made in 1998 for 1998.

(c) All conversion contributions received during the same taxable year by all the individual's Roth IRAs are aggregated. Notwithstanding the preceding sentence, all conversion contributions made by an individual during 1999 that were distributed from a traditional IRA in 1998 and with respect to which the 4-year spread applies are treated for purposes of A-8(b) of this section as contributed to the individual's Roth IRAs prior to any other conversion contributions made by the individual during 1999.

(d) A distribution from an individual's Roth IRA that is rolled over to another Roth IRA of the individual is disregarded for purposes of determining the amount of both contributions and distributions.

(e) Any amount distributed as a corrective distribution (including net income), as described in A-1(d) of this section, is disregarded in determining the amount of contributions, earnings, and distributions.

(f) If an individual recharacterizes a contribution made to a traditional IRA (FIRST IRA) by transferring the contribu-

tion to a Roth IRA (SECOND IRA) in accordance with §1.408A-5, then, pursuant to §1.408A-5 A-3, the contribution to the Roth IRA is taken into account for the same taxable year for which it would have been taken into account if the contribution had originally been made to the Roth IRA and had never been contributed to the traditional IRA. Thus, the contribution to the Roth IRA is treated as contributed to the Roth IRA on the same date and for the same taxable year that the contribution was made to the traditional IRA.

(g) If an individual recharacterizes a regular or conversion contribution made to a Roth IRA (FIRST IRA) by transferring the contribution to a traditional IRA (SECOND IRA) in accordance with §1.408A-5, then pursuant to §1.408A-5 A-3, the contribution to the Roth IRA and the recharacterizing transfer are disregarded in determining the amount of both contributions and distributions for the taxable year with respect to which the original contribution was made to the Roth IRA.

(h) Pursuant to §1.408A-5 A-3, the effect of income or loss (determined in accordance with §1.408A-5 A-2) occurring after the contribution to the FIRST IRA is disregarded in determining the amounts described in paragraphs (f) and (g) of this A-9. Thus, for purposes of paragraphs (f) and (g), the amount of the contribution is determined based on the original contribution.

Q-10. Are there examples to illustrate the ordering rules described in A-8 and A-9 of this section?

A-10. Yes. The following examples illustrate these ordering rules:

*Example 1.* In 1998, individual B converts \$80,000 in his traditional IRA to a Roth IRA. B has a basis of \$20,000 in the conversion amount and so must include the remaining \$60,000 in gross income. He decides to spread the \$60,000 income by including \$15,000 in each of the 4 years 1998-2001, under the rules of §1.408A-4 A-8. B also makes a regular contribution of \$2,000 in 1998. If a distribution of \$2,000 is made to B anytime in 1998, it will be treated as made entirely from the regular contributions, so there will be no Federal income tax consequences as a result of the distribution.

*Example 2.* The facts are the same as in *Example 1*, except that the distribution made in 1998 is \$5,000. The distribution is treated as made from \$2,000 of regular contributions and \$3,000 of conversion contributions that were includible in gross income. As a result, B must include \$18,000 in gross income for 1998: \$3,000 as a result of the acceleration of amounts that otherwise would have been in-

cluded in later years under the 4-year-spread rule and \$15,000 includible under the regular 4-year-spread rule. In addition, because the \$3,000 is allocable to a conversion made within the previous 5 taxable years, the 10-percent additional tax under section 72(t) would apply to this \$3,000 distribution as if it were includible in gross income for 1998, unless an exception applies. Under the 4-year-spread rule, B would now include in gross income \$15,000 for 1999 and 2000, but only \$12,000 for 2001, because of the accelerated inclusion of the \$3,000 distribution.

*Example 3.* The facts are the same as in *Example 1*, except that B makes an additional \$2,000 regular contribution in 1999 and he does not take a distribution in 1998. In 1999, the entire balance in the account, \$90,000 (\$84,000 of contributions and \$6,000 of earnings), is distributed to B. The distribution is treated as made from \$4,000 of regular contributions, \$60,000 of conversion contributions that were includible in gross income, \$20,000 of conversion contributions that were not includible in gross income, and \$6,000 of earnings. Because a distribution has been made within the 4-year-spread period, B must accelerate the income inclusion under the 4-year-spread rule and must include in gross income the \$45,000 remaining under the 4-year-spread rule in addition to the \$6,000 of earnings. Because \$60,000 of the distribution is allocable to a conversion made within the previous 5 taxable years, it is subject to the 10-percent additional tax under section 72(t) as if it were includible in gross income for 1999, unless an exception applies. The \$6,000 allocable to earnings would be subject to the tax under section 72(t), unless an exception applies. Under the 4-year-spread rule, no amount would be includible in gross income for 2000 or 2001 because the entire amount of the conversion that was includible in gross income has already been included.

*Example 4.* The facts are the same as in *Example 1*, except that B also makes a \$2,000 regular contribution in each year 1999 through 2002 and he does not take a distribution in 1998. A distribution of \$85,000 is made to B in 2002. The distribution is treated as made from the \$10,000 of regular contributions (the total regular contributions made in the years 1998-2002), \$60,000 of conversion contributions that were includible in gross income, and \$15,000 of conversion contributions that were not includible in gross income. As a result, no amount of the distribution is includible in gross income; however, because the distribution is allocable to a conversion made within the previous 5 years, the \$60,000 is subject to the 10-percent additional tax under section 72(t) as if it were includible in gross income for 2002, unless an exception applies.

*Example 5.* The facts are the same as in *Example 4*, except no distribution occurs in 2002. In 2003, the entire balance in the account, \$170,000 (\$90,000 of contributions and \$80,000 of earnings), is distributed to B. The distribution is treated as made from \$10,000 of regular contributions, \$60,000 of conversion contributions that were includible in gross income, \$20,000 of conversion contributions that were not includible in gross income, and \$80,000 of earnings. As a result, for 2003, B must include in gross income the \$80,000 allocable to earnings, unless the distribution is a qualified distribution; and if it is not a qualified distribution, the \$80,000 would be subject to the 10-percent additional tax under section 72(t), unless an exception applies.

*Example 6.* Individual C converts \$20,000 to a Roth IRA in 1998 and \$15,000 (in which amount C had a basis of \$2,000) to another Roth IRA in 1999. No other contributions are made. In 2003, a \$30,000 distribution, that is not a qualified distribution, is made to C. The distribution is treated as made from \$20,000 of the 1998 conversion contribution and \$10,000 of the 1999 conversion contribution that was includible in gross income. As a result, for 2003, no amount is includible in gross income; however, because \$10,000 is allocable to a conversion contribution made within the previous 5 taxable years, that amount is subject to the 10-percent additional tax under section 72(t) as if the amount were includible in gross income for 2003, unless an exception applies. The result would be the same whichever of C's Roth IRAs made the distribution.

*Example 7.* The facts are the same as in *Example 6*, except that the distribution is a qualified distribution. The result is the same as in *Example 6*, except that no amount would be subject to the 10-percent additional tax under section 72(t), because, to be a qualified distribution, the distribution must be made on or after the date on which the owner attains age 59½, made to a beneficiary or the estate of the owner on or after the date of the owner's death, attributable to the owner's being disabled within the meaning of section 72(m)(7), or to which section 72(t)(2)(F) applies (exception for a first-time home purchase). Under section 72(t)(2), each of these conditions is also an exception to the tax under section 72(t).

*Example 8.* Individual D makes a \$2,000 regular contribution to a traditional IRA on January 1, 1999, for 1998. On April 15, 1999, when the \$2,000 has increased to \$2,500, D recharacterizes the contribution by transferring the \$2,500 to a Roth IRA (pursuant to §1.408A-4 A-1). In this case, D's regular contribution to the Roth IRA for 1998 is \$2,000. The \$500 of earnings is not treated as a contribution to the Roth IRA. The results would be the same if the \$2,000 had decreased to \$1,500 prior to the recharacterization.

*Example 9.* In December 1998, individual E receives a distribution from his traditional IRA of \$300,000 and in January 1999 he contributes the \$300,000 to a Roth IRA as a conversion contribution. In April 1999, when the \$300,000 has increased to \$350,000, E recharacterizes the conversion contribution by transferring the \$350,000 to a traditional IRA. In this case, E's conversion contribution for 1998 is \$0, because the \$300,000 conversion contribution and the earnings of \$50,000 are disregarded. The results would be the same if the \$300,000 had decreased to \$250,000 prior to the recharacterization. Further, since the conversion is disregarded, the \$300,000 is not includible in gross income in 1998.

Q-11. If the owner of a Roth IRA dies prior to the end of the 5-taxable-year period described in A-1 of this section (relating to qualified distributions) or prior to the end of the 5-taxable-year period described in A-5 of this section (relating to conversions), how are different types of contributions in the Roth IRA allocated to multiple beneficiaries?

A-11. Each type of contribution is allo-

cated to each beneficiary on a pro-rata basis. Thus, for example, if a Roth IRA owner dies in 1999, when the Roth IRA contains a regular contribution of \$2,000, a conversion contribution of \$6,000 and earnings of \$1,000, and the owner leaves his Roth IRA equally to four children, each child will receive one quarter of each type of contribution. Pursuant to the ordering rules in A-8 of this section, an immediate distribution of \$2,000 to one of the children will be deemed to consist of \$500 of regular contributions and \$1,500 of conversion contributions.

Q-12. How do the withholding rules under section 3405 apply to Roth IRAs?

A-12. Distributions from a Roth IRA are distributions from an individual retirement plan for purposes of section 3405 and thus are designated distributions unless one of the exceptions in section 3405(e)(1) applies. Pursuant to section 3405 (a) and (b), nonperiodic distributions from a Roth IRA are subject to 10-percent withholding by the payor and periodic payments are subject to withholding as if the payments were wages. However, an individual can elect to have no amount withheld in accordance with section 3405(a)(2) and (b)(2).

Q-13. Do the withholding rules under section 3405 apply to conversions?

A-13. Yes. A conversion by any method described in §1.408A-4 A-1 is considered a designated distribution subject to section 3405. However, a conversion occurring in 1998 by means of a trustee-to-trustee transfer of an amount from a traditional IRA to a Roth IRA established with the same or a different trustee is not required to be treated as a designated distribution for purposes of section 3405. Consequently, no withholding is required with respect to such a conversion (without regard to whether or not the individual elected to have no withholding).

Q-14. What minimum distribution rules apply to a Roth IRA?

A-14. (a) No minimum distributions are required to be made from a Roth IRA under section 408(a)(6) and (b)(3) (which generally incorporate the provisions of section 401(a)(9)) while the owner is alive. The post-death minimum distribution rules under section 401(a)(9)(B) that apply to traditional IRAs, with the exception of the at-least-as-rapidly rule de-

scribed in section 401(a)(9)(B)(i), also apply to Roth IRAs.

(b) The minimum distribution rules apply to the Roth IRA as though the Roth IRA owner died before his or her required beginning date. Thus, generally, the entire interest in the Roth IRA must be distributed by the end of the fifth calendar year after the year of the owner's death unless the interest is payable to a designated beneficiary over a period not greater than that beneficiary's life expectancy and distribution commences before the end of the calendar year following the year of death. If the sole beneficiary is the decedent's spouse, such spouse may delay distributions until the decedent would have attained age 70½ or may treat the Roth IRA as his or her own.

(c) Distributions to a beneficiary that are not qualified distributions will be includible in the beneficiary's gross income according to the rules in A-4 of this section.

Q-15. Does section 401(a)(9) apply separately to Roth IRAs and individual retirement plans that are not Roth IRAs?

A-15. Yes. An individual required to receive minimum distributions from his or her own traditional or SIMPLE IRA cannot choose to take the amount of the minimum distributions from any Roth IRA. Similarly, an individual required to receive minimum distributions from a Roth IRA cannot choose to take the amount of the minimum distributions from a traditional or SIMPLE IRA. In addition, an individual required to receive minimum distributions as a beneficiary under a Roth IRA can only satisfy the minimum distributions for one Roth IRA by distributing from another Roth IRA if the Roth IRAs were inherited from the same decedent.

Q-16. How is the basis of property distributed from a Roth IRA determined for purposes of a subsequent disposition?

A-16. The basis of property distributed from a Roth IRA is its fair market value (FMV) on the date of distribution, whether or not the distribution is a qualified distribution. Thus, for example, if a distribution consists of a share of stock in XYZ Corp. with an FMV of \$40.00 on the date of distribution, for purposes of determining gain or loss on the subsequent sale of the share of XYZ Corp. stock, it has a basis of \$40.00.

Q-17. What is the effect of distributing an amount from a Roth IRA and contributing it to another type of retirement plan other than a Roth IRA?

A-17. Any amount distributed from a Roth IRA and contributed to another type of retirement plan (other than a Roth IRA) is treated as a distribution from the Roth IRA that is neither a rollover contribution for purposes of section 408(d)(3) nor a qualified rollover contribution within the meaning of section 408A(e) to the other type of retirement plan. This treatment also applies to any amount transferred from a Roth IRA to any other type of retirement plan unless the transfer is a recharacterization described in §1.408A-5.

Q-18. Can an amount be transferred directly from an education IRA to a Roth IRA (or distributed from an education IRA and rolled over to a Roth IRA)?

A-18. No amount may be transferred directly from an education IRA to a Roth IRA. A transfer of funds (or distribution and rollover) from an education IRA to a Roth IRA constitutes a distribution from the education IRA and a regular contribution to the Roth IRA (rather than a qualified rollover contribution to the Roth IRA).

Q-19. What are the Federal income tax consequences of a Roth IRA owner transferring his or her Roth IRA to another individual by gift?

A-19. A Roth IRA owner's transfer of his or her Roth IRA to another individual by gift constitutes an assignment of the owner's rights under the Roth IRA. At the time of the gift, the assets of the Roth IRA are deemed to be distributed to the owner and, accordingly, are treated as no longer held in a Roth IRA. In the case of any such gift of a Roth IRA made prior to October 1, 1998, if the entire interest in the Roth IRA is reconveyed to the Roth IRA owner prior to January 1, 1999, the Internal Revenue Service will treat the gift and reconveyance as never having occurred for estate tax, gift tax, and generation-skipping tax purposes and for purposes of this A-19.

#### §1.408A-7 Reporting.

Q-1. What reporting requirements apply to Roth IRAs?

A-1. Generally, the reporting requirements applicable to IRAs other than Roth IRAs also apply to Roth IRAs, except

that, pursuant to section 408A(d)(3)(D), the trustee of a Roth IRA must include on Forms 1099-R and 5498 additional information as described in the instructions thereto. Any conversion of amounts from an IRA other than a Roth IRA to a Roth IRA is treated as a distribution for which a Form 1099-R must be filed by the trustee maintaining the non-Roth IRA. In addition, the owner of such IRAs must report the conversion by completing Form 8606. In the case of a recharacterization described in §1.408A-5 A-1, IRA owners must report such transactions in the manner prescribed in the instructions to the applicable Federal tax forms.

Q-2. Can a trustee rely on reasonable representations of a Roth IRA contributor or distributee for purposes of fulfilling reporting obligations?

A-2. A trustee maintaining a Roth IRA is permitted to rely on reasonable representations of a Roth IRA contributor or distributee for purposes of fulfilling reporting obligations.

#### §1.408A-8 Definitions.

Q-1. Are there any special definitions that govern in applying the provisions of §§1.408A-1 through 1.408A-7 and this section?

A-1. Yes, the following definitions govern in applying the provisions of §§1.408A-1 through 1.408A-7 and this section. Unless the context indicates otherwise, the use of a particular term excludes the use of the other terms.

(a) *Different types of IRAs*—(1) *IRA*. Sections 408(a) and (b), respectively, describe an individual retirement account and an individual retirement annuity. The term IRA means an IRA described in either section 408(a) or (b), including each IRA described in paragraphs (a)(2) through (5) of this A-1. However, the term IRA does not include an education IRA described in section 530.

(2) *Traditional IRA*. The term traditional IRA means an individual retirement account or individual retirement annuity described in section 408(a) or (b), respectively. This term includes a SEP IRA but does not include a SIMPLE IRA or a Roth IRA.

(3) *SEP IRA*. Section 408(k) describes a simplified employee pension (SEP) as an employer-sponsored plan under which an employer can make contributions to

IRAs established for its employees. The term SEP IRA means an IRA that receives contributions made under a SEP. The term SEP includes a salary reduction SEP (SARSEP) described in section 408(k)(6).

(4) *SIMPLE IRA*. Section 408(p) describes a SIMPLE IRA Plan as an employer-sponsored plan under which an employer can make contributions to SIMPLE IRAs established for its employees. The term SIMPLE IRA means an IRA to which the only contributions that can be made are contributions under a SIMPLE IRA Plan or rollovers or transfers from another SIMPLE IRA.

(5) *Roth IRA*. The term Roth IRA means an IRA that meets the requirements of section 408A.

(b) *Other defined terms or phrases*—(1) *4-year spread*. The term 4-year spread is described in §1.408A-4 A-8.

(2) *Conversion*. The term conversion means a transaction satisfying the requirements of §1.408A-4 A-1.

(3) *Conversion amount or conversion contribution*. The term conversion amount or conversion contribution is the amount of a distribution and contribution with respect to which a conversion described in §1.408A-4 A-1 is made.

(4) *Modified AGI*. The term modified AGI is defined in §1.408A-3 A-5.

(5) *Recharacterization*. The term recharacterization means a transaction described in §1.408A-5 A-1.

(6) *Recharacterized amount or recharacterized contribution*. The term recharacterized amount or recharacterized contribution means an amount or contribution treated as contributed to an IRA other than the one to which it was originally contributed pursuant to a recharacterization described in §1.408A-5 A-1.

(7) *Taxable conversion amount*. The term taxable conversion amount means the portion of a conversion amount includible in income on account of a conversion, determined under the rules of section 408(d)(1) and (2).

(8) *Tax-free transfer*. The term tax-free transfer means a tax-free rollover described in section 402(c), 402(e)(6), 403(a)(4), 403(a)(5), 403(b)(8), 403(b)(10) or 408(d)(3), or a tax-free trustee-to-trustee transfer.

(9) *Treat an IRA as his or her own*. The phrase treat an IRA as his or her own means to treat an IRA of a surviving



spouse for which one is the beneficiary as his or her own IRA after the death of the IRA owner in accordance with the terms of the IRA instrument or in the manner provided in the regulations under section 408(a)(6) or (b)(3).

(10) *Trustee*. The term trustee includes a custodian or issuer (in the case of an annuity) of an IRA (except where the context clearly indicates otherwise).

*§1.408A-9 Effective date.*

Q-1. To what taxable years do §§1.408A-1 through 1.408A-8 apply?

A-1 Sections 1.408A-1 through 1.408A-8 apply to taxable years beginning on or after January 1, 1998.

Michael P. Dolan,  
*Deputy Commissioner of  
Internal Revenue.*

(Filed by the Office of Federal Register on August 31, 1998, 11:11 a.m., and published in the issue of the Federal Register for September 3, 1998, 63 F.R. 46937)

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# Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents, or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employ-

ing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent, or enrolled actuary, and date or 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 or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Galt, Edward G.	Monterey, CA	CPA	October 25, 1997
Lopez, Andrew L.	Albuquerque, NM	CPA	December 11, 1997
Branch, Jimmie L.	Jacksonville, FL	CPA	January 15, 1998
Harrison, Rebecca A.	Carmichael, CA	Enrolled Agent	March 4, 1998
Mayer, Robert J.	Wexford, PA	CPA	June 4, 1998

# Announcement of the Expedited Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under title 31 of the Code of Federal Regulations, section 10.76, 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 any crime under title 26 of the United States Code or, of a felony under title 18 of the United States Code involving dishonesty or breach of trust.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are

prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify practitioners under expedited suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, en-

rolled agent, or enrolled actuary, and date or 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 or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

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

Name	Address	Designation	Date of Suspension
Clark, Sheila	Houston, TX	CPA	Indefinite from April 21, 1998
Kimes, Larry W.	Austin, TX	Attorney	Indefinite from May 5, 1998
Braiteman, Sheldon	Baltimore, MD	Attorney	Indefinite from June 5, 1998
Pollack, Michael	Guttenberg, NJ	Attorney	Indefinite from June 11, 1998
Eichenbaum, Irving	Huntingdon Valley, PA	CPA	Indefinite from August 4, 1998
Corley, Francis R.	Irmo, SC	CPA	Indefinite from August 4, 1998
Scott, Richard	Lincoln, NE	Attorney	Indefinite from August 4, 1998
Wilson, Douglas D.	Roanoke, VA	Attorney	Indefinite from August 4, 1998
Watkins, Brian R.	Lincoln, NE	Attorney	Indefinite
Congdon Jr., Byron E.	San Bernadino, CA	Attorney	Indefinite from August 4, 1998
Abrams, Robert	Elmsford, NY	CPA	Indefinite from August 4, 1998
Robinson, Doane	Rapid City, SD	CPA	Indefinite from August 4, 1998
Szarwark, Ernest	Nashville, TN	Attorney	Indefinite from August 4, 1998
Roberts, Mark	Norman, OK	CPA	Indefinite from August 4, 1998
Wood, Randall K.	Springfield, MO	Attorney	Indefinite from August 5, 1998
Chappell, Ronald L.	Antelope, CA	CPA	Indefinite from August 12, 1998

# Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 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 disbarment or suspension from practice before the Internal Revenue Service, may offer his 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.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Ser-

vice matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public ac-

countant, enrolled agent, or enrolled actuary, and date or 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 or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

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

Name	Address	Designation	Date of Suspension
Makula, John G.	Park Ridge, IL	CPA	April 1, 1998 to March 31, 2003
Slomski, Michael	Gross Pointe Woods, MI	CPA	April 1, 1998 to March 31, 2001
Bozeman Jr., T. Alvin	Sylvester, GA	CPA	May 22, 1998 to November 21, 1999
Parness, Richard A.	Westfield, NJ	CPA	June 1, 1998 to December 31, 1998
Register, Billy	Havana, FL	CPA	Indefinite from July 10, 1998
Cooper, Michael E.	Edina, MN	CPA	August 19, 1998 to February 18, 1999
Minello, Michael J.	Clarks Summit, PA	CPA	August 28, 1998 to April 27, 2001
Holden, William W.	Fairfield, CT	CPA	September 1, 1998 to March 31, 1999
Freeman, Samuel	Bedford, NH	CPA	September 1, 1998 to August 31, 1999
Anders, Kevin	Williamport, MD	CPA	September 1, 1998 to August 31, 2001
Breed, Robert M.	Concord, MA	CPA	September 1, 1998 to February 28, 2001
Sandirk, Paula Brooks	Chehalis, WA	CPA	November 1, 1998 to April 30, 2000
Neuhaus Jr., George	Brewster, NY	CPA	November 1, 1998 to April 30, 2000

## 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 ap-

plies 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 Contribution 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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<sup>1</sup> A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1998–1 through 1998–28 will be found in Internal Revenue Bulletin 1998–29, dated July 20, 1998.

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<sup>1</sup> A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1998–1 through 1998–28 will be found in Internal Revenue Bulletin 1998–29, dated July 20, 1998.

# Notes



# Notes

# Notes



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