

Internal Revenue bulletin

Bulletin No. 2003-21
May 27, 2003

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2003-43, page 935.

Health plans. This ruling sets forth the rules regarding the use of debit and credit cards to reimburse participants in self-insured medical reimbursement plans. Rev. Rul. 2002-80 distinguished.

Rev. Rul. 2003-50, page 944.

LIFO; price indexes; department stores. The March 2003 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, March 31, 2003.

Rev. Rul. 2003-51, page 938.

Transfer to corporation. This ruling provides guidance regarding the control requirement under section 351 of the Code involving successive transfers of property and stock. Rev. Ruls. 70-140, 70-522, 79-70, and 79-194 distinguished.

T.D. 9055, page 945.

Final regulations under section 3406 of the Code clarify the method of determining whether a payer has received two IRS notices that a payee's taxpayer identification number (TIN) is incorrect, for purposes of backup withholding. This document also contains regulations under section 6724 which clarify when an information return filer must solicit a payee's TIN in response to a penalty notice based on an incorrect TIN if a notice under section 3406(a)(1)(B) was already received with respect to the same tax year.

Announcement 2003-35, page 956.

This document sets forth an advance notice of proposed rule-making (REG-100420-03) and asks for comments on a possible safe harbor the IRS and the Treasury Department are considering that would allow a financial statement-tax conformity approach to valuation of certain securities and commodities for purposes of section 475 of the Code. This approach would be elective and would have certain requirements that must be met before the safe harbor could be used, including record-keeping and record production requirements. The ANPRM also seeks comments on any other alternative valuation methodology.

EMPLOYEE PLANS

T.D. 9056, page 940.

Final regulations under section 408 of the Code provide a new method to be used for calculating the net income attributable to an IRA contribution that is distributed as a returned contribution pursuant to section 408(d)(4) or recharacterized pursuant to section 408A(d)(6). These regulations will affect IRA owners and IRA trustees, custodians, and issuers.

Notice 2003-32, page 949.

Weighted average interest rate update. The weighted average interest rate for May 2003 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.

(Continued on the next page)

Finding Lists begin on page ii.



Department of the Treasury
Internal Revenue Service

EXEMPT ORGANIZATIONS

Notice 2003–31, page 948.

This notice announces that the Treasury Department and the Service intend to propose regulations providing guidance under section 501(m) of the Code, which will define the term “commercial-type insurance” and address how section 501(m) applies to organizations described in sections 501(c)(3) and 501(c)(4), including health maintenance organizations. This notice also requests comments on the content of the regulations to be proposed. Finally, this notice announces that, in light of the regulations project, the Service is withdrawing from the Internal Revenue Manual the sections of Part 7.8.1, Chapter 27, Exempt Organizations Examination Guidelines Handbook, Health Maintenance Organizations that relate to section 501(m) of the Code.

Announcement 2003–34, page 953.

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

EXCISE TAX

Announcement 2003–33, page 953.

The Service announces the availability of new Form 8876, *Excise Tax on Structured Settlement Factoring Transactions*. Use this form to report and pay the 40% excise tax imposed under section 5891 of the Code on the factoring discount of a structured settlement factoring transaction.

ADMINISTRATIVE

Rev. Proc. 2003–37, page 950.

This procedure describes documentation and information a taxpayer that uses the fair market value method of apportionment of interest expense may prepare and make available to the Service upon request in order to establish the fair market value of the taxpayer’s assets to the satisfaction of the Commissioner as required by section 1.861–9T(g)(1)(iii) of the regulations. It also sets forth the procedure to be followed in the case of elections to use the fair market value method.

The IRS Mission

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

Introduction

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

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

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

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court

decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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

Section 105.—Amounts Received Under Accident and Health Plans

(Also Section 106, 125.)

Health plans. This ruling sets forth the rules regarding the use of debit and credit cards to reimburse participants in self-insured medical reimbursement plans.

Rev. Rul. 2003-43

ISSUE

Whether, under the facts described, employer-provided expense reimbursements made through debit or credit cards and other electronic media are excludable from gross income under § 105 of the Internal Revenue Code.

FACTS

Situation 1. Employer N sponsors one or more major medical plans for employees that provide coverage under accident and health insurance. Each plan has a fixed copayment amount (e.g., a \$15 copayment for physician office visits). Employer N also sponsors both a health flexible spending arrangement (health FSA) and a health reimbursement arrangement (HRA). The health FSA and the HRA reimburse the uninsured medical care expenses of all participating employees and their spouses and dependents up to a maximum reimbursement amount that is fixed at the beginning of each year. The health FSA is paid pursuant to salary reduction elections under Employer N's § 125 cafeteria plan. The HRA is paid by Employer N and employees make no salary reduction election to pay for the HRA. The HRA plan document specifies that coverage under the HRA is available only after expenses exceeding the dollar amount elected under the § 125 health FSA have been paid from the health FSA. Both the health FSA and the HRA meet the nondiscrimination requirements of § 105(h).

In conjunction with the health FSA and the HRA, Employer N permits electronic reimbursement of medical expenses through the use of a debit card or stored-value card ("card"). Under the arrangement adopted by Employer N, each participating employee

is issued a card and certifies upon enrollment in the health FSA and HRA and each plan year thereafter that the card will only be used for eligible medical care expenses, as defined in § 213(d), of the employee and the employee's spouse and dependents. The employee also certifies that any expense paid with the card has not been reimbursed and that the employee will not seek reimbursement under any other plan covering health benefits. An employee-cardholder understands that the certification, which is printed on the back of the card, is reaffirmed each time the card is used. The cardholder also agrees to acquire and retain sufficient documentation for any expense paid with the card, including invoices and receipts where appropriate. The card is automatically cancelled at termination of employment.

The cardholder's use of the card is limited to the maximum dollar amount of coverage available in the cardholder's health FSA or HRA. As described below, the card is ineffective except at those merchants and service providers authorized by Employer N, so that the use of the card at other merchants or service providers would be rejected. Employer N limits the card's use to specified Merchant Codes relating to health care. Thus, the card's use is limited to physicians, pharmacies, dentists, vision care offices, hospitals, and other medical care providers. When a cardholder uses the card at the point-of-sale, the merchant or service provider is paid the full amount of the charge (assuming there is sufficient coverage available in the health FSA or HRA), and the cardholder's maximum available coverage remaining is reduced by that amount.

To provide assurance that only eligible medical expenses are reimbursed, Employer N has established, in the health FSA and HRA documents, the following procedures for substantiating claimed medical expenses after the use of the card.

First, if the dollar amount of the transaction at a health care provider equals the dollar amount of the copayment for that service under the major medical plan of the specific employee-cardholder, the charge is fully substantiated without the need for submission of a receipt or further review. For example, Employee A is enrolled in a ma-

ior medical plan with a \$15 physician's office visit copayment. When Employee A uses the card to satisfy the copayment requirement, the system matches the amount of the transaction, \$15, with the copayment under Employee A's coverage and the fact that the transaction is at a physician's office.

Second, Employer N permits automatic reimbursement, without further review, of recurring expenses that match expenses previously approved as to amount, provider, and time period (e.g., for an employee who refills a prescription drug on a regular basis at the same provider for the same amount).

Third, if the merchant, service provider, or other independent third-party (e.g., Pharmacy Benefit Manager), at the time and point of sale, provides information to verify to Employer N (including electronically by e-mail, the internet, intranet, or telephone) that the charge is for a medical expense, the charge is fully substantiated without the need for submission of a receipt or further review (i.e., "real-time substantiation"). For example, Employee A fills a prescription at a pharmacy. The Pharmacy Benefit Manager under Employee A's major medical coverage provides information that \$37.85 of the cost of the prescription is a medical expense that is not covered by the major medical coverage. Because the information about the medical expense, \$37.85, matches the amount of the transaction, the transaction is substantiated. The transaction would also be fully substantiated where, for example, treatment at a physician's office results in charges in addition to the copayment and, after obtaining authorization for the card, the provider is prompted to enter treatment codes and charges. The additional third-party information regarding the type of care, date of service, and amount provides substantiation of the expense without the need for further review.

Employer N's procedures provide that all charges to the card, other than copayments, recurring expenses, and real-time substantiation as described above, are treated as conditional pending confirmation of the charge. Thus, Employer N requires that additional third-party information, such as

merchant or service provider receipts, describing (1) the service or product, (2) the date of the service or sale and, (3) the amount, be submitted for review and substantiation.

An employee may also obtain benefits under the health FSA or HRA without the use of the card by submitting to Employer N either an Explanation of Benefits (EOB) received from a health insurance provider or a receipt from a merchant or service provider showing that funds are owed for an eligible medical expense (e.g., on a deductible). In this case, Employer N pays the merchant or service provider directly. Alternatively, an employee may pay the merchant or service provider directly and submit a claim for reimbursement, including third-party information supporting the claim.

Under Employer N's card arrangement, a few of the claims that have been reimbursed are subsequently identified as not qualifying for reimbursement. As a result, Employer N has adopted, in the health FSA and HRA plan documents, all of the following correction procedures with respect to the improper payments. First, upon identifying an improper payment, Employer N requires the employee to pay back to the plan an amount equal to the improper payment. Second, where this proves unsuccessful, Employer N has the amount of the improper payment withheld from the employee's wages or other compensation to the extent consistent with applicable law. Third, if the improper payment still remains outstanding, Employer N utilizes a claims substitution or offset approach to resolve improper claims. For example, if Employee A has received an improper reimbursement of \$200 and subsequently submits a substantiated claim incurred during the same coverage period, no reimbursement is made until the improper payment is fully recouped. In addition to the above, Employer N takes other actions to ensure that further violations of the terms of the card do not occur, including denial of access to the card until the indebtedness is repaid by the employee.

If these correction efforts prove unsuccessful, or are otherwise unavailable, the employee remains indebted to Employer N for the amount of the improper payment. In that event and consistent with its business practices, Employer N treats the payment as it would any other business indebtedness.

Situation 2. The facts are the same as Situation 1, except that Employer P's procedures utilize sampling techniques based on transaction amounts. For example, Employer P reviews 20% of dental office transactions paid with the card that have not been otherwise substantiated and are above \$100 on the assumption that no dental cosmetic procedures are available for less than \$100. Also, Employer P reviews a smaller percentage (e.g., 5%) of physician office transactions paid with the card that have not been otherwise substantiated and are below \$150 on the assumption that almost all such charges are for eligible medical care. In addition, Employer P does not review any card transaction below a low dollar threshold (e.g., \$25) or where the amount of the transaction is a multiple of a specified whole-dollar amount (e.g., \$5, \$10, \$15, etc.) on the assumption that these latter amounts are copayments. Only those payments selected for review are required to be substantiated by submission of merchant or service provider receipts. Thus, Employer P does not substantiate all reimbursements made through the card.

Situation 3. Employer R sponsors major medical plans, a health FSA, and an HRA for employees. The health FSA and the HRA meet the nondiscrimination requirements of § 105(h). In conjunction with the health FSA and the HRA, Employer R has entered into an agreement with a sponsoring bank to issue to each participating employee a credit card with individual limits equaling the coverage available in the health FSA or HRA. As in Situation 1, Employer R requires each employee to certify upon enrollment in the plans (which is reaffirmed upon each use of the credit card) that the card will only be used for eligible medical care expenses and that any medical expense paid with the card has not been reimbursed and the employee will not seek reimbursement under any other plan covering health benefits. In addition, as in Situation 1, the credit card is usable only at a merchant or service provider with a specified Merchant Code relating to health care. Pursuant to the agreement between Employer R and the sponsoring bank, Employer R agrees to be liable to the sponsoring bank for all charges made with the credit card against the line of credit. When the card is used at the point-of-sale, the

merchant or service provider is paid the full amount of the charge by the sponsoring bank.

Employer R utilizes substantiation methods identical to those of Employer N in Situation 1, so that copayments, recurring expenses, and real-time substantiation need no further review. Employer R treats all other charges to the card as conditional pending confirmation of the medical expense. If the claim is approved, the employee's maximum available coverage in the health FSA or HRA is reduced by that amount and Employer R repays the sponsoring bank. If the employee fails to provide substantiation of the medical expense or the claim is denied, Employer R repays the sponsoring bank and the employee becomes liable to Employer R for the charge. To recoup amounts that have been identified as improper payments, Employer R has adopted the same correction procedures as those utilized by Employer N in Situation 1. Also, as described in Situation 1, an employee may obtain benefits under the health FSA or HRA without the use of the credit card.

LAW AND ANALYSIS

Section 61(a)(1) and § 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106 provides that "gross income of an employee does not include employer-provided coverage under an accident or health plan." Section 1.106-1 provides that the gross income of an employee does not include contributions which the employee's employer makes to an accident or health plan for compensation (through insurance or otherwise) for personal injuries or sickness to the employee or the employee's spouse or dependents (as defined in § 152).

Section 105(a) provides that "amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer."

Section 105(e) states that amounts received under an accident or health plan for

employees are treated as amounts received through accident or health insurance for purposes of § 105. Section 1.105-5(a) provides that an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness. Thus, amounts that are paid to an employee regardless of whether the employee incurs expenses for medical care or suffers a personal injury or sickness are not received under an accident or health plan.

Section 105(b) states that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts referred to in § 105(a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by the taxpayer for the medical care (as defined in § 213(d)) of the taxpayer or the taxpayer's spouse or dependents (as defined in § 152).

Section 1.105-2 provides that only amounts that are paid specifically to reimburse the taxpayer for expenses incurred by the taxpayer for the prescribed medical care are excludable from gross income. Section 105(b) does not apply to amounts that the taxpayer would be entitled to receive irrespective of whether or not the taxpayer incurs expenses for medical care. Accordingly, if an employee is not paid specifically to reimburse medical care expenses but is entitled to receive the payment irrespective of whether any medical expenses have been incurred, none of those payments are excludable from gross income under § 105(b) whether or not the employee has incurred medical expenses during the year.

Under § 125, an employer may establish a cafeteria plan that permits an employee to choose among two or more benefits, consisting of cash (generally, salary) and qualified benefits, including accident or health coverage. Pursuant to § 125, the amount of an employee's salary reduction applied to purchase such coverage is not included in gross income, even though it is available to the employee and the employee could have chosen to receive cash instead. If an employee elects salary reduction pursuant to § 125, the accident and health coverage is excludable from gross income under § 106 as employer-provided accident or health coverage.

Q&A-7(a) of § 1.125-2 of the Proposed Income Tax Regulations states that health plans that are FSAs must conform to the generally applicable rules under §§ 105 and 106 in order for the coverage and reimbursements to qualify for tax-favored treatment. Thus, health FSAs must qualify as accident or health plans and reimbursements must be paid specifically to reimburse the participant for medical expenses incurred previously during the period of coverage.

Q&A-7(b)(5) of § 1.125-2 addresses claims substantiation for health FSAs and provides that a health FSA may reimburse a medical expense only if the participant provides a written statement from an independent third-party stating that the medical expense has been incurred and the amount of such expense and the participant also provides a written statement that the medical expense has not been reimbursed or is not reimbursable under any other health plan coverage.

Part 1 of Notice 2002-45, 2002-28 I.R.B. 93, describes an HRA as an arrangement that: (1) is paid for solely by the employer and not pursuant to salary reduction; (2) reimburses the employee for medical care expenses as defined in § 213(d); and (3) provides that any unused portion of the maximum dollar amount available during the coverage period is carried forward to subsequent coverage periods. Part 2 of the notice provides that to qualify for the exclusion under §§ 106 and 105, an HRA may only provide benefits that reimburse § 213(d) medical expenses and that each medical expense submitted for reimbursement must be substantiated.

Rev. Rul. 2002-80, 2002-49 I.R.B. 925, describes plans in which amounts are automatically paid to an employee as "advance reimbursements" or "loans" of uninsured medical expenses. The employer treats the "advance reimbursements" or "loans" as an indebtedness that is forgiven by the end of the year or upon termination of employment. In addition, to the extent an employee does not have uninsured medical expenses equal to the "advance reimbursements" or "loans," the excess payments to the employee are included in gross income. The ruling holds that the exclusion from gross income under § 105(b) does not apply to these plans because the "advance reimbursements" or "loans" are paid

to the employee whether or not the employee incurs medical expenses. See § 1.105-2

Not all health-related expenses qualify for tax-free treatment under § 105(b). Only amounts that are paid specifically to reimburse eligible medical care expenses as defined in § 213(d) receive tax-favored treatment. Therefore, to provide certainty that a particular expense is for medical care within the meaning of § 213(d), all claims for expense reimbursements must be substantiated. However, § 105(b) does not specify the method of substantiation. The procedures adopted by Employer N in Situation 1 with respect to the electronic reimbursement of medical expenses meet the requirements of § 105(b). First, Employer N requires a certification upon enrollment and a reaffirmation upon each use of the card, as printed on the back, that the card will only be used for eligible medical care expenses. Second, reimbursements for medical expenses are processed only if they originate with certain vendors having health care related Merchant Codes. Third, Employer N's procedures provide that every claim is reviewed and substantiated, either automatically without additional documentation or manually through the submission of merchant or service provider receipts. Fourth, Employer N has adopted meaningful correction procedures for claims that are subsequently identified as impermissible. These procedures meet the requirements of § 105(b) and the same conclusion applies to the procedures adopted by Employer R in Situation 3.

In contrast, the sampling techniques adopted by Employer P in Situation 2 do not provide that every claim is substantiated. Thus, because Employer P's procedures, by plan design, do not specifically limit reimbursements or payments of claims to eligible medical expenses, the procedures do not meet the requirements of § 105(b).

HOLDING

Employer-provided expense reimbursements made through debit or credit cards and other electronic media, as described in Situation 1 and Situation 3, are excludable from gross income under § 105(b). Employer-provided expense reimbursements, as described in Situation 2, are not excludable from gross income under § 105(b) because the payments are made ir-

respective of whether any medical expenses have been incurred. Thus, in Situation 2, all payments made during the year, including amounts paid to reimburse medical expenses, are included in the gross income of the employee.

SCOPE

This ruling addresses only issues under the specific Code sections mentioned. No inference is intended as to any other section of the Internal Revenue Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 2002-80 is distinguished because in that ruling, unlike Situations 1 and 3, a payment is made in advance and irrespective of the employee incurring a medical expense. In Situations 1 and 3, a payment is made concurrent with the employee incurring a medical expense that is substantiated. Final regulations under § 125 will reflect the modifications to the rules concerning claims substantiation of health FSA expenses as set forth in this revenue ruling.

FORM 1099 CONSIDERATION

Under the facts described, payments made to medical service providers through the use of debit, credit, and stored-value cards are reportable by the employer on Form 1099-MISC under § 6041. Section 6041 provides for information reporting by persons engaged in a trade or business who make payments of fixed or determinable income to another person in the course of such trade or business of \$600 or more in a taxable year. The exceptions provided in § 1.6041-3 may apply to this requirement, such as the exception for payments to tax-exempt hospitals.

EFFECTIVE DATE

The holding in Situation 2 is effective for plan years beginning after December 31, 2003.

COMMENTS REQUESTED

The Service requests comments on sampling techniques or statistical approaches, other than those described in Situation 2, that may be used by employers in identifying types of transactions that should be deemed to be substantiated. The method-

ology proposed should demonstrate that the outcome of measures selected provide a high degree of certainty sufficient to constitute substantiation that the employee has incurred a medical expense. Send comments to: CC:PA:RU (Rev. Rul. 2003-43), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Comments may be hand-delivered between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (Rev. Rul. 2003-43), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. In the alternative, taxpayers may submit comments electronically at: *Notice.Comments@irs.counsel.treas.gov*. All comments will be available for public inspection.

DRAFTING INFORMATION

The principal author of this revenue ruling is Barbara E. Pie of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Pie at (202) 622-6080 (not a toll-free call).

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by transferor.

Transfer to corporation. This ruling provides guidance regarding the control requirement under section 351 of the Code involving successive transfers of property and stock. Rev. Ruls. 70-140, 70-522, 79-70, and 79-194 distinguished.

Rev. Rul. 2003-51

ISSUE

Whether a transfer of assets to a corporation (the "first corporation") in exchange for an amount of stock in the first corporation constituting control satisfies the control requirement of § 351 of the Internal Revenue Code if, pursuant to a binding agreement entered into by the transferor with a third party prior to the exchange, the transferor transfers the stock of the first corporation to another corporation (the "second corporation") simultaneously with the transfer of assets to the third party to the

second corporation, and immediately thereafter, the transferor and the third party are in control of the second corporation.

FACTS

Corporation W, a domestic corporation, engages in businesses A, B, and C. The fair market values of businesses A, B, and C are \$40x, \$30x, and \$30x, respectively. X, a domestic corporation unrelated to W, also engages in business A through its wholly owned domestic subsidiary, Y. The fair market value of X's Y stock is \$30x. W and X desire to consolidate their business A operations within a new corporation in a holding company structure. Pursuant to a prearranged binding agreement with X, W forms a domestic corporation, Z, by transferring all of its business A assets to Z in exchange for all of the stock of Z (the "first transfer"). Immediately thereafter, W contributes all of its Z stock to Y in exchange for stock of Y (the "second transfer"). Simultaneous with the second transfer, X contributes \$30x to Y to meet the capital needs of business A after the restructuring in exchange for additional stock of Y (the "third transfer"). After the second and third transfers, Y transfers the \$30x and its business A assets to Z (the "fourth transfer"). After the second and third transfers, W and X own 40 percent and 60 percent, respectively, of the outstanding stock of Y. Viewed separately, each of the first transfer, the combined second and third transfers, and fourth transfer qualifies as a transfer described in § 351.

LAW

Section 351(a) provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation.

Section 368(c) defines control to mean the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Section 1.351-1(a)(1) of the Income Tax Regulations provides that the phrase "immediately after the exchange" does not nec-

essarily require simultaneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure.

Courts have held that the control requirement of § 351 is not satisfied where, pursuant to a binding agreement entered into by the transferor prior to the transfer of property to the corporation in exchange for stock, the transferor loses control of the corporation by a taxable sale of all or part of that stock to a third party who does not also transfer property to the corporation in exchange for stock. *See, e.g., S. Klein on the Square, Inc. v. Commissioner*, 188 F.2d 127 (2d Cir.), *cert. denied*, 342 U.S. 824 (1951); *Hazeltine Corp. v. Commissioner*, 89 F.2d 513 (3d Cir. 1937); *Intermountain Lumber Co. v. Commissioner*, 65 T.C. 1025 (1976). The Service has reached the same conclusion when addressing similar facts. *See* Rev. Rul. 79-194, 1979-1 C.B. 145; Rev. Rul. 79-70, 1979-1 C.B. 144; Rev. Rul. 70-522, 1970-2 C.B. 81.

In Rev. Rul. 70-140, 1970-1 C.B. 73, A, an individual, owns all of the stock of corporation X and operates a business similar to that of X through a sole proprietorship. Pursuant to an agreement between A and Y, an unrelated, widely held corporation, A transfers all of the assets of the sole proprietorship to X in exchange for additional shares of X stock. A then transfers all his X stock to Y solely in exchange for voting common stock of Y. The ruling reasons that because the two steps of the transaction are parts of a prearranged plan, they may not be considered independently of each other for federal income tax purposes. The ruling concludes that A's receipt of the X stock in exchange for the sole proprietorship assets is transitory and without substance for tax purposes because it is apparent that the assets of the sole proprietorship are transferred to X to enable Y to acquire those assets without the recognition of gain to A. Accordingly, the ruling treats A as transferring its sole proprietorship assets directly to Y in a transfer to which § 351 does not apply, and Y as transferring these assets to X, independently of A's transfer of the X stock to Y in exchange for Y voting stock. The exchange by A of the stock of X solely for voting

stock of Y constitutes an exchange to which § 354 applies. *See also* § 1.1361-5(b)(3), *Example 9*.

In Rev. Rul. 77-449, 1977-2 C.B. 110, *amplified by* Rev. Rul. 83-34, 1983-1 C.B. 79, and Rev. Rul. 83-156, 1983-2 C.B. 66, a corporation transfers assets to a wholly owned subsidiary, which in turn transfers, as part of the same plan, the same assets to its own wholly owned subsidiary. The ruling states that the transfers should be viewed separately for purposes of § 351. Because each transfer satisfies the requirements of § 351, no gain or loss is recognized by the transferor.

In Rev. Rul. 83-34, corporation P owns 80 percent of the stock of a subsidiary, S1. An unrelated corporation owns the remaining 20 percent. P transfers assets to S1 solely in exchange for additional shares of S1 stock. As part of the same plan, S1 transfers the same assets to S2, a newly formed corporation of which S1 will be an 80 percent shareholder. An unrelated corporation will own the remaining 20 percent of the S2 stock. Citing Rev. Rul. 77-449, the ruling concludes that the transfers should be viewed separately for purposes of § 351 and that each transfer satisfies the requirements of § 351.

In Rev. Rul. 84-111, 1984-2 C.B. 88, *Situation 1*, a partnership transfers all of its assets to a newly formed corporation in exchange for all the outstanding stock of the corporation and the assumption by the corporation of the partnership's liabilities. The partnership then terminates by distributing all the stock of the corporation to the partners in proportion to their partnership interests. The steps undertaken by the partnership were parts of a plan to transfer the partnership operations to a corporation organized for valid business reasons in exchange for its stock and were not devices to avoid or evade recognition of gain. The ruling concludes that, under § 351, the partnership recognizes no gain or loss on the transfer of its assets to the corporation in exchange for the corporation's stock and the corporation's assumption of the partnership's liabilities, notwithstanding the partnership's subsequent distribution of the corporation's stock to the partners and consequent loss of control within the meaning of § 368(c) of the corporation.

ANALYSIS

As described above, if the first transfer were viewed as separate from each of

the other transfers, the first transfer would satisfy the technical requirements of a transfer under § 351 because W transfers property to Z in exchange for stock in Z and, immediately after the exchange, W is in control of Z. However, because the first and second transfers are undertaken pursuant to a prearranged binding agreement, it is necessary to determine whether the second transfer causes the first transfer to fail to satisfy the control requirement of § 351.

"Section 351 has been described as a deliberate attempt by Congress to facilitate the incorporation of ongoing businesses and to eliminate any technical constructions which are economically unsound." *Hempt Bros., Inc. v. United States*, 490 F.2d 1172, 1177 (3d Cir.), *cert. denied*, 419 U.S. 826 (1974). Section 351(a) is intended to apply to "certain transactions where gain or loss may have accrued in a constitutional sense, but where in a popular and economic sense there has been a mere change in the form of ownership and the taxpayer has not really 'cashed in' on the theoretical gain, or closed out a losing venture." *Portland Oil Co. v. Commissioner*, 109 F.2d 479, 488 (1st Cir.), *cert. denied*, 310 U.S. 650 (1940). *See* S. Rep. No. 67-275, at 12 (1921) (explaining that the predecessor to § 351 was enacted in 1921 to "permit business to go forward with the readjustments required by existing conditions"). A transaction described under § 351 "lacks a distinguishing characteristic of a sale, in that, instead of the transaction having the effect of terminating or extinguishing the beneficial interests of the transferors in the transferred property, . . . the transferors continue to be beneficially interested in the transferred property and have dominion over it by virtue of their control of the new corporate owner of it." *American Compress & Warehouse Co. v. Bender*, 70 F.2d 655, 657 (5th Cir.), *cert. denied*, 293 U.S. 607 (1934).

As described above, courts have held that the control requirement of § 351 is not satisfied where, pursuant to a binding agreement entered into by the transferor prior to the transfer of property to the corporation in exchange for stock, the transferor loses control of the corporation by a taxable sale of all or part of that stock to a third party that does not also transfer property to the corporation in exchange for stock. Treating a transfer of property that is followed by such a prearranged sale of the stock received as a transfer described in § 351 is

not consistent with Congress' intent in enacting § 351 to facilitate the rearrangement of the transferor's interest in its property. Treating a transfer of property that is followed by a nontaxable disposition of the stock received as a transfer described in § 351 is not necessarily inconsistent with the purposes of § 351. Accordingly, the control requirement may be satisfied in such a case, even if the stock received is transferred pursuant to a binding commitment in place upon the transfer of the property in exchange for stock. For example, in Rev. Rul. 84-111, *Situation 1*, the partnership's transfer of property to the transferee corporation qualified as a transfer described in § 351, even though the partnership relinquished control of the transferee corporation within the meaning of § 368(c) pursuant to a prearranged plan to transfer the transferee stock.

In Rev. Rul. 70-140, the transfer of assets to the transferor's wholly owned subsidiary followed by an exchange of stock of the wholly owned subsidiary for stock of another corporation was recast as a direct transfer of assets to the unrelated, widely held corporation in a taxable transaction. In Rev. Rul. 70-140, there was no alternative form of transaction that would have qualified for nonrecognition treatment. In contrast, in this case, W's transfer of the business A assets to Z was not necessary for W and X to combine their business A assets in a holding company structure in a manner that would have qualified for nonrecognition of gain or loss under § 351. A transfer of W's business A assets to Y in exchange for Y stock as part of a plan that included X's transfer of \$30x to Y in exchange for Y stock, and Y's transfer of the business A assets and \$30x to Z in exchange for all of the Z stock, would have qualified as successive transfers described in § 351. See Rev. Rul. 83-34; Rev. Rul. 77-449. Accordingly, in these circumstances, Rev. Rul. 70-140 is distinguishable.

In this case, even though the first transfer is followed by a transfer of the stock received, treating the first transfer as a transfer described in § 351 is not inconsistent with the purposes of § 351. Accordingly, the sec-

ond transfer will not cause the first transfer to fail to satisfy the control requirement of § 351.

HOLDING

A transfer of assets to the first corporation in exchange for an amount of stock in the first corporation constituting control satisfies the control requirement of § 351 even if, pursuant to a binding agreement entered into by the transferor with a third party prior to the exchange, the transferor transfers the stock of the first corporation to the second corporation simultaneously with the transfer of assets by the third party to the second corporation, and immediately thereafter, the transferor and the third party are in control of the second corporation.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-194, 1979-1 C.B. 145, Rev. Rul. 79-70, 1979-1 C.B. 144, Rev. Rul. 70-522, 1970-2 C.B. 81, and Rev. Rul. 70-140, 1970-1 C.B. 73, are distinguished.

DRAFTING INFORMATION

The principal author of this revenue ruling is Lisa K. Leong of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Ms. Leong at (202) 622-7530 (not a toll-free call).

Section 408.—Individual Retirement Accounts

26 CFR 1.408-4: Treatment of distributions from individual retirement arrangements.

T.D. 9056

DEPARTMENT OF THE TREASURY Internal Revenue Service (IRS) 26 CFR Part 1

Earnings Calculation for Returned or Recharacterized IRA Contributions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide a new method to be used for calculating the net income attributable to IRA contributions that are distributed as a returned contribution pursuant to section 408(d)(4) of the Internal Revenue Code (Code) or recharacterized pursuant to section 408A(d)(6). These regulations will affect IRA owners and IRA trustees, custodians, and issuers.

DATES: *Effective Date:* These final regulations are effective on May 5, 2003.

Applicability Date: These final regulations are applicable for calculating income allocable to IRA contributions made on or after January 1, 2004.

FOR FURTHER INFORMATION CONTACT: Cathy Vohs at (202) 622-6090.

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under Code sections 408 and 408A. These regulations provide a new method for calculating the net income attributable to IRA contributions that are distributed as a returned contribution pursuant to section 408(d)(4) or recharacterized pursuant to section 408A(d)(6).

Section 408(d)(4) provides that an IRA contribution will not be included in the IRA owner's gross income when distributed as a returned contribution if: (1) it is received by the IRA owner on or before the day prescribed by law (including extensions) for filing the owner's federal income tax return for the year of the contribution; (2) no deduction is allowed with respect to the contribution; and (3) the distribution is accompanied by the amount of net income attributable to the contribution.

Section 408A(d)(6) provides that a contribution made to one type of IRA may be recharacterized as having been made to another type of IRA if: (1) the recharacterization transfer occurs on or before the date prescribed by law (including extensions) for filing the IRA owner's federal income tax return for the year for which the contribution was made; (2) no deduction is allowed with respect to the contribution to the trans-

feror IRA; and (3) the transfer is accompanied by any net income allocable to the contribution.

Notice 2000-39, 2000-2 C.B. 132, provided a new method for calculating net income that generally based the calculation of the amount of net income attributable to a contribution on the actual earnings and losses of the IRA during the time it held the contribution, and provided that under the new method, net income could be negative. Notice 2000-39 provided that until further guidance is issued, either the old method (*i.e.*, the method specified in

§1.408-4(c)(2)(ii)) or the new method may be used to calculate net income.

Proposed regulations under sections 408 and 408A were published in the **Federal Register** on July 23, 2002 (REG-124256-02, 2002-33 I.R.B. 383 [67 FR 48067]). These proposed regulations incorporated, with certain modifications, the new method provided in Notice 2000-39. The public reaction to Notice 2000-39 was generally favorable and few comments were received on the proposed regulations. Consequently, these final regulations adopt the rules in the proposed regulations without modification.

Explanation of Provisions

These final regulations retain, without change, the methods provided in the proposed regulations. Thus, under these final regulations, for purposes of returned contributions under section 408(d)(4) and recharacterized contributions under section 408A(d)(6), the net income attributable to a contribution is determined by allocating to the contribution a *pro-rata* portion of the net income on the assets in the IRA (whether positive or negative) during the period the IRA held the contribution. This new method is represented by the following formula:

$$\text{Net Income} = \text{Contribution} \times \frac{(\text{Adjusted Closing Balance} - \text{Adjusted Opening Balance})}{\text{Adjusted Opening Balance}}$$

Under the final regulations, generally, the adjusted opening balance means the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions or transfers made to the IRA during the computation period. A special rule is provided for an IRA asset that is not normally valued on a daily basis. In this case, the fair market value of the asset at the beginning of the computation period is deemed to be the most recent, regularly determined, fair market value of the asset, determined as of a date that coincides with or precedes the first day of the computation period. One commentator suggested that the application of this special rule be extended to all IRA assets as an alternate fair market value determination so that the value of an IRA at the beginning of the computation period could be the most recent statement value just prior to the contribution, rather than the actual value on the exact date of the contribution.

The final regulations do not extend the special valuation rule to all IRA assets because the IRS and Treasury believe that if an IRA asset is normally valued on a daily basis, these values must be used so that the calculation of the amount of net income attributable to a contribution is based on the actual earnings and losses of the IRA during the time it held the contribution. The alternate rule suggested by the commentator would increase the chances of producing anomalous results because account activity in the part of the year that pre-

cedes the date the contribution was made would be taken into account in the calculation of the net income attributable to the contribution.

One commentator suggested that where both regular Roth IRA contributions and conversion contributions have been made to the same Roth IRA, the net income calculation attributable to a recharacterization of a conversion contribution may require that some of the regular Roth IRA contributions be recharacterized to the traditional IRA. The commentator recommended that if a conversion contribution is being recharacterized, and the Roth IRA contains both regular contributions and conversion contributions, the final rules should permit the principal amount of any regular Roth IRA contributions in that same Roth IRA to remain in the Roth IRA.

The final regulations retain the rule, without modification, that net income calculations and allocations must be based on the overall value of an IRA and the dollar amounts contributed, distributed or recharacterized to or from the IRA. Even in a recharacterization of an amount converted to a Roth IRA where the Roth IRA contains both regular contributions and conversion contributions, the final regulations do not permit net income, including any losses, to be allocated other than *pro rata*. Thus, the principal amount of regular Roth IRA contributions cannot be protected against adjustment for their *pro rata* share of net income, including any net

losses, during the computation period. Once contributions are commingled in an account, those dollars are no longer associated with particular assets or contributions. In the absence of maintaining separate accounts, tying particular assets to a particular contribution would create administrative problems for taxpayers, IRA providers and the IRS.

Effective Date

These final regulations are applicable for calculating income allocable to IRA contributions made on or after January 1, 2004. For purposes of determining net income applicable to IRA contributions made during 2002 and 2003, taxpayers may continue to apply the rules set forth in Notice 2000-39 or may rely on the proposed regulations.

Special Analyses

It has been determined that these final regulations are 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. Because §1.408-11 and A-2(c) of §1.408A-5 impose no new collection of information on small entities, 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 Inter-

nal Revenue Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Cathy A. Vohs of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805 * * *
§1.408-4 also issued under 26 U.S.C. 408.
§1.408-11 also issued under 26 U.S.C. 408. * * *

Par. 2. In §1.408-4, paragraph (c)(1) is amended by adding two sentences before the current first sentence to read as follows:

§1.408-4 Treatment of distributions from individual retirement arrangements.

* * * * *
(c) * * *(1)* * * The rules in this paragraph (c) apply for purposes of determining net income attributable to IRA contributions made before January 1, 2004, and returned pursuant to section 408(d)(4). The rules in §1.408-11 apply for purposes

of determining net income attributable to IRA contributions made on or after January 1, 2004, and returned pursuant to section 408(d)(4).* * *

* * * * *

Par. 3. Section 1.408-11 is added to read as follows:

§1.408-11 Net income calculation for returned or recharacterized IRA contributions.

(a) *Net income calculation for returned IRA contributions—(1) General rule.* For purposes of returned contributions under section 408(d)(4), the net income attributable to a contribution made to an IRA is determined by allocating to the contribution a *pro-rata* portion of the earnings on the assets in the IRA during the period the IRA held the contribution. This attributable net income is calculated by using the following formula:

$$\text{Net Income} = \text{Contribution} \times \frac{(\text{Adjusted Closing Balance} - \text{Adjusted Opening Balance})}{\text{Adjusted Opening Balance}}$$

(2) *Special rule.* If an IRA is established with a contribution and no other contributions, distributions or transfers are made to or from that IRA, then the subsequent distribution of the entire account balance of the IRA pursuant to section 408(d)(4) will satisfy the requirement of that Internal Revenue Code section that the return of a contribution be accompanied by the amount of net income attributable to the contribution.

(b) *Definitions.* For purposes of this section the following definitions apply:

(1) *Adjusted opening balance.* The term *adjusted opening balance* means the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions or transfers (including the contribution that is distributed as a returned contribution pursuant to section 408(d)(4) and recharacterizations of contributions pursuant to section 408A(d)(6)) made to the IRA during the computation period.

(2) *Adjusted closing balance.* The term *adjusted closing balance* means the fair market value of the IRA at the end of the computation period plus the amount of any distributions or transfers (including recharacterizations of contributions pursuant to

section 408A(d)(6)) made from the IRA during the computation period.

(3) *Computation period.* The term *computation period* means the period beginning immediately prior to the time that the contribution being returned was made to the IRA and ending immediately prior to the removal of the contribution. If more than one contribution was made as a regular contribution and is being returned from the IRA, the computation period begins immediately prior to the time the first contribution being returned was contributed.

(4) *Regular contribution.* The term *regular contribution* means an IRA contribution made by the IRA owner that is neither a trustee-to-trustee transfer from another IRA nor a rollover from another IRA or retirement plan.

(c) *Additional rules.* (1) When an IRA asset is not normally valued on a daily basis, the fair market value of the asset at the beginning of the computation period is deemed to be the most recent, regularly determined, fair market value of the asset, determined as of a date that coincides with or precedes the first day of the computation period. In addition, solely for purposes of this section, notwithstanding A-3 of §1.408A-5, recharacterized contributions are

taken into account for the period they are actually held in a particular IRA.

(2) In the case of an IRA that has received more than one regular contribution for a particular taxable year, the last regular contribution made to the IRA for the year is deemed to be the contribution that is distributed as a returned contribution under section 408(d)(4), up to the amount of the contribution identified by the IRA owner as the amount distributed as a returned contribution.

(3) In the case of an individual who owns multiple IRAs, the net income calculation is performed only on the IRA containing the contribution being returned, and that IRA is the IRA that must distribute the contribution.

(d) *Examples.* The following examples illustrate the net income calculation under section 408(d)(4) and this section:

Example 1. (i) On May 1, 2004, when her IRA is worth \$4,800, Taxpayer A makes a \$1,600 regular contribution to her IRA. Taxpayer A requests that \$400 of the May 1, 2004, contribution be returned to her pursuant to section 408(d)(4). Pursuant to this request, on February 1, 2005, when the IRA is worth \$7,600, the IRA trustee distributes to Taxpayer A the \$400 plus attributable net income. During this time, no other contributions have been made to the IRA and no distributions have been made.

(ii) The adjusted opening balance is \$6,400 [\$4,800 + \$1,600] and the adjusted closing balance is \$7,600. Thus, the net income attributable to the \$400 May 1, 2004, contribution is \$75 [\$400 x (\$7,600 - \$6,400) ÷ \$6,400]. Therefore, the total to be distributed on February 1, 2005, pursuant to § 408(d)(4) is \$475.

Example 2. (i) Beginning in January 2004, Taxpayer B contributes \$300 on the 15th of each month to an IRA for 2004, resulting in an excess regular contribution of \$600 for that year. Taxpayer B requests that the \$600 excess regular contribution be returned to her pursuant to section 408(d)(4). Pursuant to this request, on March 1, 2005, when the IRA is worth \$16,000, the IRA trustee distributes to Taxpayer B the \$600 plus attributable net income. The excess regular contributions to be returned are deemed to be the last two made in 2004: the \$300 December 15 contribution and the \$300 November 15 contribution. On

November 15, the IRA was worth \$11,000 immediately prior to the contribution. No distributions or transfers have been made from the IRA and no contributions or transfers, other than the monthly contributions (including \$300 in January and February 2005), have been made.

(ii) As of the beginning of the computation period (November 15), the adjusted opening balance is \$12,200 [\$11,000 + \$300 + \$300 + \$300 + \$300] and the adjusted closing balance is \$16,000. Thus, the net income attributable to the excess regular contributions is \$187 [\$600 x (\$16,000 - \$12,200) ÷ \$12,200]. Therefore, the total to be distributed as returned contributions on March 1, 2005, to correct the excess regular contribution is \$787 [\$600 + \$187].

Par. 4. In § 1.408A-5, A-2(c) is revised to read as follows:

§1.408A-5 Recharacterized contributions.

* * * * *

A-2. * * *

(c) (1) If paragraph (b) of this A-2 does not apply, then, for purposes of determining net income attributable to IRA contributions, the net income attributable to the amount of a contribution is determined by allocating to the contribution a *pro-rata* portion of the earnings on the assets in the IRA during the period the IRA held the contribution. This attributable net income is calculated by using the following formula:

$$\text{Net Income} = \text{Contribution} \times \frac{(\text{Adjusted Closing Balance} - \text{Adjusted Opening Balance})}{\text{Adjusted Opening Balance}}$$

(2) For purposes of this paragraph (c), the following definitions apply:

(i) The term *adjusted opening balance* means the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions or transfers (including the contribution that is being recharacterized pursuant to section 408A(d)(6) and any other recharacterizations) made to the IRA during the computation period.

(ii) The term *adjusted closing balance* means the fair market value of the IRA at the end of the computation period plus the amount of any distributions or transfers (including contributions returned pursuant to section 408(d)(4) and recharacterizations of contributions pursuant to section 408A(d)(6)) made from the IRA during the computation period.

(iii) The term *computation period* means the period beginning immediately prior to the time the particular contribution being recharacterized is made to the IRA and ending immediately prior to the recharacterizing transfer of the contribution. If a series of regular contributions was made to the IRA, and consecutive contributions in that series are being recharacterized, the computation period begins immediately prior to the time the first of the regular contributions being recharacterized was made.

(3) When an IRA asset is not normally valued on a daily basis, the fair market value of the asset at the beginning of the computation period is deemed to be the most recent, regularly determined, fair mar-

ket value of the asset, determined as of a date that coincides with or precedes the first day of the computation period. In addition, solely for purposes of this paragraph (c), notwithstanding A-3 of this section, recharacterized contributions are taken into account for the period they are actually held in a particular IRA.

(4) In the case of an individual with multiple IRAs, the net income calculation is performed only on the IRA containing the particular contribution to be recharacterized, and that IRA is the IRA from which the recharacterizing transfer must be made.

(5) In the case of multiple contributions made to an IRA for a particular year that are eligible for recharacterization, the IRA owner can choose (by date and by dollar amount, not by specific assets acquired with those dollars) which contribution, or portion thereof, is to be recharacterized.

(6) The following examples illustrate the net income calculation under section 408A(d)(6) and this paragraph:

Example 1. (i) On March 1, 2004, when her Roth IRA is worth \$80,000, Taxpayer A makes a \$160,000 conversion contribution to the Roth IRA. Subsequently, Taxpayer A discovers that she was ineligible to make a Roth conversion contribution in 2004 and so she requests that the \$160,000 be recharacterized to a traditional IRA pursuant to section 408A(d)(6). Pursuant to this request, on March 1, 2005, when the IRA is worth \$225,000, the Roth IRA trustee transfers to a traditional IRA the \$160,000 plus allocable net income. No other contributions have been made to the Roth IRA and no distributions have been made.

(ii) The adjusted opening balance is \$240,000 [\$80,000 + \$160,000] and the adjusted closing bal-

ance is \$225,000. Thus the net income allocable to the \$160,000 is -\$10,000 [\$160,000 x (\$225,000 - \$240,000) ÷ \$240,000]. Therefore, in order to recharacterize the March 1, 2004, \$160,000 conversion contribution on March 1, 2005, the Roth IRA trustee must transfer from Taxpayer A's Roth IRA to her traditional IRA \$150,000 [\$160,000 - \$10,000].

Example 2. (i) On April 1, 2004, when her traditional IRA is worth \$100,000, Taxpayer B converts the entire amount, consisting of 100 shares of stock in ABC Corp. and 100 shares of stock in XYZ Corp., by transferring the shares to a Roth IRA. At the time of the conversion, the 100 shares of stock in ABC Corp. are worth \$50,000 and the 100 shares of stock in XYZ Corp. are also worth \$50,000. Taxpayer B decides that she would like to recharacterize the ABC Corp. shares back to a traditional IRA. However, B may choose only by dollar amount the contribution or portion thereof that is to be recharacterized. On the date of transfer, November 1, 2004, the 100 shares of stock in ABC Corp. are worth \$40,000 and the 100 shares of stock in XYZ Corp. are worth \$70,000. No other contributions have been made to the Roth IRA and no distributions have been made.

(ii) If B requests that \$50,000 (which was the value of the ABC Corp. shares at the time of conversion) be recharacterized, the net income allocable to the \$50,000 is \$5,000 [\$50,000 x (\$110,000 - \$100,000) ÷ \$100,000]. Therefore, in order to recharacterize \$50,000 of the April 1, 2004, conversion contribution on November 1, 2004, the Roth IRA trustee must transfer from Taxpayer B's Roth IRA to a traditional IRA assets with a value of \$55,000 [\$50,000 + \$5,000].

(iii) If, on the other hand, B requests that \$40,000 (which was the value of the ABC Corp. shares on November 1) be recharacterized, the net income allocable to the \$40,000 is \$4,000 [\$40,000 x (\$110,000 - \$100,000) ÷ \$100,000]. Therefore, in order to recharacterize \$40,000 of the April 1, 2004, conversion contribution on November 1, 2004, the Roth IRA trustee must transfer from Taxpayer B's Roth IRA to a traditional IRA assets with a value of \$44,000 [\$40,000 + \$4,000].

(iv) Regardless of the amount of the contribution recharacterized, the determination of that amount (or of the net income allocable thereto) is not affected by whether the recharacterization is accomplished by the transfer of shares of ABC Corp. or of shares of XYZ Corp.

(7) This paragraph (c) applies for purposes of determining net income attributable to IRA contributions, made on or after January 1, 2004. For purposes of determining net income attributable to IRA contributions made before January 1, 2004, see paragraph (c) of this A-2 of §1.408A-5 (as it appeared in the April 1, 2003, edition of 26 CFR part 1).

* * * * *

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

Approved April 25, 2003.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 2, 2003, 8:45 a.m., and published in the issue of the Federal Register for May 5, 2003, 68 F.R. 23586)

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

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

LIFO; price indexes; department stores. The March 2003 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, March 31, 2003.

Rev. Rul. 2003-50

The following Department Store Inventory Price Indexes for March 2003 were is-

sued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, March 31, 2003.

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

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

Groups	Mar. 2002	Mar. 2003	Percent Change from Mar. 2002 to Mar. 2003 ¹
1. Piece Goods	490.6	458.9	-6.5
2. Domestic and Draperies	583.6	552.6	-5.3
3. Women's and Children's Shoes	647.4	642.6	-0.7
4. Men's Shoes	903.0	842.0	-6.8
5. Infants' Wear	624.2	600.3	-3.8
6. Women's Underwear.....	563.7	524.9	-6.9
7. Women's Hosiery.....	355.7	341.2	-4.1
8. Women's and Girls' Accessories.....	563.4	556.0	-1.3
9. Women's Outerwear and Girls' Wear	401.0	380.1	-5.2
10. Men's Clothing	594.6	570.0	-4.1
11. Men's Furnishings	607.3	591.1	-2.7
12. Boys' Clothing and Furnishings.....	482.6	470.9	-2.4
13. Jewelry	905.5	871.7	-3.7
14. Notions	800.4	797.7	-0.4
15. Toilet Articles and Drugs.....	972.7	976.3	0.4
16. Furniture and Bedding.....	630.0	625.2	-0.8
17. Floor Coverings	616.3	589.1	-4.4
18. Housewares	756.2	734.0	-2.9
19. Major Appliances	223.2	217.5	-2.6
20. Radio and Television	51.1	46.6	-8.8
21. Recreation and Education ²	87.5	83.8	-4.2
22. Home Improvements ²	125.6	125.7	0.1
23. Auto Accessories ²	110.8	111.7	0.8

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

Groups	Mar. 2002	Mar. 2003	Percent Change from Mar. 2002 to Mar. 2003 ¹
Groups 1–15: Soft Goods	591.8	570.4	-3.6
Groups 16–20: Durable Goods	414.6	400.8	-3.3
Groups 21–23: Misc. Goods ²	97.2	95.0	-2.3
 Store Total ³	 526.5	 508.5	 -3.4

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

²Indexes on a January 1986 = 100 base.

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

DRAFTING INFORMATION

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

Section 861.—Income From Sources Within the United States

26 CFR 1.861-8T: Computations of taxable income from sources within the United States and from other sources and activities (Temporary).

26 CFR 1.861-9T: Allocation and apportionment of interest expense (Temporary).

See Rev. Proc. 2003-37, page 950.

Section 864.—Definitions and Special Rules

This revenue procedure provides guidance to taxpayers that use the fair market value method to apportion interest expense for purposes of calculating the foreign tax credit. See Rev. Proc. 2003-37, page 950.

Section 901.—Taxes of Foreign Countries and of Possessions of United States

This revenue procedure provides guidance to taxpayers that use the fair market value method to apportion interest expense for purposes of calculating the foreign tax credit. See Rev. Proc. 2003-37, page 950.

Section 904.—Limitation on Credit

This revenue procedure provides guidance to taxpayers that use the fair market value method to apportion interest expense for purposes of calculating the foreign tax credit. See Rev. Proc. 2003-37, page 950.

Section 3406.—Backup Withholding

26 CFR 31.3406(d)-5: Backup withholding when the Service or a broker notifies the payor to withhold because the payee's taxpayer identification number is incorrect.

T.D. 9055

**DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 31 and 301**

Receipt of Multiple Notices With Respect to Incorrect Taxpayer Identification Numbers

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations relating to backup withholding. These regulations clarify the method of determining whether the payor has received two notices that a payee's taxpayer identification number (TIN) is incorrect. If a payor receives two or more such notices with respect to the same account during a three-year period, the payor must begin backup withholding unless the payee provides verification of its correct TIN pursuant to the regulations. This document also contains regulations which clarify when an information return filer must solicit a payee's TIN following the receipt of a penalty notice.

DATES: These regulations are effective January 1, 2004.

FOR FURTHER INFORMATION CONTACT: Nancy L. Rose at (202) 622-4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Employment Tax Regulations (26 CFR

part 31) under section 3406 of the Internal Revenue Code (Code), and to the Procedure and Administration Regulations (26 CFR part 301) under section 6724 of the Code. These regulations finalize proposed amendments to existing §§31.3406(d)–5(d)(2)(ii) and (g)(4), and 301.6724–1(f)(2), (f)(3), (f)(5), and (k). These regulations also revise existing §301.6724(f)(1) and (g)(1) to remove obsolete cross-references. A notice of proposed rulemaking (REG–116644–01, 2002–31 I.R.B. 268 [67 FR 44579]) was published in the **Federal Register** on July 3, 2002. The IRS received written comments responding to the notice of proposed rulemaking, but no commentators requested the opportunity to present oral comments at a public hearing. A notice cancelling the public hearing scheduled for October 22, 2002, was published on October 17, 2002 (67 FR 64067).

Explanation of Provisions and Summary of Comments

Section 3406

Section 3406 imposes a requirement to backup withhold on any reportable payment if the Secretary notifies the payor that the TIN furnished by the payee is incorrect. After receiving a notice of incorrect TIN, the payor must backup withhold on reportable payments until the payee furnishes another TIN. However, if the payor receives two notices with respect to the same account within a three year period, the payor must backup withhold on reportable payments until the payor receives a verification of the payee's TIN from the Social Security Administration or the IRS.

The regulations under section 3406 set forth detailed procedures for payors to follow after receipt of a notice of incorrect TIN from the IRS. When the first such notice is received by the payor, the payor must send a notice (commonly referred to as a "B" notice) to the payee stating that the payee will be subject to backup withholding if the payee does not furnish a certified TIN. If a second notice of incorrect TIN is received by a payor with respect to the payee's account within a three-year period, the payor must send a second "B" notice to the payee stating that the payee will be subject to backup withholding unless the payor receives verification of the payee's TIN from the Social Security Administration or IRS.

If the payor receives two or more notices of incorrect TIN with respect to a pay-

ee's account within the same calendar year, the regulations provide that the multiple notices may be treated as one notice for purposes of sending out a first "B" notice, and must be treated as one notice for purposes of sending out a second "B" notice. However, in some cases, a payor may receive multiple notices of incorrect TIN in different calendar years which relate to the same payee's account for the same year. This may occur where a payor files different types of information returns with respect to the same payee, such as a Form 1099–B (gross proceeds reported by brokers) and a Form 1099–DIV (payment of dividends). Typically these information returns all contain the same TIN, following information contained in the payor's records. Variations in the processing of such returns by the IRS may result in the issuance of incorrect TIN notices at different times.

The amendments to the regulations provide that two or more notices of incorrect TIN relating to the same payee and the same year, but which are received in different calendar years, count as one notice. Accordingly, a payor who sends a first "B" notice to the payee after receipt of the first notice of incorrect TIN would not be required to send a second "B" notice after receipt of the second notice of incorrect TIN if the second notice relates to an information return filed for the same year as the first notice.

Section 6724

Section 6724 provides for a waiver of information reporting penalties under sections 6721 through 6723 where the failure giving rise to such penalties was due to reasonable cause and not willful neglect. Under §301.6724–1(a) of the regulations, in order to prove reasonable cause for a failure, the filer must establish either that there are significant mitigating factors with respect to the failure or that the failure arose from events beyond the filer's control. In addition, the filer must have acted in a responsible manner both before and after the failure.

Section 301.6724–1(c)(1)(v) of the regulations provides that certain actions of the payee or another person providing necessary information with respect to the return may be an event beyond the filer's control. Thus, a payee's furnishing of an incorrect TIN to a payor may be an event beyond the payor's control.

As provided in §301.6724–1(a), the payor must also act in a responsible manner with respect to the failure. That section sets forth special rules for acting in a responsible manner with respect to incorrect TINs. The filer is required to make an initial solicitation for the payee's correct TIN at the time the account is opened, and up to two annual solicitations following receipt of penalty notices.

If a filer receives a penalty notice with respect to an incorrect payee TIN and a notice of incorrect TIN under section 3406(a)(1)(B) during the same calendar year for the same payee, the filer will satisfy the section 6724 annual solicitation requirements by sending the required "B" notice. The filer does not have to make another solicitation pursuant to section 6724.

The amendments to the regulations address the situation where a filer receives a section 3406(a)(1)(B) notice with respect to a payee in one year, and the following year receives a penalty notice with respect to the same payee and the same year as the section 3406(a)(1)(B) notice. The amendments provide that the filer is not required to make an annual solicitation for the payee's TIN pursuant to section 6724 in this situation, provided the filer has sent the required "B" notice.

The written comments received expressed the view that the proposed regulations clarified the backup withholding rules and reduced the regulatory burden associated with backup withholding. No revisions to the proposed amendments were suggested by commentators.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Drafting Information

The principal author of these regulations is Nancy L. Rose of the Office of the Associate Chief Counsel (Procedure and

Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 31 and 301 are amended as follows:

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

Par. 1. The authority citation for part 31 continues to read in part as follows:

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

Par. 2. Section 31.3406(d)-5 is amended by revising paragraphs (d)(2)(ii) and (g)(4) to read as follows:

§31.3406(d)-5 Backup withholding when the Service or a broker notifies the payor to withhold because the payee's taxpayer identification number is incorrect.

* * * * *

(d) * * *

(2) * * *

(ii) *Two or more notices for an account for the same year or received in the same year.* A payor who receives, under the same payor taxpayer identification number, two or more notices under paragraph (c)(1) or (2) of this section with respect to the same payee's account for the same year, or in the same calendar year, need only send one notice to the payee under this section.

* * * * *

(g) * * *

(4) *Receipt of two notices for the same year or in the same calendar year.* A payor who receives, under the same payor taxpayer identification number, two or more notices under paragraph (c)(1) or (2) of this section with respect to the same payee's account for the same year, or in the same calendar year, must treat such notices as one notice for purposes of this paragraph (g).

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

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

Par. 4. Section 301.6724-1 is amended as follows:

1. Amending paragraph (f)(1)(ii), fourth sentence, by removing “(n)” after “section 6721”.

2. Revising paragraphs (f)(2) and (f)(3).

3. Amending paragraph (f)(5)(vi), last sentence, by removing the language “paragraph (f)(2)” and adding “paragraph (f)(3)” in its place.

4. Amending paragraph (g)(1) by removing the language “as provided under section 6724(c)(1)”.

5. Amending paragraph (k), *Example 3(ii)*, second sentence, by removing the language “§35a.3406-1(c)(1) of this paragraph” and adding “§31.3406(d)-5(d)(2)(i) of this chapter” in its place; and by removing the language “(f)(2)” and adding “(f)(3)” in its place.

6. Amending paragraph (k), *Example 3(ii)*, fifth sentence, by removing the language “§301.6721-1T” and adding “§301.6721-1” in its place.

7. Amending paragraph (k), *Example 3(iii)*, fifth sentence, by removing the language “§35a.3406-1(c)(1)” and adding “§31.3406(d)-5(d)(2)(i)” in its place.

8. Amending paragraph (k), *Example 3(iii)*, last sentence, by removing the language “§301.6721-1T” and adding “§301.6721-1” in its place.

9. Amending paragraph (k), *Example 5*, final sentence, by removing the language “§301.6721-1T” and adding “§301.6721-1” in its place.

10. Amending paragraph (k), *Example 6(ii)*, sixth sentence, by removing the language “(f)(3)” and adding the language “(f)(2)” in its place.

11. Amending paragraph (k), *Example 7(ii)*, fourth sentence, by removing the language “(f)(2)” and adding “(f)(3)” in its place; and by removing the language “§35a.3406-1(c)(1)” and adding “§31.3406(d)-5(g)(1)(ii)” in its place.

12. Amending paragraph (k), *Example 7(ii)*, fifth sentence, by removing the language “§35a.3406-1(c)(1)” and adding “§31.3406(d)-5(g)(1)(ii)” in its place.

The revisions read as follows:

§301.6724-1 Reasonable cause.

* * * * *

(f) * * *

(2) *Manner of making annual solicitation if notified pursuant to section 6721.* A filer that has been notified of an incorrect TIN by a penalty notice or other notification pursuant to section 6721 may satisfy the solicitation requirement of this para-

graph (f) either by mail, in the manner set forth in paragraph (e)(2)(i) of this section; by telephone, in the manner set forth in paragraph (e)(2)(ii) of this section; or by requesting the TIN in person.

(3) *Coordination with solicitations under section 3406(a)(1)(b).* (i) A filer that has been notified of an incorrect TIN pursuant to section 3406(a)(1)(B) (except filers to which §31.3406(d)-5(b)(4)(i)(A) of this chapter applies) will satisfy the solicitation requirement of this paragraph (f) only if it makes a solicitation in the manner and within the time period required under §31.3406(d)-5(d)(2)(i) or (g)(1)(ii) of this chapter, whichever applies.

(ii) A filer that has been notified of an incorrect TIN by a notice pursuant to section 6721 (except filers to which §31.3406(d)-5(b)(4)(i)(A) of this chapter applies) is not required to make the annual solicitation of this paragraph (f) if—

(A) The filer has received an effective notice pursuant to section 3406(a)(1)(B) with respect to the same payee, either during the same calendar year or for information returns filed for the same year; and

(B) The filer makes a solicitation in the manner and within the time period required under §31.3406(d)-5(d)(2)(i) or (g)(1)(ii) of this chapter, whichever applies, before the filer is required to make the annual solicitation of this paragraph (f).

(iii) A filer that has been notified of an incorrect TIN by a notice pursuant to section 6721 with respect to a fiduciary or nominee account to which §31.3406(d)-5(b)(4)(i)(A) of this chapter applies is required to make the annual solicitation of this paragraph (f).

* * * * *

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

Approved April 13, 2003.

Pamela F. Olson,
Assistant Secretary of the
Treasury (Tax Policy).

(Filed by the Office of the Federal Register on April 28, 2003, 8:45 a.m., and published in the issue of the Federal Register for April 29, 2003, 68 F.R. 22594)

Part III. Administrative, Procedural, and Miscellaneous

Commercial-Type Insurance Activities of Certain Exempt Organizations

Notice 2003-31

I. PURPOSE

This notice announces that the Treasury Department and the Internal Revenue Service intend to propose regulations providing guidance under § 501(m) of the Internal Revenue Code (the “Code”), which will define the term “commercial-type insurance” and address how § 501(m) applies to organizations described in § 501(c)(3) and § 501(c)(4), including health maintenance organizations. This notice also requests comments on the content of the regulations to be proposed. Finally, this notice announces that, in light of the regulations project, the Service is withdrawing from the Internal Revenue Manual the sections of Part 7.8.1, Chapter 27, Exempt Organizations Examination Guidelines Handbook, Health Maintenance Organizations (the “IRM HMO Guidelines”) that relate to § 501(m) of the Code.

II. BACKGROUND

A. Legislative History § 501(m)

Section 501(c)(3) describes organizations organized and operated exclusively for charitable, religious, educational and other specified purposes. Section 501(c)(4) describes organizations not organized for profit but operated exclusively for the promotion of social welfare. Section 501(m) provides that an organization described in § 501(c)(3) or § 501(c)(4) shall be exempt from tax under § 501(a) “only if no substantial part of its activities consists of providing commercial-type insurance.” Section 501(m)(3)(A) provides that the term “commercial-type insurance” does not include “insurance provided at substantially below cost to a class of charitable recipients.” Section 501(m)(3)(B) provides that

the term “commercial-type insurance” does not include “incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations.”

Congress adopted § 501(m) in 1986 because it was “concerned that exempt charitable and social welfare organizations that engage in insurance activities are engaged in an activity whose nature and scope is so inherently commercial that tax exempt status is inappropriate.” H.R. Rep. No. 99-426, at 664 (1985). Congress believed that the “tax-exempt status of organizations engaged in insurance activities provides an unfair competitive advantage to these organizations” over commercial insurers. *Ibid.*¹

B. Definition of Insurance

Neither the Code nor the Income Tax Regulations (the “Regulations”) define the term “insurance.” The United States Supreme Court, however, has explained that, for an arrangement to constitute insurance for federal income tax purposes, both risk shifting and risk distribution must be present. *Helvering v. LeGierse*, 312 U.S. 531, 539 (1941).

Risk shifting occurs if a person facing the possibility of an economic loss transfers some or all of the financial consequences of the potential loss to the insurer, such that a loss by the insured does not affect the insured because the loss is offset by the insurance payment. Risk distribution incorporates the statistical phenomenon known as the law of large numbers. Distributing risk allows the insurer to reduce the possibility that a single costly claim will exceed the amount taken in as premiums and set aside for the payment of such a claim. Insuring many independent risks in return for numerous premiums serves to distribute risk. By assuming numerous relatively small, independent risks that occur randomly over time, the insurer smoothes out losses to match more closely its receipt of premiums. *Clougherty Packing Co. v. Commissioner*, 811 F.2d 1297,

1300 (9th Cir. 1987). Risk distribution necessarily entails a pooling of premiums, so that a potential insured is not in significant part paying for its own risks. *See Humana, Inc. v. Commissioner*, 881 F.2d 247, 257 (6th Cir. 1989).

When Congress enacted § 501(m), it followed the Supreme Court’s definition of insurance. *See* 1986 General Explanation, at 585 (Under § 501(m), “commercial-type insurance does not include arrangements that are not treated as insurance [*i.e.*, in the absence of sufficient risk shifting and risk distribution for the arrangement to constitute insurance],” *citing Helvering v. LeGierse*, 312 U.S. at 539).

C. Definition of “Commercial-Type Insurance”

When § 501(m) was enacted, Congress did not specifically define the term “commercial-type insurance.” The legislative history of § 501(m) states that “commercial-type insurance generally is any insurance of a type provided by commercial insurance companies.” H.R. Rep. No. 99-426, at 665 (1985); H.R. Conf. Rep. No. 99-841, at II-345, 346 (1986); 1986 General Explanation, at 585. Congress explained that “the provision of insurance to the general public at a price sufficient to cover the costs of insurance generally constitutes an activity that is commercial.” H.R. Rep. No. 99-426, at 664; 1986 General Explanation, at 584.

In *Paratransit Insurance Corporation v. Commissioner*, 102 T.C. 745, 754 (1994), the court held that “‘commercial-type insurance,’ as used in § 501(m), encompasses every type of insurance that can be purchased in the commercial market.”²

In *Florida Hospital Trust Fund v. Commissioner*, 103 T.C. 140, 158 (1994), *aff’d on other grounds*, 71 F.3d 808, 812 (11th Cir. 1996), the court held that the term “commercial-type insurance” under § 501(m) means insurance “normally offered by commercial insurers.”

In *Nonprofits’ Insurance Alliance of California v. U. S.*, 32 Fed. Cl. 277, 284

¹ For a detailed discussion of the legislative history of § 501(m), see H.R. Rep. No. 99-426, at 662 – 666 (1985); H.R. Conf. Rep. No. 99-841, at II-344 – 351 (1986); Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, at 583 – 591 (Comm. Print 1987) (“1986 General Explanation”); H.R. Rep. No. 100-795, at 114 – 116 (1988); S. Rep. No. 100-445, at 120 – 122 (1988); H.R. Conf. Rep. No. 100-1104, at 9 (1988); Staff of the Joint Committee on Taxation, *Description of the Technical Corrections Act of 1988 (H.R. 4333 and S. 2238)*, at 115 – 117 (Comm. Print 1988).

² The court also found that the organization did not satisfy the exception in § 501(m)(3)(A). 102 T.C. at 757-758.

(1994), the court compared the organization's activities to commercial insurance companies and found they were "commercial in nature."³

III. NEED FOR GUIDANCE

Treasury and the Service believe that guidance is necessary to provide § 501(c)(3) and § 501(c)(4) organizations with greater certainty as to the definition of the term "commercial-type insurance" and how § 501(m) applies to organizations described in § 501(c)(3) and § 501(c)(4), including health maintenance organizations. The Code does not define the term "commercial-type insurance," and no regulations or published guidance have been issued under § 501(m). In addition, since the enactment of § 501(m), there have been significant developments in the insurance and health care industries, including changes in the operation of health maintenance organizations.

Taxpayers have asked the Service to provide guidance under § 501(m), defining the term "commercial-type insurance" and describing the application of the exceptions in § 501(m)(3)(A) and § 501(m)(3)(B). Treasury and the Service intend to propose regulations under § 501(m). The proposed regulations will define the term "commercial-type insurance" and address how § 501(m) applies to organizations described in § 501(c)(3) and § 501(c)(4), including health maintenance organizations.

Treasury and the Service expect that these regulations will apply prospectively, effective as of the date that final regulations under § 501(m) are published in the Federal Register. Treasury and the Service will consider proposing appropriate transition rules, if necessary.

IV. WITHDRAWAL OF IRM

A health maintenance organization that satisfies the IRM HMO Guidelines is treated as qualifying for exemption under either § 501(c)(3) or § 501(c)(4), as applicable, and its activities are not treated as "commercial-type insurance" under § 501(m). In light of the regulations project, the Service is withdrawing for further study the sections of the IRM HMO Guidelines that relate to § 501(m).

V. REQUEST FOR COMMENTS

Treasury and the Service request comments on the content of the regulations to be proposed, including the definition of the term "commercial-type insurance" and the application of § 501(m) to organizations described in § 501(c)(3) and § 501(c)(4), including health maintenance organizations. In particular, comments are requested on what factors may be indicative of "commercial-type insurance."

In addition, comments are requested on the exception from "commercial-type insurance" in § 501(m)(3)(A). Comments are specifically requested on: (i) the meaning of the term "insurance provided at substantially below cost," (ii) the application of this exception to Medicaid-only health maintenance organizations, and (iii) the treatment of grants or contractual payments from states or the federal government for purposes of this exception.

Further, Treasury and the Service request comments on the exception from "commercial-type insurance" in § 501(m)(3)(B). In light of the legislative history, comments are specifically requested on: (i) what historical industry data or other criteria the Service should use to determine whether the health insurance a health maintenance organization provides is "of a kind customarily provided by such organizations"; (ii) what factors or criteria the Service should consider in determining whether a health maintenance organization's "principal activity" is "providing health care"; (iii) what factors or criteria the Service should consider in determining whether the health insurance a health maintenance organization provides is "incidental to the organization's principal activity of providing health care"; and (iv) how this exception should be applied to a health maintenance organization that does not provide "health care to its members predominantly at its own facility through the use of health care professionals and other workers employed by the organization."⁴

VI. SUBMISSION OF COMMENTS

Comments should be submitted by August 25, 2003, in writing and should include a reference to Notice 2003-31.

Comments may be submitted to:

Internal Revenue Service
Attn: T:EO:RA:T:1 (Notice 2003-31)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Comments may be hand delivered between the hours of 8 a.m. and 4 p.m., Monday through Friday, to:

T:EO:RA:T:1 (Notice 2003-31)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Alternatively, comments may be sent via facsimile to (202) 283-9462 or via e-mail to tege.501m@irs.gov and include a reference to Notice 2003-31.

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

VII. DRAFTING INFORMATION

The principal author of this notice is Lawrence M. Brauer, TE/GE Division, Exempt Organizations. For further information on this notice, contact Mr. Brauer at (202) 283-9457 (not a toll-free call).

Weighted Average Interest Rate Update

Notice 2003-32

Sections 412(b)(5)(B) and 412(l)(7)(C)(i) of the Internal Revenue Code provide that the interest rates used to calculate current liability for purposes of determining the full funding limitation under § 412(c)(7) and the required contribution under § 412(l) must be within a permissible range around the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year.

Notice 88-73, 1988-2 C.B. 383, 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 Code.

Section 417(e)(3)(A)(ii)(II) defines the applicable interest rate, which must be used for purposes of determining the minimum

³ The court also found that the organization did not satisfy the exception in § 501(m)(3)(A). 32 Fed. Cl. at 292.

⁴ See H.R. Rep. No. 99-426, at 665; 1986 General Explanation, at 585.

present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)-1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the

Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury Securities for April 2003 is 4.90 percent. Pursuant to Notice 2002-26, 2002-1 C.B. 743, the Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2031.

Section 405 of the Job Creation and Worker Assistance Act of 2002 amended § 412(l)(7)(C) of the Code to provide that for plan years beginning in 2002 and 2003 the permissible range is extended to 120 percent.

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

Month	Year	Weighted Average	90% to 110% Permissible Range	90% to 120% Permissible Range
May	2003	5.43	4.89 to 5.97	4.89 to 6.52

Drafting Information

The principal authors of this notice are Paul Stern and Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Mr. Stern may be reached at 1-202-283-9703. Mr. Montanaro may be reached at 1-202-283-9714. The telephone numbers in the preceding two sentences are not toll-free.

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 864; 1.861-8T; 1.861-9T.)

Rev. Proc. 2003-37

SECTION 1. PURPOSE

This revenue procedure describes documentation and information a taxpayer that uses the fair market value method of apportionment of interest expense may prepare and make available to the Internal Revenue Service ("Service") upon request in order to establish the fair market value of the taxpayer's assets to the satisfaction of the Commissioner as required by § 1.861-9T(g)(1)(iii). It also sets forth the procedures to be followed in the case of elections to use the fair market value method.

SECTION 2. BACKGROUND

Section 901 of the Internal Revenue Code ("Code") allows taxpayers to elect to receive a credit, subject to the limitations of section 904, for any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States. Section 904 generally limits the amount of credit taken under section 901 to the portion of the taxpayer's U.S. tax attributable to the taxpayer's taxable income from sources without the United States.

Sections 862(b) and 863(a) provide that taxable income attributable to gross income from foreign sources shall be determined by deducting the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, and other deductions that cannot be definitely allocated to some item or class of gross income. Section 864(e)(2) provides that all allocations and apportionments of interest expense must be made on the basis of assets rather than gross income. Sections 1.861-8T and 1.861-9T provide general rules governing the asset method of interest expense apportionment, and §§ 1.861-8T(c)(2) and 1.861-9T(g)(1)(ii) provide that a taxpayer apportions its interest expense on the basis of the tax book value of its assets or, at the election of the taxpayer, the fair market value of its assets. Under both methods, § 1.861-9T(g)(3) requires assets to be characterized according to the source and type of income that they generate, have generated, or may reasonably be expected to generate.

Section 1.861-9T(g)(1)(iii) requires a taxpayer that elects to apportion its interest expense using the fair market value method to establish the fair market value of its assets to the satisfaction of the Commissioner for each taxable year. If a taxpayer fails to establish the fair market value of an asset to the satisfaction of the Commissioner, the Commissioner may determine the appropriate asset value. If a taxpayer fails to establish the value of a substantial portion of its assets to the satisfaction of the Commissioner, the Commissioner may require the taxpayer to use the tax book value method. Section 1.861-9T(h) provides specific rules for valuing assets for taxpayers that use the fair market value method of interest expense apportionment.

SECTION 3. DOCUMENT AND INFORMATION REQUIREMENTS

.01 If a taxpayer satisfies the requirements of sections 3.02 and 3.03 of this revenue procedure regarding the preparation and production of documents and other information relating to valuation of assets and the Commissioner determines that the taxpayer's valuation of an asset is reasonable, then the taxpayer will have established the fair market value of the asset to the satisfaction of the Commissioner pursuant to § 1.861-9T(g)(1)(iii).

.02 A taxpayer satisfies the requirements of this section 3.02 if the taxpayer prepares and makes available to the Service upon request a narrative statement describing the apportionment of interest expense under the fair market value method in sufficient detail such that the Service can

reconcile the information on Schedule H of Form 1118 with such apportionment methodology, which narrative statement incorporates or is accompanied by the following information:

(a) A description of how the taxpayer calculated the aggregate value of the taxpayer's assets on the last day of its taxable year. In the case of a publicly traded corporation, the taxpayer must describe how the taxpayer calculated the aggregate trading value of stock traded on established securities markets at year-end and how the taxpayer calculated year-end liabilities to unrelated persons and *pro rata* share of year-end liabilities of all related persons owed to unrelated persons as required by § 1.861-9T(h)(1)(i). In the case of a corporation that is not publicly traded, the taxpayer must describe how the taxpayer calculated the aggregate value of its assets by reference to the capitalization of corporate earnings as required by § 1.861-9T(h)(1)(i).

(b) A description, by entity, of tangible assets referred to in § 1.861-9T(h)(1)(ii). With respect to assets that have significant value or that generate significant income, the description must include detailed information for the asset. For example, with respect to real property, the description should include location, zoning, and square footage.

(c) An explanation of company structure and an identification of cost centers or other reporting divisions or units to which assets are assigned.

(d) A description of the valuation techniques used to value tangible assets and the reasons for selecting such valuation techniques over alternative techniques. Any valuation study relied upon by the taxpayer must include an explanation describing the valuation of the tangible assets as set forth in § 1.861-9T(h)(1)(ii) in detail sufficient to enable the Service, upon examination, to duplicate the methodology used to obtain those fair market values. The taxpayer must also provide a description of all assumptions made in applying the valuation techniques used in the study, including but not limited to, discount rates, obsolescence factors, and risk adjustments.

(e) An explanation of the manner in which tangible assets were combined into reasonable groupings and the reasons for such grouping.

(f) An identification of any fungible property, such as commodities, that was val-

ued using statistical methods of valuation, and an explanation of such methods.

(g) A description of the apportionment of interest expense to intangible asset values as computed under § 1.861-9T(h)(1)(iii).

.03 If the taxpayer or a third party used any computer software to determine asset values, characterize assets in accordance with § 1.861-9T(g)(3), or calculate the taxpayer's foreign tax credit limitation, the taxpayer satisfies the requirements of this section 3.03 if the taxpayer makes available to the Service upon request the following:

(a) Any computer software executable code used for such purposes, including an executable copy of the version of the software used in the preparation of the taxpayer's return (including any plug-ins, supplements, etc.), and a copy of all related electronic data files. Thus, if software subsequently is upgraded or supplemented, a separate executable copy of the version used in preparing the taxpayer's return must be retained.

(b) Any related computer software source code acquired or developed by the taxpayer or a related person, or primarily for internal use by the taxpayer or such person rather than for commercial distribution.

(c) In the case of any spreadsheet software or similar software, any formulae or links to supporting worksheets.

For these purposes, "software," "computer software executable code," and "computer software source code" have the meanings provided for those terms under section 7612(d). For example, computer software executable code includes any related user manuals or similar documentation. Finally, nothing in this revenue procedure shall affect the limitations and protections applicable to summonses for software under section 7612, or the authority of the Commissioner generally to issue a summons for information in accordance with subchapter A of Chapter 78 of the Code.

SECTION 4. USE OF FAIR MARKET VALUE METHOD

.01 A taxpayer may elect to use the fair market value method with respect to any taxable year for which the statute of limitations has not closed. However, an election to use the fair market value method that

is not made until an audit of the taxable year to which the election relates has commenced, or a taxpayer's failure to provide timely the documentation and other information supporting the valuation of the taxpayer's assets, creates administrative difficulties for the Service. Accordingly, section 4 of this revenue procedure sets forth the procedures the Service will follow in the case of taxpayers using the fair market value method and the actions it will request of taxpayers.

.02 In the case of a taxpayer that has made an election to use the fair market value method prior to the opening conference for the audit of the taxable year to which the election relates or who makes such an election within 90 days of such opening conference, if the Service issues a written information document request asking the taxpayer to provide the documents and other information described in sections 3.02 and 3.03 of this revenue procedure and the taxpayer complies with such request within 30 days of the request, then the Service will complete its examination, if any, with respect to the taxpayer's method of interest expense apportionment for that year as part of the current examination cycle. If the taxpayer does not provide the documents and information described in sections 3.02 and 3.03 within 30 days of the request, then the procedures described in section 4.03 of this revenue procedure shall apply.

.03 If a taxpayer makes an election to use the fair market value method more than 90 days after the opening conference for the audit of the taxable year to which the election relates or the taxpayer does not provide the documents and information as requested in accordance with section 4.02 of this revenue procedure, then the Service will in a separate cycle determine whether an examination of the taxpayer's method of interest expense apportionment is warranted and complete any such examination. The separate cycle will be worked as resources are available and may not have the same estimated completion date as the other issues under examination for the taxable year. The Service may ask the taxpayer to agree to extend the statute of limitations on assessment and collection for the taxable year to permit examination of the taxpayer's method of interest expense apportionment, including an extension limited, where appropri-

ate, to the taxpayer's method of interest expense apportionment.

.04 For a taxable year for which the taxpayer and the Service have agreed to use the Limited Issue Focused Exam (LIFE) process announced in IR 2002-133 (December 4, 2002), the time periods agreed to in that process shall apply for purposes of both the election to use the fair market value method and the provision of documents and other information with respect to such method.

SECTION 5. EFFECTIVE DATE

Section 3 of this revenue procedure is effective for taxpayers using the fair market value method for taxable years ending after May 7, 2003. Section 4 of this revenue procedure is effective for fair market value method elections relating to taxable years for which the opening conference of the audit occurs more than 30 days after May 7, 2003.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has 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 1545-1833.

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

The collection of information in this revenue procedure is in section 3, under which taxpayers may prepare and make available to the Commissioner upon request the documents and other information described therein in order for the Commissioner to make a determination regarding whether a taxpayer's valuation of an asset is reasonable. This information will be used by revenue agents to assist in determining if the taxpayer has established the fair market value of the taxpayer's assets to the satisfaction of the Commissioner. The likely re-

spondents are multinational businesses or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 625 hours. The estimated annual burden per respondent/recordkeeper is an estimated average of 5 hours. The estimated number of respondents and/or recordkeepers is 125. The estimated frequency of response is on occasion.

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

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Melissa Arndt of the Office of the Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Ms. Arndt at (202) 622-3850 (not a toll-free call).

Part IV. Items of General Interest

New Form 8876, *Excise Tax on Structured Settlement Factoring Transactions*

Announcement 2003-33

The IRS has released new **Form 8876, *Excise Tax on Structured Settlement Factoring Transactions***. Use Form 8876 to report and pay the 40% excise tax imposed under section 5891 on the factoring discount.

You can obtain Form 8876 by telephone or by using IRS electronic information services.

Request by	Number or Address
Telephone	1-800-TAX-FORM (1-800-829-3676)
Personal computer:	
IRS web site	<i>www.irs.gov</i>
File transfer protocol	<i>ftp.irs.gov</i>

Foundations Status of Certain Organizations

Announcement 2003-34

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

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

4 Bar M Coach, Inc., Decatur, TX
 11th Hour Company, Inc.,
 Brooklyn, NY
 Academy of Artistic Gymnastics TAAG
 Parents Club, San Antonio, TX
 Actors Project Theatre Company, Inc.,
 Coral Springs, FL
 African Cultural Center, Incorporated,
 Rockville, MD
 American Childrens Ice Theatre, Inc.,
 Saugus, MA
 Angell School PTO, Ann Arbor, MI
 Another Byte, Inc., Flagstaff, AZ

Apex Financial Support Group, Inc.,
 East Meadow, NY
 Appalachian Focus, Inc.,
 Middlesboro, KY
 Arizona Education Academy,
 Phoenix, AZ
 Arkansas Friends for Better Schools,
 Little Rock, AR
 Arrowhead Elementary Parents and
 Teachers Organization,
 Lewis Center, OH
 Arsenal Football Associates, Ltd.,
 Mt. Lake Park, MD
 Arts for Art, Inc., New York, NY
 Asheville Puppetry Alliance,
 Fairview, NC
 Ashland United Soccer, Ashland, OH
 Asylum, Las Vegas, NV
 Baker Brownsfield Athletic Association,
 Baton Rouge, LA
 Baldwin RHF Housing, Inc.,
 Long Beach, CA
 Baldwin Childrens Home, Saltillo, MS
 Bean Station PTO, Bean Station, TN
 Bible Research Study Institute,
 Santa Cruz, CA
 Bittenbender Jr. Ballet Co., Inc.,
 Mesquite, TX
 Blackman TKD Parents Association,
 Inc., Albuquerque, NM
 Bloomfield Youth Basketball League,
 Bloomfield, CT
 Borderline Volunteer Caregivers, Inc.,
 Monroe, WI
 Breakaway Ministries, Burnsville, MN
 Breakers of Rocky River, Inc.,
 Rocky River, OH

Brentwood Area Soccer Association —
 BASA, Pittsburgh, PA
 Bridge to Tomorrow Housing, Inc.,
 Mineola, NY
 British Film Festival, West Jordan, UT
 Broadreach Foundation, Raleigh, NC
 Burlington Iowa Stepperettes &
 Travelers, Burlington, IA
 Byron Center Band and Orchestra
 Boosters, Kentwood, MI
 Capital Area Resource Center of the
 Deaf and Hard of Hearing, Inc.,
 Richmond, VA
 Caprock Childrens Services,
 Lubbock, TX
 Center for Youth Activism,
 State College, PA
 Central Florida Riptide, Inc.,
 Orlando, FL
 Cfec-Chorus, Myrtle Beach, SC
 Chance Youth Foundation, Inc.,
 Richmond, VA
 Childrens Assistance Organization,
 Lansing, MI
 Christian Faculty and Staff Fellowship,
 Fargo, ND
 Christian Ministries United,
 Richmond, VA
 Chronic Fatigue Syndrome Foundation
 of Greater Baton Rouge, Inc.,
 Baton Rouge, LA
 Church Multiplication International, Inc.,
 Duluth, GA
 Civic Health Institute, Inc.,
 Pittsburgh, PA
 Clear Ink Foundation, Alamo, CA
 Coastal Bend Resource Group, Inc.,
 Corpus Christi, TX

Colton C A R E Coalition, Colton, OR
Columbia School PTO,
McGuire AFB, NJ
Com Scribe Service, Inc.,
East Lansing, MI
Communities Handling Alterns Needs
for Cont. Education, Memphis, TN
Community Outreach and Youth
Development Services, Inc.,
Macon, GA
Community Preschool Inclusion
Program, Virginia Beach, VA
Copii House Foundation, Inc.,
Cohocton, NY
Copper Basin Baseball Diamond Club,
Inc., Copperhill, TN
Copper Basin Cougar Basketball Club,
Inc., Copperhill, TN
Copper Basin Lady Cougars Softball
Club, Inc., Copperhill, TN
Copper Basin Touch Down Club, Inc.,
Copperhill, TN
Coterie Club, Senatobia, MS
Cottonwood-Granite Baseball League,
Salt Lake City, UT
Cougar Haven, Gore Springs, MS
Crisis Pregnancy Center,
Greenwood, MS
Cy-Fair Special Olympic Booster Club,
Cypress, TX
Cypress Housing Foundation,
Downey, CA
Dan Adders, Incorporated,
Las Vegas, NV
David Binn Foundation, San Diego, CA
Dazzle Song & Dance Company,
Williamsburg, VA
Deer Park FFA Booster Club,
Deer Park, TX
Denton Youth Basketball, Inc.,
Denton, TX
Desert Coyote Youth Hockey Assn.,
Bermuda Dunes, CA
Deutschland Michigan-Exchange,
West Bloomfield, MI
Diabetes Youth Support Foundation,
Santa Monica, CA
Discovery Learning Fund, Inc.,
Newark, NJ
District Resource Investments, Inc.,
Brackettville, TX
Diversity in Literature for Kids (DLK),
Inc., Atlanta, GA
Dobson Crew Chiefs, Chandler, AZ
Dobyns Bennett Orchestra Guild,
Kingsport, TN
Domenica Enrichment Center for Special
Needs, Inc., Ridgewood, NJ
East End Swim Club, Inc., Shirley, NY
East Falmouth Elementary Parent
Teacher Organization,
East Falmouth, MA
East Union Grad Night, Manteca, CA
Edmond Figure Skating Club,
Edmond, OK
Edwards Volunteer Organization,
Newberg, OR
Elegance in Style, Incorporated,
Ellicott City, MD
Empowering Residents to Achieve
Scenic Excellence Foundation, Inc.,
Charleston, WV
Encampment Riverside Youth Baseball,
Encampment, WY
Epiphany Place, Marshall, MN
Express Youth Baseball, Waco, TX
Family Tyme, Madrid, IA
Fantasia Arts of York Maine (FAYM),
York, ME
FCW, Defiance, MO
First Night Newark, Inc., Newark, NJ
For FEMALES, Houston, TX
For the Love of Children,
Colleyville, TX
Fort Lauderdale Childrens Ballet
Theatre, Inc., Ft. Lauderdale, FL
Fort Wellington Hopetown Belair
Charity Association, Brooklyn, NY
Foundation for United Neighborhood
Development Opportunities,
Concord, CA
Framingham Community Development
Corporation, Framingham, MA
Front Forty Productions, Inc.,
Stevens Point, WI
GE Federation Booster Club,
Meraux, LA
George Jenkins High School Chorus
Booster Club, Inc., Lakeland, FL
Georgia Std. Coalition, Inc.,
Gainesville, GA
Get Up On It, Inc., Philadelphia, PA
Global Unity, La Jolla, CA
Gold Coast Basketball, Inc.,
Santa Barbara, CA
Gourmet Gala, Slidell, LA
Grace Little Peoples Learning Center,
Inc., University Cy, MO
Great Hills Swim Team, Inc.,
Austin, TX
Great Lakes Puppetry Center,
Chicago, IL
Greater Roanoke Basketball Union,
Roanoke, VA
Greater Rochesters Kingdom Bound
Kids, Inc., Penfield, NY
Green Ridge Booster Club,
Green Ridge, MO
Gymnastrum Parents Association, Inc.,
Allentown, PA
Hall of Fame Charitable Foundation,
Columbus, OH
Hands From Heaven, San Francisco, CA
Haralson Coalition for Children Youth
and Families, Inc., Bremen, GA
Harbor Arts, Inc., Union Pier, MI
Hard Hat Theater Company,
Toluca Lake, CA
Harvested Seeds, Inc., Birmingham, AL
Haude Elementary Parent Teacher
Organization, Inc., Spring, TX
Health Resource Center for Palestine,
Inc., Sarasota, FL
Heart of the City Neighborhoods, Inc.,
Buffalo, NY
Help Under Direct Care Organization,
Cape Coral, FL
Helping Hands Helping Hearts, Inc.,
Tampa, FL
Helzberg Entrepreneurial Mentoring
Program, Kansas City, MO
Hep C Advocated Network,
Longview, TX
Home Scholars, Richmond, CA
Homeschoolers Support Network, Inc.,
Trenton, NJ
House of Hope of Northeast Tennessee,
Elizabethton, TN
House of Levi Keter Kehuna Shevet
Levi, Inc., New York, NY
Houston Justice & Peace Center,
Houston, TX
Hudson River Community Counseling
Alliance, Mount Kisco, NY
Hurlbutt Elementary School PTO,
Weston, CT
Huron High School PTSO,
Ann Arbor, MI
Inner-City Scholarship Endowment
Fund, New York, NY
International Electronic Library, Incorp.,
Fontana, CA
International Professional Assoc. for
AIDS and Childrens Charities,
New York, NY
Intertribal Arts Project, Inc.,
Falmouth, MA
Iowa City Music Auxiliary, Inc.,
Iowa City, IA
Irvine Girls Softball Association,
Irvine, CA
Island University Foundation,
Corpus Christi, TX

Jackys Recreation and Family Life Center, Inc., Kilgore, TX
 Jenkins Wrestling Club, Lakeland, FL
 Jim Ned Project Graduation, Tuscola, TX
 Jimmy Raye Youth Foundation, Inc., Fayetteville, NC
 Jo Ella Ellison Ministries DBA Therapon Counseling Center, Austin, TX
 Joseph House Ministries, Tega Cay, SC
 Joyful Choices Institute, Sierra Madre, CA
 Juice Guys Care, Inc., Nantucket, MA
 K C Youth Sports Inc., Overland Park, KS
 Kairos Academy, Newark, OH
 Kansas City Globe 100 Most Influential Charitable Fund, Inc., Kansas City, MO
 Kenya Shoe Expedition, Houston, TX
 Keren Chaverim, Inc., Brooklyn, NY
 Kids Campus Daycare and Learning Center, Inc., Florence, NJ
 Kinney County Youth Development Association, Brackettville, TX
 Korima Foundation of the Big Bend Ranch, Inc., Houston, TX
 Lady Bug Booster Club, Muncie, IN
 Lafayette Youth Amateur Ice Hockey Association, Inc., Carencro, LA
 Lagrange Ball Association, Inc., Canton, MO
 Lake Country Ami, Inc., Pittsburg, TX
 Lake Unified Visitation Center, Inc., Griffith, IN
 Learning Link, Palm Springs, CA
 Lee County MHMR Board, Inc., Giddings, TX
 Life Builders Ministries, Irvine, CA
 Literacy Connection, Kennewick, WA
 Literature for Humanity Foundation, Richmond, CA
 Living Books Literacy Center, Inc., Austin, TX
 Local Active Women LAW Association, Brownsville, TX
 Lone Star Behavioral Health Services, Inc., Round Rock, TX
 Los Amigos Del Fortin, Presidio, TX
 Los Angeles Youth Hockey Association, Long Beach, CA
 MacArthur-Eisenhower Scholastic Chess Club, Schaumburg, IL
 Madge and Raford Martin Charitable Foundation, Inc., Indian Rocks Beach, FL
 Magic Valley Volleyball Club, Inc., Buhl, ID
 Mahalick Charitable TR 1519013272, Charlotte, NC
 Maine Property Rights Alliance, Inc., Sullivan, ME
 Manchester High School Band Boosters, Chesterfield, VA
 Manhigim Hadashim Foundation, Inc., San Diego, CA
 March for Jesus of South Bend, Mishawaka, IN
 Mariemont High School Parent Teacher Organization, Cincinnati, OH
 Mariemont Junior High PTO, Cincinnati, OH
 Marx Toy Museum, Inc., Erie, PA
 Maryland Arts Den, Inc., Baltimore, MD
 Mascotas Jibaras, San Juan, PR
 Maui Dolphins Swim Club, Pukalani, HI
 McArts Fine Art Organization Limited, Kimball, WV
 Mid South Gospel Association, New Orleans, LA
 Mililani High School Spada, Inc., Mililani, HI
 Millington Area Education Foundation, Millington, TN
 Miracle Network, Inc., Dallas, TX
 Miracle Star Womens Recovering Community, Lancaster, CA
 Montour Antique Farm Machine Collectors Association, Danville, PA
 Mountain View Family Youth Center, Mountain View, MO
 Multi-County Child and Family Services, Forrest City, AR
 My Sisters Closet, Baltimore, MD
 Nashville Fencing Academy, Nashville, TN
 Natick on Ensemble Theater, Incorporated, Natick, MA
 National Catholic Forensic League, Inc., Milford, MA
 Nederland Educational Foundation, Inc., Nederland, TX
 Network of Indian Professionals-New York Foundation, Inc., New York, NY
 New Faith New Beginning, National City, CA
 New Hampshire Criminal Justice Resource Center, Inc., Concord, NH
 New Neighbors Charitable Tr., Rancho Palos Verdes, CA
 Newtowne Court-Washington Elms Tenant Council, Cambridge, MA
 Nicolet Soccer Club, Inc., Glendale, WI
 Norman Park Educational Foundation, Chula Vista, CA
 North Louisiana Gospel Association, Inc., New Orleans, LA
 North Warren Elementary School PTO, N. Warren, PA
 Northland College Lumberjack Hockey Booster Club, Inc., Ashland, WI
 Northwestern Choral Boosters, Rock Hill, SC
 Nueva Vida Por Nueva Mexico, Santa Fe, NM
 Nursing Education Alumni Association, Inc., Astoria, NY
 Oakland Community Theatre, Inc., Oakland, NJ
 Octopi, Richmond, VA
 Offering an Entrance to Him Ministries, Inc., St. Louis, MO
 Ohio F C, Dublin, OH
 Ohr Hadash Jewish Healing Center, Inc., Dallas, TX
 Owasso Cheerleader Booster Club (OCBC), Owasso, OK
 P S 11 Programs, Inc., New York, NY
 Pacific Justice Institute, Citrus Heights, CA
 Peoples Princess Charitable Foundation, Tampa, FL
 Perimeter Global Associates, Inc., Duluth, GA
 Philanthropic Charities, Castro Valley, CA
 PHP Ministries, Inc., Ridgewood, NJ
 Piece of Work Theater Company, Inc., New York, NY
 Piihonua EA, Hilo, HI
 Pine Tree High School Theater Booster Club, Longview, TX
 Pioneer Lyric Theatre, Denton, TX
 Planet ECO, San Diego, CA
 Point Dujour Renel, Brooklyn, NY
 Pondering the Documentary, Santa Monica, CA
 Presbyterian Learning Center, Inc., Morganton, NC
 Pride Productions, Port Isabel, TX
 Project Vision, Inc., Port St. Lucie, FL
 Prospect Historical Society, Prospect, VA
 Rancho Selah, Inc., Harwood, TX
 Red River Foundation, Grand Forks, ND
 Relief Effort Act Charitable Trust (REACT), Quakertown, PA
 River City Junior Volleyball, Inc., Omaha, NE

Rock Youth Ministries, Inc.,
Boynton Beach, FL
Rocks Coordinating Committee,
Chicago, IL
Rolling Plains Industrial Foundation,
Haskell, TX
Rush-Henrietta Soccer Club, Inc.,
Henrietta, NY
S F Striders, San Francisco, CA
Salazar Park Youth Association,
Los Angeles, CA
Salt Council of Triad of Jefferson
County Alabama, Birmingham, AL
San Jose Coral Project, Sunnyvale, CA
Sanders Enterprise Community
Development, Brooklyn, NY
SCDF Loan and Technical Assistance
Fund, Inc., Lafayette, LA
Seaside High School Instrumental Music
Boosters, Marina, CA
Seguin Project, Buffalo, NY
Servants of Society Foundation, Inc.,
Portland, OR
Shaarei Zion Day Care, Inc.,
Baltimore, MD
Share Mothers Program, Inc.,
Madison, TN
Shared Technologies, Incorporated,
Norfolk, VA
Sierra Housing Foundation,
Downey, CA
Sierra Leone Charitable Foundation,
Detroit, MI
Sign of the Times-the Recycle Manland
Project, Inc., Waco, TX
Silhouettes School of Construction,
Oakland, CA
Simple Way, Philadelphia, PA
Somali Community Service, Inc.,
Chelsea, MA
Sonoma Creek Adopt-a-Watershed,
Sonoma, CA
South Newton Music Boosters,
Kentland, IN
Southern Senior High School Sports
Booster Club, Inc., Tracys Lndg, MD
Squires League Rockies Baseball
Organization, Inc., Baton Rouge, LA
SRI Sadguru Swayam Prakasha
Avadhootha Swamigal Intl. Mission,
Jackson Heights, NY
St. Louis Gator AAU Basketball,
Chesterfield, MO
Students for DC, Salinas, CA
Talk Afterschool, Inc., Smoketown, PA
Tao of Holy Confucius Association, Inc.,
Oceanside, NY
Tarkington Community Baseball
Association, Inc., Cleveland, TX

TDDJ, Inc., Loxahatchee, FL
Team First Volleyball Club,
Cameron, TX
Technological Instruction International,
Culver City, CA
Templeton Grad Night Committee,
Templeton, CA
Ten Thousand Villages Tucson, Inc.,
Tucson, AZ
Texas Alternative Certification
Association, Katy, TX
Texas Music Library & Research Center,
Houston, TX
Third Eye, San Diego, CA
Together Education Accomplish More
Success, Seattle, WA
Training and Restoring Urban
Empowerment, Cape Girardeau, MO
Trampoline and Tumbling Team
Association, Blue Springs, MO
T R I P Plus, Riverside, CA
Union of Siguri People, Inc.,
New York, NY
United Rescue Groups, Inc., Austin, TX
United Scholarship America Foundation,
Pleasant Grove, UT
United States Service Agency USSA,
Buena Park, CA
United Success-Ful Ministries, Inc.,
Tacoma, WA
Unity Network and Counseling Center,
Atlanta, GA
Universal Concert Association, Inc.,
Buffalo, NY
Upward Community Builders, Inc.,
Mineola, NY
UW-Random Acts of Kindness,
Madison, WI
Veterans Refuge Center,
Long Beach, CA
Village Project, Seattle, WA
Virginia Citizenship Institute,
Arlington, VA
Virginia Raptors, Virginia Beach, VA
Vox Populi, Philadelphia, PA
Wagner Middle School Parents
Association, New York, NY
Washoe County Assess to Justice
Foundation, Reno, NV
Wax Fruit Theatre Company,
Chicago, IL
WCV, Inc., Brooklyn, NY
We Assist, Inc., Brooklyn, NY
Westchester Chinese School, Inc.,
Scarsdale, NY
Western Institute for Nature Resources
Education and Policy, Rickreall, OR
Westfield Baseball Association, Inc.,
Houston, TX

Windy City P. A. W. S., Chicago, IL
Wing & Groove Theatre Company,
Chicago, IL
Women in Gods Word Ministries,
Rialto, CA
World Historical Society for
Thoroughbred Horses,
Las Vegas, NV
Young Artist With Integrity Destine to
Succeed, Brooklyn, NY
Youth Soccer Development Fund, Inc.,
Norwalk, CT

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

Safe Harbor for Satisfying Statutory Requirements for Valuation Under Section 475 for Certain Securities and Commodities

Announcement 2003-35

AGENCY: Internal Revenue Service (IRS),
Treasury.

ACTION: Advance notice of proposed rule-
making.

SUMMARY: This document describes and explains a possible framework for a safe harbor (including recordkeeping and record retention requirements) that would satisfy the statutory requirement to value certain securities and commodities under section 475 of the Internal Revenue Code. This document also invites comments from the public on this safe harbor and other alternative valuation methodologies. All materials submitted will be available for public inspection and copying.

DATES: Written or electronic comments
must be submitted by August 4, 2003.

ADDRESSES: Send submissions to: CC:PA:RU (REG-100420-03), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (REG-100420-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may send electronic comments directly to the IRS Internet site at www.irs.gov/regs.

FOR FURTHER INFORMATION CONTACT: Concerning submissions, LaNita Van Dyke, (202) 622-7180; concerning the proposals, Marsha Sabin or John W. Rogers III, (202) 622-3950 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

A. Overview

Section 475(a) requires dealers in securities to mark their securities to market. If a security is inventory, it must be included in inventory at its fair market value. If a security is not inventory and is held at the end of the taxable year, it must be treated as if it were sold for its fair market value on the last business day of the taxable year. Mark-to-market treatment is available on an elective basis to commodities dealers and to traders in securities or commodities. See sections 475(e) and (f).

Although the meaning of the term "fair market value" has long been established, it has been difficult for both taxpayers and the IRS to determine fair market value in certain situations. To reduce the administrative burden on taxpayers and the IRS of determining fair market value under section 475, the IRS and the Treasury Department are considering the publication of a notice of proposed rulemaking that, by allowing values used on a financial statement to be used on the tax return, would provide an elective safe harbor for satisfying the statutory requirement to value securities and commodities.

Three broad principles guide eligibility for the safe harbor. First, any mark-to-market methodology used on a financial statement submitted for financial reporting purposes would have to be sufficiently consistent with the mark-to-market methodology used under section 475. Second,

the financial statement would have to be one for which the taxpayer has a strong incentive to report values fairly. Third, if requested, the taxpayer would have to timely provide the IRS with the information and documents necessary to verify the relationship between the values reported on the financial statement and the values used for purposes of section 475.

B. Principle One: Mark-to-Market Methodology for Financial Reporting

To qualify for the safe harbor, a mark-to-market methodology used for financial reporting should be sufficiently consistent with the requirements of a mark-to-market methodology used for section 475. Under section 475, a mark-to-market methodology must (i) value securities and commodities as of the last business day of each taxable year, (ii) recognize into income the gains and losses arising from changes in value each year, and (iii) compute gain or loss on disposition by reference to the value at the end of the prior year. To the extent that mark-to-market methodologies for financial reporting and section 475 differ, the IRS and the Treasury Department request comments identifying the differences and addressing whether and how the differences should affect the safe harbor.

The valuation standard under section 475 is fair market value, the price at which property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. The IRS and the Treasury Department are considering whether to use the fair value standard under U.S. Generally Accepted Accounting Principles ("GAAP") as a proxy for the fair market value standard required for tax purposes. In particular, the IRS and the Treasury Department seek comments on whether GAAP permits (i) valuation of securities at the bid price, (ii) downward adjustments from mid-market values for future administrative, hedging, or financing expenses, or (iii) one or more redundant downward adjustments from mid-market values for credit risk. (In other words, if future cash flows are discounted to present value using a rate, such as LIBOR (London Interbank Offered Rate), that corresponds to the credit quality of the counterparty, is there a need for any additional credit adjustment?)

The IRS and the Treasury Department are interested in receiving information on

the types of adjustments that are currently used for financial statement purposes and an explanation of these adjustments. Comments are requested on the Financial Accounting Standards Board's consideration of fair value reporting of derivatives and the valuation of projected cash flows and any impact that has on how taxpayers are reporting any valuation adjustments for fair value purposes.

C. Principle Two: Financial Statements and Business Use

Two factors are relevant in establishing that the taxpayer has a strong incentive to report values of the securities and commodities fairly on the financial statement: (i) reporting of values on a financial statement; and (ii) significant use of those reported values in the taxpayer's business.

As to the reporting of values, the IRS and the Treasury Department are considering various types of financial statements for the safe harbor. Three classes of financial statements under consideration are:

(1) A financial statement required to be filed with the Securities and Exchange Commission ("SEC") (the 10-K or the Annual Statement to Shareholders);

(2) A financial statement required to be provided to the federal government or any of its agencies (other than the SEC or the IRS); and

(3) A certified audited financial statement not required to be filed with the SEC or another federal agency.

In certain limited circumstances, it may also be appropriate to consider financial statements required to be filed with a state government or any of its agencies, a political subdivision of a state, or possibly a foreign regulator.

It may also be relevant whether a statement is provided to equity holders or creditors.

Comments are requested on the extent to which each of these various classes of financial statements is appropriate for the safe harbor and whether any other classes of financial statements may be as well.

As to significant use of reported values in the taxpayer's business, potentially significant uses include guiding the taxpayer's pricing and risk management decisions and determining employee compensation.

Special considerations arise if securities or commodities are held by a party re-

lated to the issuer or if derivatives in securities or commodities (including forward contracts in cash markets) exist between related parties. Financial consolidation can cause these securities or commodities (including derivatives) to be either eliminated (because of netting) or incompletely reported on financial statements. Additionally, in certain circumstances, these related party transactions may not receive the same level of regulatory scrutiny. It is not clear, therefore, whether the safe harbor would be appropriate for securities or commodities held by a party related to the issuer or for derivatives in securities or commodities that exist between related parties.

D. Principle Three: Recordkeeping and Record Production

Under the safe harbor, examinations of returns would focus on how the values used in the financial statements relate to gain and loss on the tax returns. Consequently, records would have to clearly show: (1) that the same value used on the financial statement was used on the tax return; (2) that no security subject to section 475 and reported under the required methodology on the financial statement was excluded in the application of the safe harbor; and (3) that only securities or commodities subject to section 475 had been carried over to the tax return under the safe harbor.

Given the complexity of the business operations of many taxpayers, comparing a single line on the financial statement to a single line on the tax return will not suffice to verify that the same value used for the financial statement was used on the tax return. Therefore, a safe harbor will impose specific verification and reconciliation requirements.

The IRS and the Treasury Department are concerned about valuation issues that may arise from pooling of securities and commodities. Comments are requested on how securities and commodities are pooled for purposes of financial reporting, how they are pooled for tax reporting, and how the Commissioner can verify the basis determination of a single position contained in the pool if that position is sold or settled in the year following the mark and other positions in the pool are not sold.

The IRS and the Treasury Department are similarly concerned about the consolidation and de-consolidation of the business structure. Comments are requested on the impact of the consolidation and de-consolidation on determining whether the same securities and commodities will be reflected on both the financial statement and the tax return.

The IRS and the Treasury Department are considering rules that would require electing taxpayers to maintain and, if requested, provide to the Commissioner in a timely manner the following records: (1) books and records clearly establishing that the values used in determining gain or loss under section 475(a) for eligible securities or commodities were the values used in the financial statement; (2) for taxpayers filing a Form 1120, a reconciliation of the amount of net income reported on the financial statement to the amount reported on line 1 of the Schedule M-1 on the Form 1120, *Corporate Income Tax Return*; and (3) for other taxpayers, a similar reconciliation schedule. The documents for reconciliation purposes include supporting schedules, exhibits, computer programs used in producing the values and schedules, and documentation of rules and procedures governing determination of the values. Books and records would include all those that are required to be maintained for financial or regulatory reporting purposes, even if those books and records are not specifically covered by section 6001. Comments are requested on whether less burdensome recordkeeping requirements could be developed that would still allow for effective verification of conformity.

The IRS and the Treasury Department are considering situations in which the Commissioner should enter into agreements with specific taxpayers establishing which records would have to be maintained, how the records would have to be maintained, and how long the records would have to be retained. Because an agreement would be tailored to a particular taxpayer's operations and environment, it is expected that an agreement would arise only after individual negotiations. Although no taxpayer would be entitled to an agreement, an agreement based on an early understanding of a taxpayer's operations

would be in the best interests of tax administration and, therefore, would be encouraged.

E. Eligible Taxpayers

The safe harbor is being considered for dealers in securities under section 475(c)(1). Whether the safe harbor would also be extended to securities traders, dealers in commodities, and commodities traders would largely depend on whether the extension would comport with the principles described in the Overview.

F. Eligible Securities and Commodities

Section 475 applies to a wide variety of securities and commodities. It is relatively easy for both taxpayers and the IRS to determine the fair market value of positions for which pricing information is readily available, such as most actively traded personal property. The need for a safe harbor is most pressing for positions for which pricing information is not readily available, including more complex notional principal contracts and derivative instruments, and hedges described in sections 475(c)(2)(D), (E), and (F). Comments are requested on what securities should be included in the safe harbor.

Commodities raise problems similar to those for securities, so the need for a safe harbor is similarly pressing for commodities (including commodities derivatives) for which pricing information is not readily available. Comments are requested addressing application of a safe harbor for commodities.

G. Comments on Other Valuation Methodologies and Safe Harbors

Comments are requested on whether there are other methodologies for determining fair market values under section 475. Comments are also requested on whether other safe harbors could act as proxies for fair market value under section 475.

Lon B. Smith,
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(Financial Institutions and Products).

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Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it

applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the

new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.

E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.

PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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Rev. Rul. 2003–46, 2003–19 I.R.B. 878

88–36

Supplemented by
Rev. Rul. 2003–46, 2003–19 I.R.B. 878

92–19

Supplemented in part by
Rev. Rul. 2003–24, 2003–10 I.R.B. 557

² A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2002–26 through 2002–52 is in Internal Revenue Bulletin 2003–1, dated January 6, 2003.

Revenue Rulings—Continued:

2000-49

Modified and superseded by
Rev. Rul. 2003-49, 2003-20 I.R.B. 903

2003-2

Revoked by
Rev. Rul. 2003-22, 2003-8 I.R.B. 494

Treasury Decisions:

9002

Corrected by
Ann. 2003-8, 2003-6 I.R.B. 451

9021

Corrected by
Ann. 2003-16, 2003-12 I.R.B. 641

9022

Supplemented by
Ann. 2003-7, 2003-6 I.R.B. 450
Corrected by
Ann. 2003-11, 2003-10 I.R.B. 585

9048

Corrected by
Ann. 2003-23, 2003-16 I.R.B. 808