

## HIGHLIGHTS OF THIS ISSUE

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

### INCOME TAX

**Rev. Rul. 2002-1, page 268.**

**Options and spin-off.** This ruling provides guidance for the income tax treatment of employee stock options and restricted stock in certain spin-offs.

**Rev. Rul. 2002-2, page 271.**

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for January 2002.

**T.D. 8968, page 274.**

**REG-105344-01, page 302.**

Temporary and proposed regulations under section 6103 of the Code permit the IRS to authorize federal, state, and local agencies with access to returns and return information to redisclose returns and return information, with the Commissioner's approval, to any authorized recipient set forth in section 6103, subject to the same conditions and restrictions, and for the same purposes, as if the recipient had received the information from the IRS directly.

**T.D. 8969, page 276.**

Final regulations under sections 6103 and 6311 of the Code authorize the Commissioner to accept payment of internal revenue taxes by credit card or debit card. Additionally, this final regulation provides that payment of tax by check or money order should be made payable to the United States Treasury.

**T.D. 8970, page 281.**

Final regulations under section 332 of the Code address the requirement of adoption of a plan of liquidation when a subsidiary corporation makes an entity classification election to be treated as a partnership or disregarded as an entity separate from its owner.

### EMPLOYEE PLANS

**Notice 2002-1, page 283.**

**EGTRRA; Employee plans user fees.** This document describes the changes in employee plans user fees as a result of the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Rev. Procs. 2002-6 and 2002-8 modified.

**Notice 2002-2, page 285.**

**EGTRRA; ESOP; dividend elections.** This document describes in question and answer format the changes in dividend elections under section 404(k) of the Code as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the effective date of section 409(p) of the Code as added by EGTRRA.

**Notice 2002-3, page 289.**

**Safe harbor explanation; certain qualified plan distributions.** This document provides an updated Safe Harbor Explanation that plan administrators may use for recipients of eligible rollover distributions from qualified plans in order to satisfy section 402(f) of the Code. Notice 2000-11 obsoleted.

**Notice 2002-4, page 298.**

**EGTRRA; section 401(k) distributions; section 414(v) contributions.** This document provides guidance with respect to the changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) which pertain to hardship distributions, severance of employment, and the availability of catch-up contributions.

## EMPLOYEE PLANS-CONT.

### **Announcement 2002-1, page 304.**

**User fees.** This announcement allows for the temporary use of a draft Form 8717 in lieu of the Form 8717 described in Q&A-15 of Notice 2002-1 in this Bulletin.

## ADMINISTRATIVE

### **Announcement 2002-2, page 304.**

**Waiver of penalties.** To encourage taxpayers to disclose their tax treatment of certain tax shelters, the IRS will waive the accuracy-related penalty under section 6662 of the Code.

### **Announcement 2002-3, page 305.**

This document includes the procedures for partnerships with more than 100 partners during the year to request a waiver of the requirement to electronically file Form 1065, *U.S. Partnership Return of Income*.

### **Announcement 2002-4, page 306.**

This document contains corrections to final regulations (T.D. 8966, 2001-45 I.R.B. 422) relating to the effect of the Family and Medical Leave Act on the operation of cafeteria plans.

# 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.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. See Rev. Rul. 2002-2, page 271.

## Section 83.—Property Transferred in Connection With Performance of Services

26 CFR 1.83-6: Deduction by employer.

*Options & Spin-off:* Income tax treatment of options and restricted stock in spin-offs, under the facts presented. See Rev. Rul. 2002-1, page 268.

## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. See Rev. Rul. 2002-2, page 271.

## Section 355.—Distributions of Stock and Securities of a Controlled Corporation

26 CFR 1.355-1: Distribution of stock and securities of a controlled corporation. (Also §§: 1.83-6, 1.1032-3).

**Options and spin-off.** Income tax treatment of options and restricted stock in spin-offs, under the facts presented.

### Rev. Rul. 2002-1

#### ISSUE

Under the facts presented below, after a distributing corporation (D) distributes the stock of a controlled corporation (C) in a transaction to which § 355(c) of the Internal Revenue Code applies,

(1) Does D recognize gain or loss when restrictions lapse on C stock held by D employees that is received in connection with the § 355 transaction? Does D recognize gain or loss when stock options for C stock held by D employees that are received in connection with the § 355 transaction are exercised?

(2) Does C recognize gain or loss when restrictions lapse on D stock held by C employees that is received before the § 355 transaction? Does C recognize gain or loss when stock options for D stock held by C employees that are received in connection with the § 355 transaction are exercised?

(3) Who is entitled to deductions for amounts includible in employees' income as a result of the lapse of restrictions on D and C stock and the exercise of options to acquire D and C stock described above?

#### FACTS

D is a domestic corporation of which A is an employee at all times relevant to this ruling. C is a wholly-owned domestic subsidiary of D of which B is an employee at all times relevant to this ruling.

In Year 1, D implements a plan to attract and retain qualified personnel and to provide incentives for continued performance of services by providing additional compensation to its employees and to the employees of C in the form of: (i) stock of D that is not transferable and is subject to a substantial risk of forfeiture, as defined in § 83(c), for a period of five years beginning in Year 1 (restricted stock); and (ii) non-statutory options to purchase shares of D stock (the pre-division options). The plan is not implemented in anticipation of a spin-off.

Under the plan, in Year 1 D issues restricted D stock to A, and to B on behalf of C, for the employees' services performed for their respective employers. In the event of forfeiture, the restricted stock would revert to D. A and B do not make an election in Year 1 pursuant to § 83(b) with respect to the restricted stock. Also in Year 1, D grants to A, and to B on behalf of C, pre-division options for their services. The options do not have a readily ascertainable fair market value (within the meaning of § 1.83-7(b) of the Income Tax Regulations) at the time they are issued.

In Year 3, D distributes the stock of C *pro rata* to D's shareholders in a transaction that qualifies for nonrecognition of gain to D under § 355(c) (hereinafter

referred to as the spin-off). In the spin-off, the shareholders of D receive one share of C stock for each share of D stock.

Although, under § 83, A and B are not treated as the owners of the restricted D stock for Federal tax purposes, A and B have rights in the D stock and receive, in connection with the spin-off, a distribution of C stock with restrictions identical to the restrictions on the D stock in order to preserve their pre-spin-off economic interest in the pre-spin-off restricted D stock. In the event of forfeiture, the restricted D stock would revert to D and the restricted C stock would revert to C. Thus, after the spin-off, A and B each hold restricted stock in both D and C.

Also as part of the spin-off, the pre-division options held by A and B are canceled and replaced with new options (the post-division options) to acquire stock in D from D and stock in C from C. Pursuant to the terms of the post-division options, the post-division options' exercise price is paid directly to the issuing corporation in exchange for the stock. Except to the extent that the post-division options separate the pre-division options into two instruments, the post-division options are designed to preserve the economic terms of the pre-division options. The total exercise price of the post-division options held by each of A and B, respectively, is equal to the total exercise price of the pre-division options held by each of A and B, respectively. The total number of shares of D stock subject to the post-division options held by each of A and B, respectively, is equal to the total number of shares of D stock subject to the pre-division options held by each of A and B, respectively. The total number of shares of C stock subject to the post-division options held by each of A and B, respectively, is equal to the total number of shares of D stock subject to the pre-division options held by each of A and B, respectively. Finally, the ratio of (a) the exercise price for each share subject to a post-division option to acquire D stock to (b) the exercise price of each share subject to a post-division option to acquire C stock is equal to the ratio of (x) the estimated fair market value of all of the outstanding D stock, excluding the estimated

fair market value attributable to D's ownership of C stock immediately prior to the spin-off to (y) the estimated fair market value of all of the outstanding C stock immediately prior to the spin-off.

In Year 6, the restrictions lapse on the restricted stock held by A and B. Also in Year 6, A and B exercise all of their post-division options.

## LAW AND ANALYSIS

Under § 83(a), when property is transferred to a person in connection with the performance of services, the service provider must include in gross income an amount equal to the fair market value of such property, less the amount (if any) paid for the property. However, if the property transferred is not transferable and is subject to a substantial risk of forfeiture in the hands of the service provider, the fair market value of the property, less the amount (if any) paid for the property, is not includible in the service provider's gross income until the property is transferable or is not subject to a substantial risk of forfeiture, unless the service provider elects to include such amount in gross income at the time of the transfer under § 83(b). Section 83(e)(3) provides that § 83 does not apply to the grant of an option without a readily ascertainable fair market value.

Under § 83(h), the service recipient is allowed a deduction under § 162 in an amount equal to the amount included in the service provider's gross income under § 83(a). Where the property is not substantially vested on transfer, the deduction is allowed for the taxable year of the service recipient in which or with which ends the service provider's taxable year in which the amount is included in the service provider's gross income. *See* § 1.83-6(a)(1), (2) of the Income Tax Regulations. Where property is substantially vested on transfer, the deduction is allowed in accordance with the service recipient's method of accounting (in conformity with §§ 446 and 461). *See* § 1.83-6(a)(3).

Section 1.83-6(b) states that, except as provided in § 1032, at the time of a transfer of property in connection with the performance of services, the transferor recognizes gain to the extent that the transferor receives an amount that exceeds its basis in the property. In addition,

at the time a deduction is allowed under §§ 83(h) and 1.83-6(a), the transferor recognizes gain or loss to the extent of the difference between (1) the sum of the amount paid plus the amount allowed as a deduction under § 83(h), and (2) the sum of the transferor's basis in the property plus any gain recognized at the time of the transfer.

Section 1032(a) provides, in part, that no gain or loss is recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation. Under § 1.1032-1(a), for purposes of § 1032(a), a transfer by a corporation of its own stock as compensation for services is considered a disposition for money or other property. Thus, when a corporation compensates employees with its own stock, the corporation does not recognize gain or loss under § 1032.

Section 1.1032-3 generally provides that in certain transactions in which a corporation (the acquiring entity) acquires money or other property in exchange, in whole or in part, for stock of a corporation (the issuing corporation), the acquiring entity is treated as purchasing the stock of the issuing corporation from the issuing corporation for fair market value with cash contributed to the acquiring entity by the issuing corporation. If the issuing corporation receives money or other property in payment for its stock, the amount of cash deemed contributed is the difference between the fair market value of the issuing corporation stock and the amount of money or fair market value of other property that the issuing corporation receives as payment. Section 1.1032-3 generally enables a corporate subsidiary to obtain a fair market value basis in parent stock contributed to the subsidiary's capital if the subsidiary disposes of the parent stock in a taxable transaction immediately after it is received from the parent. Thus, as a result of the operation of § 1.1032-3, a subsidiary generally does not recognize gain or loss on the immediate transfer of parent stock to the subsidiary's employee.

A and B recognize income in Year 6 under the rules of § 83 when the restrictions on the D and C stock lapse and when they exercise their options to acquire D and C stock. The following dis-

cussion addresses the Federal income tax consequences to D and C when these events occur.

The characterization of the events that occur in Year 6 should reflect the relationship of D and C that existed in Year 1 and continued until immediately before the spin-off. *Cf.* Rev. Rul. 83-73, 1983-1 C.B. 84 (applying a relation-back principle to characterize indemnity payments made by former shareholders of a merged corporation to the acquiring corporation). Specifically, to determine whether D recognizes gain or loss in Year 6 when the restrictions lapse on the restricted C stock held by A, whether C recognizes gain or loss in Year 6 when the restrictions lapse on the restricted D stock held by B, whether D recognizes gain or loss in Year 6 when A exercises the post-division options for C stock, and whether C recognizes gain or loss in Year 6 when B exercises the post-division options for D stock, it is appropriate to take into account the terms of the original arrangement created in Year 1, and the parent-subsidiary relationship between D and C that existed in Year 1 and continued until immediately before the spin-off.

Prior to the spin-off, the stock of D reflected an interest in C. Although, prior to the spin-off, A was not treated as the owner of the restricted D stock for Federal tax purposes, A had valuable economic rights with respect to that stock and, indirectly, with respect to D's stock ownership interest in C. Similarly, although the pre-division options did not give A ownership in D stock, the pre-division options did give A valuable economic rights with respect to D stock by reason of the right to acquire D stock at a fixed price, which would have included an indirect ownership interest in C if the spin-off had not occurred. Thus, A's receipt in connection with the spin-off of the restricted C stock and the post-division options to acquire D and C stock preserved A's economic rights with respect to the entire pre-spin-off D enterprise, which included C.

Because the restricted C stock and the post-division options to acquire C stock are a substitute in part for pre-spin-off restricted D stock and the pre-division options, it is appropriate for purposes of §§ 1032 and 355 to treat a post-spin-off lapse in restrictions on the restricted C

stock held by A and A's exercise of post-division options to acquire C stock in the same manner under §§ 1032 and 355 as a pre-spin-off lapse of restrictions on the restricted D stock held by A and A's pre-spin-off exercise of pre-division options, respectively, would be treated followed by the spin-off. Accordingly, because D would have recognized no gain or loss under § 1032 by reason of the pre-spin-off lapse of restrictions on D stock held by A and A's pre-spin-off exercise of the pre-division options to acquire D stock, and because § 355(c) applies to the spin-off in Year 3, in Year 6 D recognizes no gain or loss with respect to the C stock by reason of the lapse of restrictions on the restricted C stock issued to A and on A's exercise of the post-division options to acquire C stock. Further, under § 83(h), in Year 6 D is entitled to a deduction under § 162 in the amount that A includes in income under § 83(a) as a result of the lapse in restrictions on the C stock and the exercise of the post-division options to acquire C stock.

Similarly, it is appropriate for purposes of § 1032 to treat a post-spin-off lapse in restrictions on the restricted D stock held by B and B's exercise of post-division options to acquire D stock in the same manner under § 1032 as a pre-spin-off lapse of restrictions on the restricted D stock held by B and B's pre-spin-off exercise of pre-division options, respectively, would be treated followed by the spin-off. C would have recognized no gain or loss under § 1032 by reason of the pre-spin-off lapse of restrictions on D stock held by B and B's pre-spin-off exercise of the pre-division options to acquire D stock. *See* §§ 1.83-6(d) and 1.1032-3; *see also* § 1.1032-3(e), exs. 6, 8. Consistent with this analysis, the consequences of the post-spin-off lapse of restrictions on the restricted D stock held by B and B's post-spin-off exercise of D options are characterized by reference to the parent-subsidiary relationship between D and C that existed in Year 1 and continued until immediately before the spin-off. Accordingly, in Year 6, for purposes of § 1032, C is treated as if it bought the D stock from D at fair market value after a shareholder capital contribution from D, with the result that C recognizes no gain or loss with respect to the D stock by reason of the lapse of restrictions on the

restricted D stock issued to B and on B's exercise of the post-division options to acquire D stock. *See* §§ 1.83-6(d) and 1.1032-3. Under § 83(h), in Year 6 C is entitled to a deduction under § 162 in the amount that B includes in income under § 83(a) as a result of the lapse of restrictions on the D stock and the exercise of post-division options to acquire D stock.

Under § 1032, in Year 6 D recognizes no gain or loss when the restrictions lapse on the restricted D stock held by A and B and when A and B exercise the post-division options to acquire D stock. In addition, under § 1032, C recognizes no gain or loss when the restrictions lapse on the restricted C stock held by A and B and when A and B exercise the post-division options to acquire C stock.

#### HOLDING

Under the facts presented above, after D distributes the stock of C in a transaction to which § 355(c) applies,

(1) D recognizes no gain or loss when restrictions lapse on the C stock held by A that is received in connection with the spin-off; D recognizes no gain or loss when stock options for C stock held by A that are received in connection with the spin-off are exercised;

(2) C recognizes no gain or loss when restrictions lapse on D stock held by B that is received before the spin-off; C recognizes no gain or loss when stock options for D stock held by B that are received in connection with the spin-off are exercised; and

(3) D is entitled to deductions for amounts includible in A's income as a result of the lapse of restrictions on D and C stock and the exercise of options to acquire D and C stock, and C is entitled to deductions for amounts includible in B's income as a result of the lapse of restrictions on D and C stock and the exercise of options to acquire D and C stock.

#### DRAFTING INFORMATION

For further information regarding this revenue ruling, contact Mark Weiss of the Office of Associate Chief Counsel (Corporate) at 202-622-7790 (not a toll-free call).

### Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of January 2002. *See* Rev. Rul. 2002-2, page 271.

### Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. *See* Rev. Rul. 2002-2, page 271.

### Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. *See* Rev. Rul. 2002-2, page 271.

### Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. *See* Rev. Rul. 2002-2, page 271.

### Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. *See* Rev. Rul. 2002-2, page 271.

### Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. *See* Rev. Rul. 2002-2, page 271.

## Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. See Rev. Rul. 2002-2, on this page.

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. See Rev. Rul. 2002-2, on this page.

## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. See Rev. Rul. 2002-2, on this page.

## Section 1032.—Exchange of Stock for Property

26 CFR 1.1032-3: *Disposition of stock or stock options in certain transactions not qualifying under any other nonrecognition provision.*

*Options and Spin-off:* Income tax treatment of options and restricted stock in spin-offs, under the facts presented. See Rev. Rul. 2002-1, page 268.

## Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for January 2002.

### Rev. Rul. 2002-2

This revenue ruling provides various prescribed rates for federal income tax purposes for January 2002 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in

service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the deemed rate of return for transfers made during calendar year 2002 to pooled income funds described in § 642(c)(5) that have been in existence for less than 3 taxable years immediately preceding the taxable year in which the transfer is made.

REV. RUL. 2002-2 TABLE 1

Applicable Federal Rates (AFR) for January 2002

*Period for Compounding*

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-Term</i>				
AFR	2.73%	2.71%	2.70%	2.69%
110% AFR	3.00%	2.98%	2.97%	2.96%
120% AFR	3.28%	3.25%	3.24%	3.23%
130% AFR	3.55%	3.52%	3.50%	3.49%

REV. RUL. 2002-2 TABLE 1—CONTINUED

Applicable Federal Rates (AFR) for January 2002

	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Mid-Term</i>				
AFR	4.49%	4.44%	4.42%	4.40%
110% AFR	4.94%	4.88%	4.85%	4.83%
120% AFR	5.40%	5.33%	5.29%	5.27%
130% AFR	5.85%	5.77%	5.73%	5.70%
150% AFR	6.77%	6.66%	6.61%	6.57%
175% AFR	7.92%	7.77%	7.70%	7.65%
<i>Long-Term</i>				
AFR	5.46%	5.39%	5.35%	5.33%
110% AFR	6.02%	5.93%	5.89%	5.86%
120% AFR	6.57%	6.47%	6.42%	6.38%
130% AFR	7.13%	7.01%	6.95%	6.91%

REV. RUL. 2002-2 TABLE 2

Adjusted AFR for January 2002

	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	2.47%	2.45%	2.44%	2.44%
Mid-term adjusted AFR	3.57%	3.54%	3.52%	3.51%
Long-term adjusted AFR	4.82%	4.76%	4.73%	4.71%



REV. RUL. 2002-2 TABLE 3

Rates Under Section 382 for January 2002

Adjusted federal long-term rate for the current month	4.82%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.82%

REV. RUL. 2002-2 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for January 2002

Appropriate percentage for the 70% present value low-income housing credit	8.16%
Appropriate percentage for the 30% present value low-income housing credit	3.50%

REV. RUL. 2002-2 TABLE 5

Rate Under Section 7520 for January 2002

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.4%
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REV. RUL. 2002-2 TABLE 6

Rate Under Section 7520 for January 2002

Deemed rate of return for transfers during 2002 to pooled income funds that have been in existence for less than 3 taxable years	6.6%
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## Section 1288.—Treatment of Original Issue Discounts on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term, rates are set forth for the month of January 2002. See Rev. Rul. 2002-2, page 271.

## Section 6103.—Confidentiality and Disclosure of Returns and Return Information

*26 CFR 301.6103(p)(2)(B)-1T: Disclosure of returns and return information by other agencies.*

**T.D. 8968**

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

### Disclosure of Returns and Return Information by Other Agencies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulation.

**SUMMARY:** This temporary regulation relates to the disclosure of returns and return information by Federal, state and local agencies other than the IRS. The temporary regulation permits the IRS to authorize agencies with access to returns and return information under section 6103 of the Internal Revenue Code (Code) to redisclose returns and return information, with the Commissioner's approval, to any authorized recipient set forth in section 6103, subject to the same conditions and restrictions, and for the same purposes, as if the recipient had received the information from the IRS directly.

**DATES:** This regulation is effective December 13, 2001.

**FOR FURTHER INFORMATION CONTACT:** Julie C. Schwartz, 202-622-4570 (not a toll-free number).

## SUPPLEMENTARY INFORMATION:

### Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-1757. Responses to this collection of information are required if the Commissioner is to authorize the disclosure of returns and return information from agencies with access to returns and return information under section 6103 to other authorized recipients of returns and return information in accordance with section 6103.

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

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**.

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

### Background

Section 6103(p)(2)(B) provides that return information disclosed pursuant to the Code may be disclosed by any mode or means that the Secretary determines necessary or appropriate. 26 C.F.R. section 301.6103(p)(2)(B)-1 currently permits certain recipients of returns and return information under section 6103, with the Commissioner's approval, to disclose returns and return information to certain other permissible recipients under section 6103. Specifically, the existing

regulation permits disclosure by Federal agencies, with the Commissioner's approval, to 1) other Federal agencies, 2) state tax agencies, 3) the General Accounting Office, 4) Federal, state and local child support enforcement agencies, 5) persons described in section 6103(c) (person designated in a taxpayer consent), and 6) persons described in section 6103(e) (person with a material interest).

The Consolidated Appropriations Act, 2001, Pub. L. No. 106-554 (114 Stat. 2763), was signed into law on December 21, 2000. Section 1 of that Act enacted into law H.R. 5662, the Community Renewal Tax Relief Act of 2000. Section 310 of the Community Renewal Tax Relief Act of 2000 added section 6103(j)(6) to the Code, authorizing the Commissioner to disclose return information to the Congressional Budget Office (CBO) for the purpose of, but only to the extent necessary for, long term models of the Social Security and Medicare programs. The conference report, H.R. Conf. Rep. No. 106-1033, at 1020-21 (2000), provides that it is the intent of Congress that all requests for information made by CBO under this provision be made to the Commissioner, who will use his authority under section 6103(p)(2) such that the Social Security Administration (SSA) or other agency can furnish the information directly to CBO for the purpose of CBO's long term models of Social Security and Medicare. SSA, not IRS, collects and maintains much of the information sought by CBO and also receives the tax information CBO seeks under other provisions of section 6103. However, section 301.6103(p)(2)(B)-1 in its current form would not allow the Commissioner to authorize SSA to redisclose return information properly in its possession to CBO, an authorized recipient of the information under section 6103(j)(6). The temporary regulation allows SSA to make return information in its possession available to CBO to the extent authorized by section 6103(j)(6).

There are other situations, similar to that found under section 6103(j)(6), where it is more efficient for returns and return information in the possession of one authorized agency recipient, to be disclosed by such agency to another statutorily authorized recipient. The inability of agencies, including Federal, state and

local agencies, to share returns and return information between themselves or even inside a single agency, even where the information is more readily available from an agency other than the IRS, was highlighted by the Department of the Treasury on pages 89-90 of its October 2000 Report to the Congress on the Scope and Use of Taxpayer Confidentiality and Disclosure Provisions. The report notes, for example, that currently a single agency within a state (or even a single caseworker) may be administering both child support under Title IV-D of the Social Security Act and welfare under Title IV-A of the Social Security Act. The agency may receive return information under both section 6103(l)(6) and section 6103(l)(7) to aid the agency in making determinations of eligibility for these programs, but the current regulation does not permit even intra-agency pooling or sharing of these data. The report notes that both intra- and inter-agency data sharing with respect to common data elements could be authorized by amendment to the Treasury regulations. The temporary regulation allows the IRS to authorize redisclosure in appropriate situations.

### Explanation of Provisions

The temporary regulation expands the agencies that may redisclose returns and return information if authorized by the Commissioner of Internal Revenue to any Federal, state or local agency that receives information under section 6103. Similarly, it expands the authorized recipients of returns and return information pursuant to this redisclosure authority to any recipient authorized to receive returns and return information in accordance with section 6103. All redisclosures by agencies pursuant to this regulation will be made subject to the same conditions, restrictions, safeguards, record-keeping requirements, and civil and criminal penalties that would apply if the disclosure were made by the IRS. The reference in the existing regulation excepting redisclosures of return information under section 6103(m) from the recordkeeping requirements has been deleted as unnecessary because section 6103(p)(3) does not require recordkeeping by the IRS of section 6103(m) disclosures. As under the existing regulation, Federal, state and local agencies making

disclosures of return information under the temporary regulation will continue to provide to the IRS certain information regarding disclosures made pursuant to this authority, in order for the IRS to fulfill its reporting requirements under section 6103(p).

### 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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel of the Small Business Administration for comment on their impact on small businesses.

### Drafting Information

The principal author of these regulations is Julie C. Schwartz, Office of the Associate Chief Counsel (Procedure and Administration), Disclosure and Privacy Law Division.

\* \* \* \* \*

### Amendments to the Regulations

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

#### PART 301—PROCEDURE AND ADMINISTRATION

##### Paragraph 1.

The authority citation for part 301 is amended by adding an entry in numerical order to read as follows:

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

Section 301.6103(p)(2)(B)–1T also issued under 26 U.S.C. 6103(p)(2);\*\*\*

##### § 301.6103(p)(2)(B)–1 [Removed]

Par. 2. Section 301.6103(p)(2)(B)–1 is removed.

Par. 3. Section 301.6103(p)(2)(B)–1T is added to read as follows:

#### § 301.6103(p)(2)(B)–1T Disclosure of Returns and Return Information by Other Agencies

(a) *General Rule.* Subject to the requirements of paragraphs (b), (c), and (d) of this section, returns or return information that have been obtained by a Federal, state or local agency, or its agents or contractors in accordance with section 6103 (the “first recipient”) may be disclosed by the first recipient to another recipient authorized to receive such returns or return information under section 6103 (the “second recipient”).

(b) *Approval by Commissioner.* A disclosure described in paragraph (a) of this section may be made if the Commissioner of Internal Revenue (the “Commissioner”) determines, after receiving a written request under this section, that such returns or return information are more readily available from the first recipient than from the Internal Revenue Service. The disclosure authorization by the Commissioner shall be directed to the head of the first recipient and may contain such conditions or restrictions as the Commissioner may prescribe. The disclosure authorization may be revoked by the Commissioner at any time.

(c) *Requirements and restrictions.* The second recipient may only receive returns or return information as authorized by the provision of section 6103 applicable to such second recipient. Any returns or return information disclosed may only be used by the second recipient for a purpose authorized by and subject to any conditions imposed by section 6103 and the regulations thereunder, including, if applicable, safeguards imposed by section 6103(p)(4).

(d) *Records and reports of disclosure.* The first recipient shall maintain to the satisfaction of the Internal Revenue Service a permanent system of standardized records regarding such disclosure authorization described in paragraph (a) of this section and any disclosure of returns and return information made pursuant to such authorization, and shall provide such information as prescribed by the Commissioner in order to enable the Internal Revenue Service to comply with its obligations under section 6103(p)(3) to keep accountings for disclosures and to make annual reports of disclosures to the Joint Committee on Taxation. The information

required for reports to the Joint Committee on Taxation must be provided within 30 days after the close of each calendar year. The requirements of this paragraph do not apply to the disclosure of returns and return information as provided by paragraph (a) of this section which, had such disclosures been made directly by the Service, would not have been subject to the recordkeeping requirements imposed by section 6103(p)(3)(A).

(e) *Effective Date.* This section is applicable on December 13, 2001.

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

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

Authority: 26 U.S.C. 7805 \*\*\*  
 Par. 5. In § 602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows:  
 § 602.101 OMB Control Numbers.

\*\*\*\*\*  
 (b)\*\*\*

CFR part or section where identified and described	Current OMB control No.
***** 301.6103(p)(2)(B)–1T .....	1545–1757
*****	

Robert E. Wenzel,  
*Deputy Commissioner of Internal Revenue.*

Approved December 4, 2001.

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

(Filed by the Office of the Federal Register on December 12, 2001, 8:45 a.m., and published in the issue of the Federal Register for December 13, 2001, 66 F.R. 64351)

**Section 6311.—Payment of Tax by Commercially Acceptable Means**

*26 CFR 6311–2: Payment by credit card and debit card.*

**T.D. 8969**

**DEPARTMENT OF THE TREASURY  
 Internal Revenue Service  
 26 CFR Part 301**

**Payment by Credit Card and Debit Card**

AGENCY: Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations and removal of temporary regulations.

**SUMMARY:** This document contains final regulations authorizing the Commissioner to accept payment of internal revenue taxes by credit card or debit card and limit the use and disclosure of information relating to payment of taxes by credit card and debit card. Additionally, the final regulations provide that payments of tax by check or money order should be made payable to the United States Treasury. The final regulations reflect changes to the law made by the Taxpayer Relief Act of 1997 and affect persons who pay their tax liabilities by credit card, debit card, check, or money order.

**DATES:** *Effective Date:* These final regulations are effective December 14, 2001.

*Applicability Date:* For dates of applicability, see §301.6311–2(h).

**FOR FURTHER INFORMATION CONTACT:** Brinton Warren (202) 622–4940 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Background**

This document contains final regulations amending the Procedure and Administration Regulations (26 CFR part 301) under sections 6103 and 6311 of the Internal Revenue Code (Code). The final regulations reflect the amendment of sections 6103 and 6311 by section 1205 of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788) (TRA 1997);

section 4003(k) of the Tax and Trade Relief Extension Act of 1998, Public Law 105-277 (112 Stat. 2681) (TREA 1998); and section 3703 of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 685) (RRA 1998).

On December 15, 1998, the IRS and Treasury published temporary regulations (T.D. 8793, 1999-1 C.B. 466) in the **Federal Register** (63 FR 68995). A notice of proposed rulemaking (REG-111435-98, 1999-1 C.B. 506) cross-referencing the temporary regulations was published on the same day in the **Federal Register** (63 FR 69031). (References herein to the proposed regulations shall be to the temporary regulations.) No public hearing was requested or held. Two written comment letters were received. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision, and the corresponding temporary regulations are removed. The comments and revisions are discussed below.

### Explanation of Provisions

Section 301.6311-1 currently provides that checks or money orders should be made payable to the Internal Revenue Service. Section 3703 of RRA 1998 states that the Secretary of the Treasury shall establish such rules, regulations, and procedures as are necessary to allow payment of taxes by check or money order payable to the United States Treasury. The amendment to § 301.6311-1 accordingly provides that checks and money orders should be made payable to the United States Treasury.

As amended by section 1205 of TRA 1997, section 6311(a) provides that it shall be lawful for the Secretary of the Treasury to receive payment for internal revenue taxes by any commercially acceptable means that the Secretary deems appropriate, to the extent and under the conditions provided in regulations prescribed by the Secretary. The legislative history accompanying TRA 1997 explains that commercially acceptable means include "electronic funds transfers, including those arising from credit cards, debit cards, and charge cards." H.R. Conf. Rep. No. 105-220, at 652 (1997). The current regulations under § 301.6311-1 permit payment of taxes by

checks, drafts drawn on financial institutions, or money orders. The final regulations add payments by credit cards (which includes charge cards) and debit cards to the acceptable methods of payment under section 6311. Section 6302 and the regulations thereunder remain the authority for forms of payment by electronic funds transfer other than payment by credit card or debit card.

Only credit cards or debit cards approved by the Commissioner may be used for payment of internal revenue taxes under section 6311, only the types of tax liabilities specified by the Commissioner may be paid by credit card or debit card, and all such payments must be made in the manner and in accordance with the forms, instructions, and procedures prescribed by the Commissioner. The Commissioner has entered into contracts with third party service providers who will process the credit and debit card transactions. The Commissioner may not impose any fee on persons making payment of taxes by credit card or debit card. However, other persons participating in the program, including third party service providers who process credit or debit card transactions, are not prohibited from charging fees.

The final regulations provide, as required by section 6311(d)(3), that the payment of taxes by credit card or debit card is subject to the error resolution procedures of section 161 of the Truth in Lending Act (TILA) (15 U.S.C. 1666), section 908 of the Electronic Fund Transfer Act (EFTA) (15 U.S.C. 1693f), or any similar provisions of state or local law. The payment, however, is subject to the error resolution procedures of these statutes only for the purpose of resolving errors relating to the credit card or debit card account, and not for the purpose of resolving any errors, disputes, or adjustments relating to the underlying tax liability. These provisions ensure that any disputes concerning the merits of the tax liability will be resolved in the traditional administrative and judicial forums (*e.g.*, by filing a petition in Tax Court or by paying the disputed tax and filing a claim for refund), and will not be raised in any dispute with the card issuer, financial institution, or other person participating in the credit card or debit card transaction.

As authorized by section 6311(d)(3)(E), the final regulations permit the Commissioner to return funds erroneously received due to errors relating to the credit card or debit card account by arranging for a credit to the taxpayer's account with the issuer of the credit card or debit card or other appropriate financial institution or person. Returns of funds through credit card or debit card account credits, however, are available only to correct errors relating to the credit card or debit card account, and not to refund overpayments of taxes.

The final regulations also provide the procedures required under sections 6103(k)(9) and 6311(e) with respect to the use and disclosure of information relating to payment of taxes by credit card and debit card. Section 1205(c)(1) of TRA 1997 (as amended by section 6012(b)(2) of RRA 1998) added section 6103(k)(9), which authorizes the IRS to disclose returns and return information to financial institutions and others to the extent necessary for the administration of section 6311. Section 6103(k)(9) further provides that disclosures of information for purposes other than to accept payments by check or money order (for example, to accept payment by credit card or debit card) shall be made only to the extent authorized by written procedures promulgated by the Secretary. Section 6311(e) provides that no person shall use or disclose any information relating to credit card or debit card transactions obtained pursuant to section 6103(k)(9), except to the extent authorized by written procedures promulgated by the Secretary.

Pursuant to section 6311(e), the final regulations provide that information received by any person in connection with the payment of tax by credit card or debit card shall be treated as confidential by all persons who receive such information, whether such information is received from the IRS or from any other person, including the taxpayer. IRS personnel are authorized to disclose to card issuers, financial institutions, and other persons information necessary to process the tax payment or to bill or collect the amount charged or debited (for example, to resolve billing errors).

The final regulations set forth the limited purposes and activities for which

such information may be used or disclosed by card issuers, financial institutions, and other persons. The permitted purposes and activities principally involve credit card and debit card processing, billing, collection, account servicing, account transfers, internal business records, legal compliance, and legal proceedings. The final regulations expressly prohibit the selling of information, the sharing of information with credit bureaus, or the use of information for any marketing purpose. Any person who uses or discloses information in violation of section 6311(e) is subject to civil liability for damages under section 7431(a)(2). See section 7431(h), added by section 1205(c)(2) of TRA 1997 (as amended by section 6012(b)(3) of RRA 1998).

### Summary of Comments

Commentators recommended that the final regulations be amended to permit the IRS to compensate private sector companies for the services they provide in connection with the payment of taxes by credit and debit card. However, section 6311(d)(2) prohibits the payment of such compensation. Thus, the final regulations do not adopt this recommendation.

Commentators also recommended that the final regulations incorporate by reference the applicable regulations and staff commentaries adopted by the Federal Reserve Board under the provisions of TILA and EFTA referenced in the final regulations. The final regulations do not adopt this recommendation because the references in section 6311 and the final regulations to section 161 of TILA and section 908 of EFTA are sufficient to make the Federal Reserve Board regulations and other legal guidance under section 161 of TILA and section 908 of EFTA applicable to the payment of taxes by credit card or debit card, except as explicitly excepted in sections 6311(d)(3)(A) and (C).

Commentators also recommended a clarification of § 301.6311-2T(c)(2) of the temporary regulations, which provides that the United States has a lien for the guaranteed amount of a transaction upon all the assets of the institution making the guarantee if the United States is not duly

paid after the taxpayer tenders a payment of taxes by credit card or debit card. The commentators note that the mere tendering of payment by credit card or debit card is not sufficient for the United States to have a lien. Rather, the parties involved in the transaction must also follow the applicable procedures required to authorize the transaction and to obtain the guarantee. Thus, the commentators recommended that language be added to the final regulations to provide that the United States will not have a lien unless the parties involved follow the procedures required to authorize the transaction and obtain a guarantee.

Under the temporary regulations, the financial institution must expressly guarantee the payment in order for the United States to have a lien on the assets of the institution making the guarantee. The financial institution's express guarantee will arise only if the applicable procedures necessary to authorize the transaction and obtain the guarantee are properly followed. Additional language in the final regulations is therefore unnecessary.

One commentator questioned the use of the term *commercial transactions* in § 301.6311-2T(d)(2)(D). The commentator recommended removing the word *commercial* because, in general, TILA does not apply to commercial transactions. The final regulations adopt this recommendation by replacing §301.6311-2T(d)(2)(D) in the final regulations with a provision covering other types of errors similar to the ones explicitly covered by error resolution procedures in the final regulations.

One commentator recommended clarification of §301.6311-2T(g)(3)(i), which prohibits use or disclosure of information relating to credit and debit card transactions for purposes related to the *sale or exchange* of such information separate from the underlying receivable or account. The commentator stated that this provision conflicts with other provisions in the temporary regulations that specifically permit an exchange of credit and debit card information to process credit and debit card transactions and resolve billing errors without a sale or exchange of the underlying receivable or account. The commentator's concern stems from an ambiguity created by the use of the

term *exchange*. To avoid confusion, the final regulations replace *exchange* with *transfer for consideration*.

### Explanation of Other Revisions

Other changes to the final regulations include the following. First, the final regulations clarify that sending receipts or confirmation of a transaction to the taxpayer, including secured electronic transmissions and facsimiles, is a permissible disclosure. See §301.6311-2(g)(1)(i)(E). Second, the final regulations clarify that disclosure of information necessary to complete a transaction by the taxpayer with a state or local government agency (for example, to pay state or local tax by credit card or debit card) is a permissible disclosure when explicitly authorized by the taxpayer. This allows a taxpayer to make a state or local tax payment immediately after making a federal tax payment without requiring the taxpayer to reenter information (for example, name and Taxpayer Identification Number). See §301.6311-2(g)(1)(i)(F). Third, the final regulations provide that the term *tax* as used in these final regulations includes interest, penalties, additional amounts, and additions to tax. See §301.6311-2(a)(1). The temporary regulations did not refer to *additional amounts*.

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these final regulations, and because these final regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding 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 final regulations is R. Bradley Taylor of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division).

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## Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

### PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding entries in numerical order to read in part as follows:

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

Section 301.6103(k)(9)–1 also issued under 26 U.S.C. 6103(k)(9) and 26 U.S.C. 6103(q). \* \* \*

Section 301.6311–2 also issued under 26 U.S.C. 6311. \* \* \*

Par. 2. Section 301.6103(k)(9)–1 is added to read as follows:

*§ 301.6103(k)(9)–1 Disclosure of returns and return information relating to payment of tax by credit card and debit card.*

Officers and employees of the Internal Revenue Service may disclose to card issuers, financial institutions, or other persons such return information as the Commissioner deems necessary in connection with processing credit card and debit card transactions to effectuate payment of tax as authorized by § 301.6311–2. Officers and employees of the Internal Revenue Service may disclose such return information to such persons as the Commissioner deems necessary in connection with billing or collection of the amounts charged or debited, including resolution of errors relating to the credit card or debit card account as described in § 301.6311–2(d).

### **§ 301.6103(k)(9)–1T [Removed]**

Par. 3. Section 301.6103(k)(9)–1T is removed.

### **§ 301.6311–1 [Amended]**

Par. 4. In section 301.6311–1, paragraph(a)(1)(i) is revised by removing the language “Internal Revenue Service” from the third sentence and adding the language “United States Treasury” in its place.

Par. 5. Section 301.6311–2 is added to read as follows:

*§ 301.6311–2 Payment by credit card and debit card.*

(a) *Authority to receive*—(1) *Payments by credit card and debit card.* Internal revenue taxes may be paid by credit card or debit card as authorized by this section. Payment of taxes by credit card or debit card is voluntary on the part of the taxpayer. Only credit cards or debit cards approved by the Commissioner may be used for this purpose, only the types of tax liabilities specified by the Commissioner may be paid by credit card or debit card, and all such payments must be made in the manner and in accordance with the forms, instructions and procedures prescribed by the Commissioner. All references in this section to *tax* also include interest, penalties, additional amounts, and additions to tax.

(2) *Payments by electronic funds transfer other than payments by credit card and debit card.* Provisions relating to payments by electronic funds transfer other than payments by credit card and debit card are contained in section 6302 and the Treasury Regulations promulgated pursuant to section 6302.

(3) *Definitions*—(i) *Credit card* means any credit card as defined in section 103(k) of the Truth in Lending Act (15 U.S.C. 1602(k)), including any credit card, charge card, or other credit device issued for the purpose of obtaining money, property, labor, or services on credit.

(ii) *Debit card* means any accepted card or other means of access as defined in section 903(1) of the Electronic Fund Transfer Act (15 U.S.C. 1693a(1)), including any debit card or similar device or means of access to an account issued for the purpose of initiating electronic fund transfers to obtain money, property, labor, or services.

(b) *When payment is deemed made.* A payment of tax by credit card or debit card shall be deemed made when the issuer of the credit card or debit card properly authorizes the transaction, provided that the payment is actually received by the United States in the ordinary course of business and is not returned pursuant to paragraph (d)(3) of this section.

(c) *Payment not made*—(1) *Continuing liability of taxpayer.* A taxpayer who tenders payment of taxes by credit card or debit card is not relieved of liability for such taxes until the payment is actually received by the United States and is not required to be returned pursuant to paragraph (d)(3) of this section. This continuing liability of the taxpayer is in addition to, and not in lieu of, any liability of the issuer of the credit card or debit card or financial institution pursuant to paragraph (c)(2) of this section.

(2) *Liability of financial institutions.* If a taxpayer has tendered a payment of internal revenue taxes by credit card or debit card, the credit card or debit card transaction has been guaranteed expressly by a financial institution, and the United States is not duly paid, then the United States shall have a lien for the guaranteed amount of the transaction upon all the assets of the institution making such guarantee. The unpaid amount shall be paid out of such assets in preference to any other claims whatsoever against such guaranteeing institution, except the necessary costs and expenses of administration and the reimbursement of the United States for the amount expended in the redemption of the circulating notes of such institution.

(d) *Resolution of errors relating to the credit card or debit card account*—(1) *In general.* Payments of taxes by credit card or debit card shall be subject to the applicable error resolution procedures of section 161 of the Truth in Lending Act (15 U.S.C. 1666), section 908 of the Electronic Fund Transfer Act (15 U.S.C. 1693f), or any similar provisions of state or local law, for the purpose of resolving errors relating to the credit card or debit card account, but not for the purpose of resolving any errors, disputes or adjustments relating to the underlying tax liability.

(2) *Matters covered by error resolution procedures.* (i) The error resolution procedures of paragraph (d)(1) of this section apply to the following types of errors—

(A) An incorrect amount posted to the taxpayer's account as a result of a computational error, numerical transposition, or similar mistake;

(B) An amount posted to the wrong taxpayer's account;

(C) A transaction posted to the taxpayer's account without the taxpayer's authorization; and

(D) Other similar types of errors that would be subject to resolution under section 161 of the Truth in Lending Act (15 U.S.C. 1666), section 908 of the Electronic Fund Transfer Act (15 U.S.C. 1693f), or similar provisions of state or local law.

(ii) An error described in paragraph (d)(2)(i) of this section may be resolved only through the procedures referred to in paragraph (d)(1) of this section and cannot be a basis for any claim or defense in any administrative or court proceeding involving the Commissioner or the United States.

(3) *Return of funds pursuant to error resolution procedures.* Notwithstanding section 6402, if a taxpayer is entitled to a return of funds pursuant to the error resolution procedures of paragraph (d)(1) of this section, the Commissioner may, in the Commissioner's sole discretion, effect such return by arranging for a credit to the taxpayer's account with the issuer of the credit card or debit card or any other financial institution or person that participated in the transaction in which the error occurred.

(4) *Matters not subject to error resolution procedures.* The error resolution procedures of paragraph (d)(1) of this section do not apply to any error, question, or dispute concerning the amount of tax owed by any person for any year. For example, these error resolution procedures do not apply to determine a taxpayer's entitlement to a refund of tax for any year for any reason, nor may they be used to pay a refund. All such matters shall be resolved through administrative and judicial procedures established pursuant to the Internal Revenue Code and the rules and regulations thereunder.

(5) *Section 170 of the Truth in Lending Act not applicable.* Payments of taxes by

credit card or debit card are not subject to section 170 of the Truth in Lending Act (15 U.S.C. 1666i) or to any similar provision of state or local law.

(e) *Fees or charges.* The Internal Revenue Service may not impose any fee or charge on persons making payment of taxes by credit card or debit card. This section does not prohibit the imposition of fees or charges by issuers of credit cards or debit cards or by any other financial institution or person participating in the credit card or debit card transaction. The Internal Revenue Service may not receive any part of any fees that may be charged.

(f) *Authority to enter into contracts.* The Commissioner may enter into contracts related to receiving payments of tax by credit card or debit card if such contracts are cost beneficial to the Government. The determination of whether the contract is cost beneficial shall be based on an analysis appropriate for the contract at issue and at a level of detail appropriate to the size of the Government's investment or interest. The Commissioner may not pay any fee or charge or provide any other monetary consideration under such contracts for such payments.

(g) *Use and disclosure of information relating to payment of taxes by credit card and debit card.* Any information or data obtained directly or indirectly by any person other than the taxpayer in connection with payment of taxes by a credit card or debit card shall be treated as confidential, whether such information is received from the Internal Revenue Service or from any other person (including the taxpayer).

(1) No person other than the taxpayer shall use or disclose such information except as follows—

(i) Card issuers, financial institutions, or other persons participating in the credit card or debit card transaction may use or disclose such information for the purpose and in direct furtherance of servicing cardholder accounts, including the resolution of errors in accordance with paragraph (d) of this section. This authority includes the following—

(A) Processing the credit card or debit card transaction, in all of its stages through and including the crediting of the amount charged on account of tax to the United States Treasury;

(B) Billing the taxpayer for the amount charged or debited with respect to payment of the tax liability;

(C) Collecting the amount charged or debited with respect to payment of the tax liability;

(D) Returning funds to the taxpayer in accordance with paragraph (d)(3) of this section;

(E) Sending receipts or confirmation of a transaction to the taxpayer, including secured electronic transmissions and facsimiles; and

(F) Providing information necessary to make a payment to state or local government agencies, as explicitly authorized by the taxpayer (*e.g.*, name, address, taxpayer identification number).

(ii) Card issuers, financial institutions or other persons participating in the credit card or debit card transaction may use and disclose such information for the purpose and in direct furtherance of any of the following activities—

(A) Assessment of statistical risk and profitability;

(B) Transfer of receivables or accounts or any interest therein;

(C) Audit of account information;

(D) Compliance with federal, state, or local law; and

(E) Cooperation in properly authorized civil, criminal, or regulatory investigations by federal, state, or local authorities.

(2) Notwithstanding the provisions of paragraph (g)(1), use or disclosure of information relating to credit card and debit card transactions for purposes related to any of the following is not authorized—

(i) Sale of such information (or transfer of such information for consideration) separate from a sale of the underlying account or receivable (or transfer of the underlying account or receivable for consideration);

(ii) Marketing for any purpose, such as, marketing tax-related products or services, or marketing any product or service that targets those who have used a credit card or debit card to pay taxes; and

(iii) Furnishing such information to any credit reporting agency or credit bureau, except with respect to the aggregate amount of a cardholder's account, with the amount attributable to payment of taxes not separately identified.



(3) Use and disclosure of information other than as authorized by this paragraph (g) may result in civil liability under sections 7431(a)(2) and (h).

(h) *Effective date.* This section applies to payments of taxes made on and after December 12, 2001.

#### § 301.6311-2T [Removed]

Par. 6. Section 301.6311-2T is removed.

Robert E. Wenzel,  
*Deputy Commissioner of  
Internal Revenue.*

Approved December 10, 2001.

Mark Weinberger,  
*Acting Assistant Secretary  
of the Treasury.*

(Filed by the Office of the Federal Register on December 13, 2001, 8:45 a.m., and published in the issue of the Federal Register for December 14, 2001, 66 FR. 64740)

## Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. See Rev. Rul. 2002-2, page 271.

## Section 7701.—Definitions

26 CFR 301.7701-3: *Classification of certain business entities.*

### T.D. 8970

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

### Amendment, Check the Box Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to elective changes in entity classification under section 7701 of the Internal Revenue Code.

The regulations apply to subsidiary corporations that elect to change their classification for federal tax purposes from a corporation to either a partnership or disregarded entity.

DATES: *Effective Date:* These regulations are effective December 17, 2001.

FOR FURTHER INFORMATION CONTACT: Beverly Katz, (202) 622-3050 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

#### Background

On November 29, 1999, final regulations were published in the **Federal Register** (T.D. 8844, 1999-2 C.B. 661 [64 FR 66580]) describing the transactions that are deemed to occur when an entity elects to change its classification for Federal tax purposes. Those regulations did not address certain requirements of section 332 as applied to the deemed liquidation incident to an association's election to be classified as a partnership or to be disregarded as an entity separate from its owner. This amendment to the final regulations addresses those requirements.

On January 25, 2000, final regulations were published in the **Federal Register** (T.D. 8869, 2000-6 I.R.B. 498 [65 FR 3843]) relating to qualified subchapter S subsidiaries (QSub). In order to permit the deemed transaction resulting from a QSub election to comply with the requirement of section 332 that a plan of liquidation has been adopted at the time of a liquidating distribution, the final regulations provide that a plan of liquidation is deemed adopted immediately before the deemed liquidation incident to the QSub election, unless a formal plan of liquidation that contemplates the filing of a QSub election is adopted on an earlier date. The preamble to the QSub regulations provides that Treasury and the IRS intend to amend the section 7701 regulations regarding elective changes in entity classification to provide a similar rule concerning the timing of the plan of liquidation.

Consistent with the commitment in the preamble to the QSub regulations, on January 17, 2001, proposed regulations were published in the **Federal Register** (REG-110659-00, 66 FR 3959 (2001-12

I.R.B. 917)) under section 7701. No comments were received from the public in response to the proposed regulations. No public hearing was requested or held. The proposed regulations are adopted by this Treasury decision.

#### Explanation of Provisions

Section 301.7701-3(g)(1) describes how elective changes in the classification of an entity will be treated for tax purposes. Section 301.7701-3(g)(1)(ii) provides that an elective conversion of an association to a partnership is deemed to have the following form: the association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership. Section 301.7701-3(g)(1)(iii) provides that an elective conversion of an association to an entity that is disregarded as an entity separate from its owner is deemed to have the following form: the association distributes all of its assets and liabilities to its single owner in liquidation of the association.

Section 332 may be relevant to the deemed liquidation of an association if it has a corporate owner. Under section 332, no gain or loss is recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation if the requirements of section 332(b) are satisfied. Those requirements include the adoption of a plan of liquidation at a time when the corporation receiving the distribution owns stock of the liquidating corporation meeting the requirements of section 1504(a)(2) (*i.e.*, 80 percent of vote and value). The elective change from an association to a partnership or to a disregarded entity results in a constructive liquidation of the association for federal tax purposes. Formally adopting a plan of liquidation for the entity, however, is potentially incompatible with an elective change under section 301.7701-3, which allows the local law entity to remain in existence while liquidating only for federal tax purposes. Accordingly, to provide tax treatment of an association's deemed liquidation that is compatible with the

requirements of section 332, the regulations state that, for purposes of satisfying the requirement of adoption of a plan of liquidation under section 332(b), a plan of liquidation is deemed adopted immediately before the deemed liquidation incident to an elective change in entity classification, unless a formal plan of liquidation that contemplates the filing of the elective change in entity classification is adopted on an earlier date.

**Effective Date**

These regulations apply to elections filed on or after December 17, 2001; however, taxpayers may apply the amendments retroactively if the corporate owner claiming treatment under section 332 and its subsidiary making the election take consistent positions with respect to the federal tax consequences of the election.

**Special Analyses**

It has been determined that these 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 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal authors of these regulations are Beverly M. Katz of the Office of Associate Chief Counsel (Passthroughs &

Special Industries) and David J. Sotos of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

\* \* \* \* \*

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 301 is amended as follows:

**PART 301—PROCEDURE AND ADMINISTRATION**

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

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

Par. 2. Section 301.7701-3 is amended as follows:

- 1. Redesignating the text of paragraph (g)(2) as paragraph (g)(2)(i) and adding a heading for newly designated paragraph (g)(2)(i).
- 2. Adding a new paragraph (g)(2)(ii).
- 3. Revising the first sentence of paragraph (g)(4).

The additions and revision read as follows:

§ 301.7701-3 *Classification of certain business entities.*

\* \* \* \* \*

(g) \* \* \*

(2) *Effect of elective changes—(i) In general.* \* \* \*

(ii) *Adoption of plan of liquidation.* For purposes of satisfying the requirement of adoption of a plan of liquidation under section 332, unless a formal plan of liquidation that contemplates the election to be classified as a partnership or to be disregarded as an entity separate from its owner is adopted on an earlier date, the making, by an association, of an election under paragraph (c)(1)(i) of this section to

be classified as a partnership or to be disregarded as an entity separate from its owner is considered to be the adoption of a plan of liquidation immediately before the deemed liquidation described in paragraph (g)(1)(ii) or (iii) of this section. This paragraph (g)(2)(ii) applies to elections filed on or after December 17, 2001. Taxpayers may apply this paragraph (g)(2)(ii) retroactively to elections filed before December 17, 2001, if the corporate owner claiming treatment under section 332 and its subsidiary making the election take consistent positions with respect to the federal tax consequences of the election.

\* \* \* \* \*

(4) *Effective date.* Except as otherwise provided in paragraph (g)(2)(ii) of this section, this paragraph (g) applies to elections that are filed on or after November 29, 1999.\*\*\*

\* \* \* \* \*

Robert E. Wenzel,  
*Deputy Commissioner of Internal Revenue.*

Approved December 10, 2001.

Mark Weinberger,  
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on December 14, 2001, 8:45 a.m., and published in the issue of the Federal Register for December 17, 2001, 66 F.R. 64911)

**Section 7872.—Treatment of Loans With Below-Market Interest Rates**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2002. See Rev. Rul. 2002-2, page 271.

## Part III. Administrative, Procedural and Miscellaneous

### Elimination of User Fees for Certain Determination Letter Requests Pursuant to Section 620 of the Economic Growth and Tax Relief Reconciliation Act of 2001

#### Notice 2002-1

##### I. Purpose

This notice provides guidance on section 620 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16 (EGTRRA) which provides that, for requests made after December 31, 2001, the Secretary of the Treasury or the Secretary's delegate shall not require payment of user fees for requests to the Internal Revenue Service (Service) for certain determination letters with respect to the qualified status of a pension, profit-sharing, stock bonus, annuity, or employee stock ownership plan. The guidance in this notice will help a plan sponsor determine if it is required to pay a user fee for a determination letter application.

##### II. Background

Rev. Proc. 2002-6 (2002-1 I.R.B. 203) (January 7, 2002), contains the procedures of the Service for issuing determination letters on the qualified status of employee plans under §§ 401(a), 403(a), 409, and 4975(e)(7) of the Internal Revenue Code and the exempt status of related trusts or custodial accounts under § 501(a). Section 3.01 of Rev. Proc. 2002-6 describes the types of determination letters that may be requested by a taxpayer.

Rev. Proc. 2002-8 (2002-1 I.R.B. 252) (January 7, 2002) provides guidance for complying with the Service's user fee program as it pertains to requests for determination letters on matters under the jurisdiction of the Commissioner, Tax Exempt and Government Entities (TE/GE). Form 8717, *User Fee for Employee Plan Determination Letter Request*, is used as an attachment to a determination

letter application to transmit the payment of the required user fee.

Notice 98-4 (1998-1 C.B. 269) provides guidance regarding SIMPLE IRA plans under § 408(p).

##### III. Questions and Answers on EGTRRA section 620

Q-1: What does section 620 of EGTRRA provide?

A-1: In general, section 620 of EGTRRA provides that the Secretary of the Treasury or his delegate shall not require, for requests made after December 31, 2001, payment of user fees for certain requests to the Service for determination letters with respect to the qualified status of a pension, profit-sharing, stock bonus, annuity, or employee stock ownership plan maintained solely by one or more eligible employers, as defined in Q&A-5, or the exempt status of any trust which is part of the plan. In order to be exempt from the user fee with respect to a determination letter request, an eligible employer must also meet the requirements of Q&A-3.

Q-2: Which determination letter requests are eligible for elimination of the user fee?

A-2: In general, any determination letter request described in section 3.01 of Rev. Proc. 2002-6 that meets the requirements of this notice is exempt from the user fee. However, a request for a determination letter on the qualified status of a group trust under Rev. Rul. 81-100 (1981-1 C.B. 326) and a request for a waiver of the minimum funding requirement are not eligible for elimination of the user fee. In addition, user fees are not eliminated for any opinion or advisory letter request made by a sponsor of any master or prototype or volume submitter specimen plan that the sponsor intends to market to participating employers.

Q-3: Are user fees eliminated for all determination letter requests filed by an eligible employer after December 31, 2001?

A-3: No. User fees are not eliminated for any determination letter request made after the later of (a) the fifth plan year the plan is in existence or (b) the end of any

remedial amendment period with respect to the plan beginning within the first five plan years.

Q-4: When is a plan "in existence" for this purpose?

A-4: In general, a plan is in existence on the first day the plan was in effect. Thus, payment of a user fee generally will not be required for any determination letter request filed by an eligible employer before the first day of a plan's sixth plan year. However, a plan established as a result of a spin-off from another plan will be treated as in existence on the first day the plan from which it was spun off was in effect. Also, a plan established as the result of a merger of two or more plans will be treated as in existence on the earliest date any of the merged plans was in effect.

Q-5: Who is an "eligible employer" for purposes of determining eligibility for elimination of the user fee?

A-5: An "eligible employer" means an eligible employer (as defined in § 408(p)(2)(C)(i)(I) of the Code) that has at least one employee who is not a highly compensated employee (as defined in § 414(q)) and is participating in the plan. Under § 408(p)(2)(C)(i)(I), an employer is an eligible employer for a year if the employer had no more than 100 employees who received at least \$5,000 of compensation from the employer for the preceding year. In general, the determination of who is an eligible employer is to be made in accordance with the provisions of Q&As B-1, B-5, C-4, and C-5 of Notice 98-4 (1998-1 C.B. 269) relating to SIMPLE IRA Plans under § 408(p), as described below. Thus, for example, in determining if an employer is an eligible employer for purposes of the elimination of the user fee, all employers aggregated under § 414(b), (c) or (m) are treated as a single employer and leased employees described in § 414(n) are treated as employed by the employer.

Q-6: When is the determination of whether an employer is an eligible employer made?

A-6: The determination of whether an employer is an eligible employer is made as of the date the determination request is

made. Thus, an employer will be an eligible employer with respect to a determination letter application if the following two conditions are met. First, the employer must have had no more than 100 employees who received at least \$5,000 of compensation from the employer for the calendar year immediately preceding the calendar year in which the determination letter request is filed (“the preceding calendar year”). Second, at least one employee who was not a highly compensated employee for the plan year immediately preceding the plan year in which the determination letter request is filed (“preceding plan year”) must have participated in the plan for the preceding plan year. If the determination letter request is filed in the first plan year, then at least one employee who is not a highly compensated employee must participate in the plan for the plan year. See Q&A-9 regarding when an employee is treated as participating in a plan.

**Q-7:** Which employees are taken into account for purposes of determining if the employer had no more than 100 employees who received at least \$5,000 of compensation from the employer for the preceding calendar year met?

**A-7:** For this purpose, all employees employed at any time during the preceding calendar year, including self-employed individuals described in § 401(c)(1) who received earned income from the employer during the preceding calendar year, are taken into account, regardless of whether they were eligible to participate in the plan. Thus, for example, employees who are excludable under the rules of § 410(b)(3) or who have not met the plan’s minimum eligibility requirements must be taken into account.

**Q-8:** What definition of compensation is used to determine if an employee received at least \$5,000 of compensation from the employer for the preceding calendar year?

**A-8:** For purposes of determining if an employee received at least \$5,000 of compensation from the employer for the preceding calendar year, in the case of an individual who is not a self-employed individual, compensation means the amount described in § 6051(a)(3) (wages, tips, and other compensation from the employer subject to income tax withholding under § 3401(a)) and amounts described in § 6051(a)(8) (elective deferrals within the meaning of § 402(g)(3) and compensation deferred under § 457). In the case of a self-employed individual, compensation means net earnings determined from self-employment under § 1402, prior to subtracting elective deferral contributions made on behalf of the individual.

**Q-9:** When is an employee treated as participating in a plan for purposes of determining if at least one employee who is not a highly compensated employee participated in the plan for the preceding plan year?

**A-9:** For this purpose, an employee is treated as participating in a plan for a plan year if the employee benefits under the plan (within the meaning of § 1.410(b)-3 of the Income Tax Regulations) for the plan year. If the plan year in which the determination letter request is filed is the first plan year of the plan, then an employee is treated as participating if the employee is eligible to benefit under the plan for the year, subject to the satisfaction of applicable conditions for accruing a benefit or receiving an allocation for the year provided in the terms of the plan (whether or not the employee satisfies these conditions).

**Q-10:** Is the user fee for an application for a determination letter for a plan maintained by more than one employer eliminated if any of the employers that maintain the plan are not eligible employers?

**A-10:** No. The user fee for an application for a determination letter for a plan maintained by more than one employer is

not eliminated unless each employer that maintains the plan meets the requirements for an eligible employer under this notice. For example, the user fee for an application for a determination letter for a multiple employer plan is not eliminated unless each employer that maintains the plan is an eligible employer, even if the application is for a letter only for the plan and not for any employer that maintains the plan.

**Q-11:** When is the elimination of user fees effective?

**A-11:** The elimination of user fees is effective with respect to determination letter requests made after December 31, 2001. The user fee for any application filed before January 1, 2002, is not eliminated, regardless of when the GUST<sup>1</sup> remedial amendment period for the plan ends. Failure to include the proper user fee with an application filed before January 1, 2002, may result in the return of the application and possible adverse effect if the application is not resubmitted with the correct user fee within 30 days. See section 9.03 of Rev. Proc. 2002-8.

**Q-12:** For purposes of determining if a user fee is eliminated, when does the GUST remedial amendment period begin?

**A-12:** The date the GUST remedial amendment period begins can vary from plan to plan. The earliest date on which a plan’s GUST remedial amendment period could have begun is December 8, 1994, the date of enactment of the Uruguay Round Agreements Act (GATT). For user fee purposes, the Service will treat the GUST remedial amendment period as beginning on December 8, 1994, in all cases. The first day of the 5-year period ending on December 8, 1994, is December 9, 1989. Thus, a GUST determination letter application for a plan that was first in existence on or after December 9, 1989, may be eligible for elimination of the user fee.

<sup>1</sup>The term “GUST” refers to the following:

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

Q-13: If a determination letter application filed before January 1, 2002, is withdrawn after December 31, 2001, will the user fee be refunded?

A-13: No. As provided in section 10.01 of Rev. Proc. 2002-8, unless the Service declines to rule, a user fee will not be refunded, regardless of when the application is withdrawn.

Q-14: If a determination letter application filed before January 1, 2002, is modified after December 31, 2001, will the user fee be affected?

A-14: Generally, the modification after December 31, 2001, of a determination letter application filed before January 1, 2002, will not result in a refund of the applicable user fee. Furthermore, if the effect of the modification of the application is to change the subcategory of the application under section 6.06 of Rev. Proc. 2002-8 to a different subcategory with a higher user fee, the applicant will be required to pay the additional user fee.

For example, assume an application for a determination letter for a single-employer plan is filed on Form 5300 before January 1, 2002. The application does not request a determination with respect to the general test for nondiscrimination in amount of contributions or benefits or the minimum coverage average benefit test. The application includes payment of the required \$700 user fee. After December 31, 2001, the applicant modifies the application to request a determination regarding the average benefit test. The Service will not issue a determination letter covering the average benefit test unless the applicant pays an additional \$550, the difference between the \$700 fee and the \$1,250 fee that applies to a request for a determination with respect to the general test or the average benefit test.

Q-15: Does a form have to be filed to indicate that a user fee for a determination letter is not required?

A-15: Yes. Form 8717 is being revised to allow applicants to indicate that the application meets the requirements for elimination of the user fee and to provide for the applicant's signature in these cases. The revised Form 8717 is to be used with all section 620 applications that are filed after December 31, 2001 (which is when that section becomes effective). The revised form will be available to be

downloaded from the IRS Web Site at [http://www.irs.gov/forms\\_pubs/forms.html](http://www.irs.gov/forms_pubs/forms.html). Failure to include Form 8717, or to sign it, if required, may result in the return of the determination letter application.

#### IV. Effect on Documents

Rev. Proc. 2002-6 and Rev. Proc. 2002-8 are modified.

#### Drafting Information

The principal drafter of this notice is James Flannery 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. Flannery may be reached at 1-202-283-9888 (not a toll-free number).

## Questions and Answers Regarding Dividend Elections Under Section 404(k) and ESOPs Holding S Corporation Stock

### Notice 2002-2

#### I. Purpose

This notice provides guidance in question and answer format regarding the changes made to § 404(k) of the Internal Revenue Code (Code) by section 662 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (Pub. L. No. 107-16) enacted on June 7, 2001. This notice also provides guidance on the effective date of § 409(p) of the Code, as added by section 656 of EGTRRA, regarding the allocation of stock in an S corporation held by an employee stock ownership plan (ESOP), as defined in § 4975(e)(7) of the Code.

#### II. Background

Section 404(k) provides a deduction for applicable dividends paid on applicable employer securities of a C corpora-

tion held by an ESOP. Under § 404(k) prior to its amendment by EGTRRA, an applicable dividend included a dividend that is paid in cash to participants or their beneficiaries or paid to the ESOP and distributed in cash to participants or their beneficiaries not later than 90 days after the end of the plan year in which the dividends were paid by the corporation. Effective for taxable years of the corporation beginning on or after January 1, 2002, section 662 of EGTRRA amended the definition of applicable dividend by adding new § 404(k)(2)(A)(iii) of the Code to allow a deduction for dividends paid on employer securities held by the ESOP and with respect to which participants or beneficiaries are provided an election to have the dividend paid in cash to participants or beneficiaries pursuant to § 404(k)(2)(A)(i), paid to the ESOP and distributed in cash to participants or beneficiaries not later than 90 days after the close of the plan year in which paid pursuant to § 404(k)(2)(A)(ii), or paid to the ESOP and reinvested in qualifying employer securities. The deduction under § 404(k) is available both with respect to dividends that the participant or beneficiary elects to reinvest and with respect to dividends that the participant or beneficiary elects to receive in cash.

Section 404(k)(5)(A) prior to its amendment by EGTRRA provided that the Secretary of the Treasury may disallow a deduction under § 404(k)(1) if the Secretary determines that the dividend constitutes, in substance, an evasion of taxation. Section 662 of EGTRRA also amended § 404(k)(5)(A) of the Code to provide that the Secretary may disallow a deduction under § 404(k)(1) if the Secretary determines that the dividend constitutes, in substance, an avoidance or evasion of taxation.

Section 656 of EGTRRA amended § 409 of the Code to add a new subsection (p) regarding the allocation of employer securities consisting of stock in an S corporation. Section 656(d)(1) of EGTRRA provides that § 409(p) of the Code applies to plan years beginning after December 31, 2004. However, section 656(d)(2) provides that § 409(p) of the Code applies to plan years ending after March 14, 2001 (the date the provision was introduced in committee), in the case of any ESOP established after March 14,

2001, or in the case of an ESOP established on or before March 14, 2001, if employer securities held by the ESOP consist of stock in a corporation with respect to which an election to be an S corporation under § 1362(a) of the Code is not in effect on such date.

### III. Questions and Answers

For purposes of this notice, the term “dividend” means a dividend paid with respect to applicable employer securities that otherwise satisfies the requirements of § 404(k)(2) and the term “employer securities” means employer securities as defined in § 404(k)(6). References to participants include beneficiaries.

**Q-1**—What is the effective date of § 404(k)(2)(A)(iii), as added by section 662 of EGTRRA?

**A-1**—(a) Section 404(k)(2)(A)(iii), as added by section 662 of EGTRRA, is effective for taxable years of a corporation beginning on or after January 1, 2002. In order for dividends with respect to which an election is provided to be applicable dividends under § 404(k)(2) of the Code for a taxable year beginning on or after January 1, 2002, the election provided must comply with § 404(k)(2)(iii) (accordingly, Q&A-2 of § 1.404(k)-1T of the temporary Income Tax Regulations no longer reflects current law).

(b) A dividend subject to an election by ESOP participants is an applicable dividend under § 404(k)(2)(A)(iii) if the election provided with respect to the dividend complies with Q&A-2 and Q&A-3 and if, based on the timing rules in Q&A-4, the deduction for the dividend is allowed for a taxable year beginning on or after January 1, 2002. Therefore, if an ESOP offers participants an election between reinvestment in employer securities and distribution with respect to dividends paid by a corporation to the ESOP in 2001 and all other applicable requirements of § 404(k) are satisfied, a dividend that a participant elects to reinvest is an applicable dividend and the corporation is allowed a deduction for 2002 if the later of the date on which the dividend is reinvested in employer securities or the date on which the participant’s election becomes irrevocable occurs in 2002. A dividend paid by a corporation to an ESOP in 2001 that a participant elects to receive in a distribution is an applicable

dividend and such corporation is allowed a deduction for 2002 if the date of the distribution occurs in 2002. Dividends paid by a corporation to an ESOP in 2001 do not fail to be applicable dividends with respect to which a corporation is allowed a deduction in 2002 solely because participants were offered an election in 2001 between reinvestment and distribution, except to the extent that such dividends were actually distributed to participants in 2001.

(c) In no event is a dividend an applicable dividend under § 404(k)(2)(A)(iii) if such dividend was paid by a corporation to an ESOP before January 1, 2001.

**Q-2**—What dividend elections can be offered to ESOP participants under § 404(k)(2)(A)(iii)?

**A-2**—Under § 404(k)(2)(A)(iii), the election provided to ESOP participants with respect to dividends paid on applicable employer securities must be offered in accordance with the terms of the plan and offer participants an election between:

(a) Either (i) the payment of dividends in cash to participants or (ii) the payment to the ESOP and distribution in cash to participants not later than 90 days after the close of the plan year in which the dividends are paid by the corporation, and,

(b) The payment of dividends to the ESOP and reinvestment in employer securities.

An ESOP can also offer participants a choice among both of the options described in (a) and the option described in (b).

**Q-3**—What are the requirements for participant elections under § 404(k)(2)(A)(iii)?

**A-3**—In order for dividends subject to an election to be applicable dividends under 404(k)(2)(A)(iii), the election must be provided in a manner that satisfies the following requirements:

(a) A participant must be given a reasonable opportunity before a dividend is paid or distributed to the participant in which to make the election.

(b) A participant must have a reasonable opportunity to change a dividend election at least annually.

(c) If there is a change in the plan terms governing the manner in which the dividends are paid or distributed to

participants, a participant must be given a reasonable opportunity to make an election under the new plan terms prior to the date on which the first dividend subject to the new plan terms is paid or distributed.

An ESOP does not fail to comply with the requirements of this Q&A-3 solely because it provides that, if a participant fails to make an affirmative dividend election, one of the options offered to participants is treated as a default election.

**Q-4**—When are dividends with respect to which an election is provided pursuant to Q&A-3 deductible by the employer corporation under § 404(k)(2)(A)(iii)?

**A-4**—(a) Dividends reinvested in employer securities pursuant to an election that satisfies the requirements of Q&A-3 of this notice are deductible in the later of the taxable year of the corporation in which (i) the dividends are reinvested in employer securities at the participant’s election or (ii) the participant’s election becomes irrevocable.

(b) Dividends paid to participants or paid to the ESOP and distributed to participants within 90 days after the end of the plan year are deductible in the taxable year of the corporation in which the dividend is paid or distributed to the participant.

(c) An election is not considered made until the date the election becomes irrevocable. Therefore, for purposes of (a), dividends are not considered to be reinvested at the participant’s election prior to the time that the participant’s election becomes irrevocable.

**Q-5**—Where dividends on employer securities are paid to participants not later than 90 days after the close of the plan year in which the dividends are paid by the corporation, can earnings on those dividends be deducted under § 404(k) if they are paid to plan participants at the same time and in the same manner? Do losses reduce the amount that may be deducted under 404(k)?

**A-5**—(a) Section 404(k) allows a deduction for dividends paid on applicable employer securities if the requirements of that section are satisfied. Earnings on dividends held in the plan do not constitute dividends within the meaning of § 404(k) and accordingly are not deductible under that section. Investment

losses attributable to the dividends, or the reduction of the dividend amount paid to the ESOP by the corporation through tax withholding (e.g., by a foreign country with respect to dividends paid by a foreign corporation) or other means, reduce the amount of dividend that is available for reinvestment or distribution to participants and therefore reduce the amount that is deductible under § 404(k).

For example, assume that dividends of \$2 per share are paid to an ESOP and invested in employer securities prior to the time when participants elect either to have the dividends reinvested in employer securities or to receive a distribution of the dividends within 90 days of the end of the plan year. During the period between when the dividends are paid by the corporation to the ESOP and when participant elections become irrevocable, the fund suffers investment losses of 50%, so that the amount of the dividend remaining is \$1 per share. The deduction available with respect to participants who elect reinvestment is determined based on \$1 of dividends per share. During the period between when participant elections become irrevocable and dividends are distributed to participants who elect a distribution, the fund suffers further losses, so that the amount of the dividend remaining is 75¢. The ESOP pays the remaining dividends (75¢ per share) and is allowed a deduction with respect to participants who elect a distribution based on a dividend of 75¢ per share, regardless of whether non-dividend amounts are paid to participants by the ESOP.

Section 404(k)(5)(B) provides that a plan is not treated as violating the requirements of § 401, 409, or 4975(e)(7) merely by reason of any payment described in § 404(k)(2)(A). The distribution of amounts not attributable to dividends from a participant's account does not constitute a payment or distribution described in § 404(k)(2) and accordingly could be treated as violating the requirements of § 401, 409 or 4975.

(b) The guidance provided in this Q&A-5 is not applicable for deductions taken in taxable years beginning before January 1, 2003.

**Q-6**—Are dividends that are paid or reinvested as provided in § 404(k)(2)(A)(iii) treated as annual additions for

purposes of the limitations on contributions to defined contribution plans under § 415(c), elective contributions under § 401(k), employee contributions under § 401(m), or elective deferrals under § 402(g)?

**A-6**—No. The payment or reinvestment of dividends under § 404(k)(2)(A)(iii) does not constitute an employer contribution, employee contribution or forfeiture under § 415(c)(2). Consequently, these dividends are not annual additions for purposes of § 415(c). In addition, these dividends are not elective deferrals for purposes of § 402(g), elective contributions for purposes of § 401(k), or employee contributions for purposes of § 401(m).

**Q-7**—If, pursuant to an election satisfying the requirements of Q&A-2 and 3 of this notice, dividends are paid to the plan and reinvested in qualifying employer securities, how are those dividends treated under the ESOP?

**A-7**—Dividends that are reinvested in qualifying employer securities at the participant's election lose their identity as dividends and are treated as earnings in the same manner as dividends with respect to which a participant is not provided an election. Therefore, for example, dividends reinvested at a participant's election are no longer eligible for the exception to the early distribution tax under § 72(t)(2)(A)(vi) for dividends paid on employer securities under § 404(k). Similarly, such amounts are no longer treated as dividends for purposes of § 72, 402, 411(a)(11) or 401(k).

In contrast, dividends paid in cash to a participant pursuant to an election under § 404(k)(2)(A)(iii) are taxable without regard to the return of basis provisions under § 72, and are not subject to the consent requirements of § 411(a)(11) or the restrictions of § 401(k)(2)(B). In addition, dividends paid to participants under § 404(k) are not eligible rollover distributions under § 402(c), even if the dividends are distributed at the same time as amounts that do constitute an eligible rollover distribution (or are reported on a 1099-R in accordance with Announcement 85-168, 1985-48 I.R.B. 40). Therefore, if, prior to the date a participant receives a distribution, such participant has made an irrevocable election offered by the ESOP under § 404(k)(2)(A)(iii) to

have dividends distributed, any dividends subject to that election are distributed under § 404(k) and are not eligible rollover distributions. The corporation is allowed a deduction with respect to such dividends for the year in which the distribution is paid to the participant.

**Q-8**—In order to receive a hardship distribution from a qualified cash or deferred arrangement, must an employee who is also a participant in an ESOP elect to receive either a payment of dividends in cash from the employer or a payment of dividends to the plan followed by a cash distribution to the participant?

**A-8**—Under § 1.401(k)-1(d)(2) of the Income Tax Regulations, a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the financial need. A distribution is deemed necessary to satisfy an immediate and heavy financial need of an employee if the employee has obtained all distributions currently available under all plans maintained by the employer. See § 1.401(k)-1(d)(2)(iii)(B)(4) or (iv)(B)(2). For purposes of satisfying these hardship distribution requirements, a participant in an ESOP that offers a dividend reinvestment election under Q&A-2 and 3 of this notice must elect to receive dividends to the extent currently available to the participant under the ESOP.

**Q-9**—What are the vesting requirements for dividends with respect to which a corporation is allowed a deduction under § 404(k)?

**A-9**—Participants must be fully vested in dividends with respect to which a corporation claims a deduction under § 404(k). Prior to its amendment by EGTRRA, a corporation was allowed a deduction only with respect to dividends that were paid in cash or distributed to participants and therefore were nonforfeitable with respect to the participant who received the distribution (and with respect to which a deduction was allowable). Under § 404(k)(2)(A)(iii), a corporation is permitted to offer participants an election between receipt of a dividend in cash or reinvestment in employer securities under the ESOP and is allowed a deduction without regard to the participant's election. Therefore, an ESOP must provide that a participant is fully vested

in any dividend with respect to which the participant is offered an election under § 404(k)(2)(A)(iii). This requirement applies to applicable dividends under § 404(k)(2)(A)(iii) for taxable years of a corporation beginning on or after January 1, 2002. An ESOP can comply with this requirement by providing that participants are fully vested in dividends with respect to which an election under § 404(k)(2)(A)(iii) is offered, without regard to whether the participant is vested in the stock with respect to which the dividend is paid. Alternatively, an ESOP can comply with this requirement by offering an election under § 404(k)(2)(A)(iii) only to vested participants. See § 1.401(a)(4)-4(b)(2)(ii)(2)(B).

**Q-10**—In order for an applicable dividend on stock held by an ESOP to be deductible under 404(k), when must the plan be an ESOP?

**A-10**—Under § 404(k)(1), the applicable dividends must be paid with respect to applicable employer securities. Section 404(k)(3) provides that, for this purpose, applicable employer securities are employer securities held on the record date for a dividend by an ESOP maintained by the corporation paying such dividend or any other corporation which is a member of the controlled group of corporations (within the meaning of § 409(l)(4)) that includes such corporation. In order to satisfy this requirement, the ESOP must be designated as an ESOP no later than the record date for such dividend and must comply with the other requirements of § 4975(e) as of a date no later than the record date. The retroactive designation of a plan as an ESOP does not satisfy the requirement that a plan be designated as an ESOP no later than the record date.

**Q-11**—When does the payment of a dividend constitute an avoidance or evasion of taxation resulting in the disallowance of the deduction under § 404(k)(5)(A)?

**A-11**—As amended by § 662 of EGTRRA, § 404(k)(5)(A) provides that the Secretary may disallow a deduction for any dividend under § 404(k)(1) if the Secretary determines that the dividend constitutes, in substance, an avoidance or evasion of taxation. This includes the authority to disallow a deduction for unreasonable dividends. With respect to

dividends reinvested under § 404(k)(2)(A)(iii), a dividend paid on common stock that is primarily and regularly traded on an established securities market (within the meaning of § 54.4975-7(b)(1)(iv) of the Pension Excise Tax Regulations) is presumed to be a reasonable dividend. In the case of a corporation with no outstanding common stock (determined on a controlled group basis) that is primarily and regularly traded on an established securities market, a determination regarding whether the dividend is reasonable is made by comparing the dividend rate on the stock held by the ESOP with the dividend rate for common stock of comparable corporations whose stock is primarily and regularly traded on an established securities market. Whether a closely held corporation is comparable to a corporation whose stock is primarily and regularly traded on an established securities market is determined by comparing relevant corporate characteristics such as industry, size of the corporation, earnings, debt-equity structure, and dividend history.

As under prior law, payments in redemption of stock held by an ESOP that are used to make distributions to terminating ESOP participants constitute an evasion of taxation under § 404(k)(5)(A) and are not applicable dividends under § 404(k)(1). See Rev. Rul. 2001-6 (2001-6 I.R.B. 491). Moreover, any deduction for such payments in redemption of stock is barred under § 162(k).

**Q-12**—Can an ESOP offer a dividend election to an ESOP participant who terminates employment but does not receive a distribution of his or her account balance?

**A-12**—A participant who terminates employment but does not receive a distribution of his or her account balance continues to be a participant in the ESOP. An ESOP may provide that the same election under § 404(k)(2)(A)(iii) is offered to all participants, including both active participants and participants who are no longer active participants in the ESOP, and the corporation is allowed a deduction with respect to all dividends subject to the election. Cf. § 1.401(a)(4)-5(b); § 1.410(b)-2(c)(1).

**Q-13**—When does an ESOP have to be amended for the changes made by § 662 of EGTRRA?

**A-13**—An ESOP has a remedial amendment period under § 401(b), ending not prior to the last day of the first plan year beginning on or after January 1, 2005, in which to adopt any needed retroactive remedial amendment with regard to section 662 of EGTRRA. Amendments necessary to establish an ESOP or for compliance with the requirements of § 4975(e) of the Code are not amendments with regard to section 662 of EGTRRA.

Under Notice 2001-42 (2001-30 I.R.B. 70) the availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of a good faith EGTRRA plan amendment for section 662 of EGTRRA. A good faith EGTRRA plan amendment is timely if it is adopted no later than the later of (i) the end of the plan year in which the EGTRRA change in the qualification requirement is required to be, or is optionally, put into effect under the plan, or (ii) the end of the GUST remedial amendment period for the plan. See also Notice 2001-57 (2001-38 I.R.B. 279). Therefore, a good faith plan amendment for section 662 of EGTRRA must be adopted by the end of the plan year in which the first taxable year of the corporation for which the deduction is being sought ends.

For purposes of determining whether a plan provision is a disqualifying provision under Notice 2001-42, a plan sponsor will not fail to have adopted a timely good faith amendment with respect to section 662 solely because the amendment does not specifically address the guidance provided in this notice. For example, an amendment does not fail to be a timely good faith amendment solely because it does not address vesting of dividends with respect to which an election is provided. However, the plan must operate in accordance with this guidance, effective as of January 1, 2002. See Notice 2001-57, sec. III (In General).

**Q-14**—The following examples illustrate the rules that appear in the questions and answers of this notice:

*Example 1* (i) Corporation A is a calendar year C corporation that maintains an ESOP. The ESOP provided that dividends paid by the corporation during 2001 would be paid to the ESOP and accumulated for distribution within 90 days of plan year end. Corporation A pays quarterly dividends to its ESOP during 2001. The ESOP accumulates these dividends during 2001 for payment to participants



within 90 days of the end of the plan year and invests the dividends in a short-term investment fund. The ESOP is amended to provide that participants can elect, in accordance with Q&A-2 and 3 of this notice, a distribution in cash of 2001 dividends within the first 90 days of 2002 or reinvestment of such dividends in employer securities within the first 90 days of 2002.

(ii) Because the 2001 dividends are distributed to participants or reinvested at the participant's election in 2002, Corporation A is allowed a deduction with respect to the 2001 dividends for 2002. In taxable years beginning on or after January 1, 2003, the amount of this deduction cannot exceed the amount of the dividends available for distribution or reinvestment.

*Example 2* (i) Corporation B is a calendar year C corporation that maintains an ESOP that accumulates dividends during the year for distribution within 90 days of the end of the plan year. In 2002, the ESOP is amended to provide participants with an election with respect to dividends paid by Corporation B in 2002. A participant's election to have a dividend distributed or reinvested in employer securities becomes irrevocable when the dividend is paid to the ESOP. The ESOP provides that dividends are invested in employer securities as soon as possible after the dividend is paid to the ESOP for those participants who elect to have dividends reinvested in employer securities. All 2002 dividends that participants elect to reinvest are actually reinvested in employer securities during 2002. The ESOP also provides that the dividends to be distributed based on participant elections are invested in a short-term investment fund. This fund does not incur losses prior to the distribution of the dividends. Distributions are made to participants during the first 90 days of 2003.

(ii) Corporation B is entitled to a deduction for 2002 for the amount of the dividends reinvested in employer securities in 2002. Corporation B is also entitled to a deduction for 2003 for the amount of dividends distributed to participants in 2003. Because Corporation B did not incur any losses with respect to the dividends that were accumulated for distribution, Corporation B's deduction is equal to the dividends paid by Corporation B.

**Q-15**—By what date must a corporation have filed a valid election to be treated as an S corporation under § 1362(a) of the Code in order for the delayed effective date in section 656(d)(1) of EGTRRA to apply to an ESOP maintained by the corporation?

**A-15**—Section 656(d)(1) provides that section 409(p) of the Code, as added by EGTRRA, applies to an ESOP for plan years beginning after December 31, 2004. Section 656(d)(2) of EGTRRA, however, provides that § 409(p) of the Code applies to plan years ending after March 14, 2001, if the ESOP is established after that date or, in the case of an ESOP established on or before March 14, 2001, the employer securities held by the plan consist of stock in a corporation with respect

to which an election under § 1362(a) to be an S corporation is not in effect on that date. For this purpose, a corporation does not have an election in effect on March 14, 2001, unless a valid election was actually filed on or before that date and is effective with respect to such corporation on or before that date. For example, a corporation that, on a date after March 14, 2001, files an election to be treated as an S corporation under § 1362(a) effective as of January 1, 2001, did not have an election under section 1362(a) in effect on March 14, 2001. Accordingly, § 409(p), as added by EGTRRA, applies to an ESOP maintained by such corporation beginning with the first plan year ending after March 14, 2001.

#### IV. Drafting Information

The principal drafters of this notice are Steven Linder of the Employee Plans, Tax Exempt and Government Entities Division and John Ricotta of the Office of Chief Counsel. 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. Linder may be reached at (202) 283-9888; Mr. Ricotta may be reached at (202) 622-6060. The telephone numbers in the preceding sentence are not toll-free.

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### Safe Harbor Explanation— Certain Qualified Plan Distributions

#### Notice 2002-3

##### PURPOSE

This notice contains a "Safe Harbor Explanation" that plan administrators may provide to recipients of eligible rollover distributions from employer plans in order to satisfy § 402(f) of the Internal Revenue Code (the "Code"). It is an updated version of the Safe Harbor Explanation that was published in Notice 2000-11 (2000-6 I.R.B. 572) to reflect changes made by the Economic Growth

and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), P.L. 107-16. This notice also contains a Safe Harbor Explanation that administrators of "governmental 457 plans" may provide to recipients of eligible rollover distributions from a governmental 457 plan in order to satisfy § 402(f).

#### BACKGROUND

Section 402(f) requires a plan administrator of a plan qualified under § 401(a) or a § 403(a) annuity plan to provide a written explanation to any recipient of an "eligible rollover distribution." In addition, as amended by EGTRRA, §§ 403(b)(8)(B) and 457(e)(16)(B) require a plan administrator, or in the case of a § 403(b) tax-sheltered annuity, a payor, to provide the written explanation to the recipient of an "eligible rollover distribution." An "eligible rollover distribution" is a payment that may be rolled over to an "eligible retirement plan." An "eligible retirement plan" includes an individual retirement arrangement described in § 408(a) or (b) ("traditional IRA") or an "eligible employer plan." An "eligible employer plan" includes a plan qualified under § 401(a), including a profit-sharing plan or stock bonus plan (whether or not the plan includes a § 401(k) plan), a money purchase plan, or a defined benefit plan; a § 403(a) annuity plan; a § 403(b) tax-sheltered annuity; and an eligible § 457(b) plan maintained by a governmental employer (a "governmental 457 plan"). The written explanation must cover the direct rollover rules, the mandatory income tax withholding on distributions not directly rolled over, the tax treatment of distributions not rolled over (including the special tax treatment available for certain lump sum distributions), and when distributions may be subject to different restrictions and tax consequences after being rolled over. Section 402(f) provides that this explanation must be given within a reasonable period of time before the plan makes an eligible rollover distribution.

This notice is being issued to reflect recent changes made to the Code by EGTRRA that affect the information provided in the Safe Harbor Explanation. Sections 636, 641, 642, and 643 of EGTRRA amended provisions of the

Code relating to eligible rollover distributions. These sections apply to distributions made on or after January 1, 2002. Section 643(a) of EGTRRA added Code § 402(c)(2) to permit the rollover of after-tax contributions. Section 636(b)(1) of EGTRRA amended Code § 402(c)(4)(C) to provide that hardship distributions are not eligible rollover distributions. Section 641(a)(1) of EGTRRA added section 457(e)(16) of the Code, which permits rollovers from a governmental 457 plan to an eligible retirement plan. Section 641(a)(2) of EGTRRA added Code § 402(c)(8)(B)(iv) to provide that a governmental 457 plan is an eligible retirement plan. Section 641(b)(2) of EGTRRA added Code § 402(c)(8)(B)(vi) to provide that a § 403(b) tax-sheltered annuity is an eligible retirement plan. Section 641(b)(1) of EGTRRA amended § 403(b)(8) to permit rollovers from a § 403(b) tax-sheltered annuity to any eligible retirement plan. Finally, Section 641(d) of EGTRRA amended Code § 402(c)(9) to expand the plans to which surviving spouses may roll over distributions.

In addition, section 641(c) of EGTRRA specifically expanded the requirements for the explanation under § 402(f) by adding new subparagraph (E) to § 402(f)(1). The expanded explanation must include information regarding when a later distribution from an eligible retirement plan receiving an eligible rollover distribution may be subject to restrictions and tax consequences which are different from the plan that made the first distribution. Section 641(c) of EGTRRA provides that if a plan administrator makes reasonable efforts to comply with the requirement to provide the expanded explanation, no penalty will be imposed for failing to provide the information required under section 641(c) with respect to any distribution made before the date that is 90 days after the issuance of a safe harbor notice by the Secretary of the Treasury.

## SAFE HARBOR AND ALTERNATIVE EXPLANATIONS

This notice contains two model written explanations (“Safe Harbor Explanations”), one for distributions from plans subject to § 402(f) other than governmental 457 plans and one for distributions from governmental 457 plans. The appropriate Safe Harbor Explanation meets the requirements of § 402(f) for distributions on or after January 1, 2002, if it is provided to the recipient of an eligible rollover distribution within a reasonable period of time before the distribution is made. In general, under § 1.402(f)-1 of the Income Tax Regulations, a reasonable period of time for providing an explanation is no less than 30 days (subject to waiver) and no more than 90 days before the date on which a distribution is made. Notice 2000-11 indicated that, if the law governing the tax treatment of distributions is amended, the Safe Harbor Explanation contained in that notice would no longer satisfy § 402(f) to the extent that the Safe Harbor Explanation no longer accurately describes the relevant law. Thus, because of the changes made by EGTRRA, for distributions on or after January 1, 2002 (the effective date of the relevant EGTRRA provisions), the explanation provided in Notice 2000-11 will not be considered a Safe Harbor Explanation. No penalty will be imposed, however, for any failure to provide the expanded explanation required by EGTRRA with respect to any distribution made before April 14, 2002, provided the plan administrator makes a reasonable attempt to comply with the expanded notice requirement of EGTRRA.

In using one of the Safe Harbor Explanations, a plan administrator may “customize” the Safe Harbor Explanation by omitting any portion that does not apply to the plan. For example, if the plan does not hold after-tax employee contributions, it would be appropriate for the paragraph headed “After-tax Contributions” to be eliminated. Similarly, if the plan does not provide for distributions of employer stock or other employer securities, it

would be appropriate for the paragraph headed “Employer Stock or Securities” to be eliminated. Other paragraphs that may not be relevant to a particular plan include, for example, “Payments Spread Over Long Periods,” “Direct Rollover of a Series of Payments,” “Special Tax Treatment,” “Hardship Distributions,” and “Repayment of Plan Loans.” In addition, a plan administrator may provide additional information with the Safe Harbor Explanation, if the information is not inconsistent with the Safe Harbor Explanation.

Alternatively, a plan administrator can satisfy § 402(f) by providing distributees with an explanation that is different from one of the Safe Harbor Explanations. Any explanation must contain the information required by § 402(f) and must be written in a manner designed to be easily understood.

If the law governing the tax treatment of distributions or the other provisions covered by the Safe Harbor Explanation is amended after publication of this notice, the Safe Harbor Explanations will not satisfy § 402(f) to the extent that the Safe Harbor Explanations no longer accurately describes the relevant law.

## EFFECT ON OTHER DOCUMENT

Notice 2000-11 is obsolete.

## DRAFTING INFORMATION

The principal authors of this notice are Steven Linder of the Employee Plans, Tax Exempt and Government Entities Division and Cathy Vohs of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact the Employee Plans taxpayer assistance telephone service between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday by calling 1-877-829-5500 (a toll-free number). Mr. Linder can be reached at (202) 283-9888 (not a toll-free number). Ms. Vohs can be reached at (202) 622-6090 (not a toll-free number).

**SAFE HARBOR EXPLANATION FOR PLANS QUALIFIED UNDER SECTION 401(a), SECTION 403(a) ANNUITY PLANS, OR SECTION 403(b) TAX SHELTERED ANNUITIES**

**SPECIAL TAX NOTICE REGARDING PLAN PAYMENTS**

This notice explains how you can continue to defer federal income tax on your retirement savings in the [INSERT NAME OF PLAN] (the "Plan") and contains important information you will need before you decide how to receive your Plan benefits.

This notice is provided to you by [INSERT NAME OF THE PLAN ADMINISTRATOR OR, IN THE CASE OF A § 403(b) TAX-SHELTERED ANNUITY, THE PAYOR] (your "Plan Administrator") because all or part of the payment that you will soon receive from the Plan may be eligible for rollover by you or your Plan Administrator to a traditional IRA or an eligible employer plan. A rollover is a payment by you or the Plan Administrator of all or part of your benefit to another plan or IRA that allows you to continue to postpone taxation of that benefit until it is paid to you. Your payment cannot be rolled over to a Roth IRA, a SIMPLE IRA, or a Coverdell Education Savings Account (formerly known as an education IRA). An "eligible employer plan" includes a plan qualified under section 401(a) of the Internal Revenue Code, including a 401(k) plan, profit-sharing plan, defined benefit plan, stock bonus plan, and money purchase plan; a section 403(a) annuity plan; a section 403(b) tax-sheltered annuity; and an eligible section 457(b) plan maintained by a governmental employer (governmental 457 plan).

An eligible employer plan is not legally required to accept a rollover. Before you decide to roll over your payment to another employer plan, you should find out whether the plan accepts rollovers and, if so, the types of distributions it accepts as a rollover. You should also find out about any documents that are required to be completed before the receiving plan will accept a rollover. Even if a plan accepts rollovers, it might not accept rollovers of certain types of distributions, such as after-tax amounts. If

this is the case, and your distribution includes after-tax amounts, you may wish instead to roll your distribution over to a traditional IRA or split your rollover amount between the employer plan in which you will participate and a traditional IRA. If an employer plan accepts your rollover, the plan may restrict subsequent distributions of the rollover amount or may require your spouse's consent for any subsequent distribution. A subsequent distribution from the plan that accepts your rollover may also be subject to different tax treatment than distributions from this Plan. Check with the administrator of the plan that is to receive your rollover prior to making the rollover.

If you have additional questions after reading this notice, you can contact your plan administrator at [INSERT PHONE NUMBER OR OTHER CONTACT INFORMATION].

**SUMMARY**

There are two ways you may be able to receive a Plan payment that is eligible for rollover:

- (1) Certain payments can be made directly to a traditional IRA that you establish or to an eligible employer plan that will accept it and hold it for your benefit ("DIRECT ROLLOVER"); or
- (2) The payment can be PAID TO YOU.

If you choose a DIRECT ROLLOVER:

- Your payment will not be taxed in the current year and no income tax will be withheld.
- You choose whether your payment will be made directly to your traditional IRA or to an eligible employer plan that accepts your rollover. Your payment cannot be rolled over to a Roth IRA, a SIMPLE IRA, or a Coverdell Education Savings Account because these are not traditional IRAs.
- The taxable portion of your payment will be taxed later when you take it out of the traditional IRA or the eligible employer plan. Depending on the type of plan, the later distribution may be subject to different tax treat-

ment than it would be if you received a taxable distribution from this Plan.

If you choose to have a Plan payment that is eligible for rollover PAID TO YOU:

- You will receive only 80% of the taxable amount of the payment, because the Plan Administrator is required to withhold 20% of that amount and send it to the IRS as income tax withholding to be credited against your taxes.
- The taxable amount of your payment will be taxed in the current year unless you roll it over. Under limited circumstances, you may be able to use special tax rules that could reduce the tax you owe. However, if you receive the payment before age 59½, you may have to pay an additional 10% tax.
- You can roll over all or part of the payment by paying it to your traditional IRA or to an eligible employer plan that accepts your rollover within 60 days after you receive the payment. The amount rolled over will not be taxed until you take it out of the traditional IRA or the eligible employer plan.
- If you want to roll over 100% of the payment to a traditional IRA or an eligible employer plan, *you must find other money to replace the 20% of the taxable portion that was withheld*. If you roll over only the 80% that you received, you will be taxed on the 20% that was withheld and that is not rolled over.

*Your Right to Waive the 30-Day Notice Period.* Generally, neither a direct rollover nor a payment can be made from the plan until at least 30 days after your receipt of this notice. Thus, after receiving this notice, you have at least 30 days to consider whether or not to have your withdrawal directly rolled over. If you do not wish to wait until this 30-day notice period ends before your election is processed, you may waive the notice period by making an affirmative election indicating whether or not you wish to make a direct rollover. Your withdrawal will then be processed in accordance with your election as soon as practical after it is received by the Plan Administrator.

MORE INFORMATION

- I. *PAYMENTS THAT CAN AND CANNOT BE ROLLED OVER*..... [ ]
- II. *DIRECT ROLLOVER*..... [ ]
- III. *PAYMENT PAID TO YOU*..... [ ]
- IV. *SURVIVING SPOUSES, ALTERNATE PAYEES, AND OTHER BENEFICIARIES* ..... [ ]

I. *PAYMENTS THAT CAN AND CANNOT BE ROLLED OVER*

Payments from the Plan may be “eligible rollover distributions.” This means that they can be rolled over to a traditional IRA or to an eligible employer plan that accepts rollovers. Payments from a plan cannot be rolled over to a Roth IRA, a SIMPLE IRA, or a Coverdell Education Savings Account. Your Plan administrator should be able to tell you what portion of your payment is an eligible rollover distribution.

*After-tax Contributions.* If you made after-tax contributions to the Plan, these contributions may be rolled into either a traditional IRA or to certain employer plans that accept rollovers of the after-tax contributions. The following rules apply:

a) Rollover into a Traditional IRA. You can roll over your after-tax contributions to a traditional IRA either directly or indirectly. Your plan administrator should be able to tell you how much of your payment is the taxable portion and how much is the after-tax portion.

If you roll over after-tax contributions to a traditional IRA, it is your responsibility to keep track of, and report to the Service on the applicable forms, the amount of these after-tax contributions. This will enable the nontaxable amount of any future distributions from the traditional IRA to be determined.

Once you roll over your after-tax contributions to a traditional IRA, those amounts CANNOT later be rolled over to an employer plan.

b) Rollover into an Employer Plan. You can roll over after-tax contributions from an employer plan that is qualified under Code section 401(a) or a section 403(a) annuity plan to another such plan using a direct rollover if the other plan provides separate accounting for amounts rolled over, including separate accounting for the after-tax employee contributions and earnings on those contributions. You can also roll over after-tax contributions from a section 403(b) tax-sheltered annuity to another section 403(b) tax-sheltered annuity using a direct rollover if the other tax-sheltered annuity provides separate accounting for amounts rolled over, including separate accounting for the after-tax employee contributions and earnings on those contributions. You CANNOT roll over after-tax contributions to a governmental 457 plan. If you want to roll over your after-tax contributions to an employer plan that accepts these rollovers, you cannot have the after-tax contributions paid to you first. You must instruct the Plan Administrator of this Plan to make a direct rollover on your behalf. Also, you cannot first roll over after-tax contributions to a traditional IRA and then roll over that amount into an employer plan.

The following types of payments *cannot* be rolled over:

*Payments Spread over Long Periods.* You cannot roll over a payment if it is part of a series of equal (or almost equal) payments that are made at least once a year and that will last for:

- your lifetime (or a period measured by your life expectancy), or
- your lifetime and your beneficiary’s lifetime (or a period measured by your joint life expectancies), or
- a period of 10 years or more.

*Required Minimum Payments.* Beginning when you reach age 70½ or retire, whichever is later, a certain portion of your payment cannot be rolled over because it is a “required minimum payment” that must be paid to you. Special rules apply if you own more than 5% of your employer.

*Hardship Distributions.* A hardship distribution cannot be rolled over.

*ESOP Dividends.* Cash dividends paid to you on employer stock held in an employee stock ownership plan cannot be rolled over.

*Corrective Distributions.* A distribution that is made to correct a failed non-discrimination test or because legal limits on certain contributions were exceeded cannot be rolled over.

*Loans Treated as Distributions.* The amount of a plan loan that becomes a taxable deemed distribution because of a default cannot be rolled over. However, a loan offset amount is eligible for rollover, as discussed in Part III below. Ask the Plan Administrator of this Plan if distribution of your loan qualifies for rollover treatment.

The Plan Administrator of this Plan should be able to tell you if your payment includes amounts which cannot be rolled over.

II. *DIRECT ROLLOVER*

A DIRECT ROLLOVER is a direct payment of the amount of your Plan benefits to a traditional IRA or an eligible employer plan that will accept it. You can choose a DIRECT ROLLOVER of all or any portion of your payment that is an eligible rollover distribution, as described in Part I above. You are not taxed on any taxable portion of your payment for which you choose a DIRECT ROLLOVER until you later take it out of the traditional IRA or eligible employer plan. In addition, no income tax withholding is required for any taxable portion of your Plan benefits for which you choose a DIRECT ROLLOVER. This Plan might not let you choose a DIRECT ROLLOVER if your distributions for the year are less than \$200.

*DIRECT ROLLOVER to a Traditional IRA.* You can open a traditional IRA to receive the direct rollover. If you choose to have your payment made directly to a traditional IRA, contact an IRA sponsor (usually a financial institution) to find out how to have your payment made in a direct rollover to a traditional IRA at that institution. If you are unsure of how to invest your money, you can temporarily establish a traditional IRA to receive the

payment. However, in choosing a traditional IRA, you may wish to make sure that the traditional IRA you choose will allow you to move all or a part of your payment to another traditional IRA at a later date, without penalties or other limitations. See IRS Publication 590, *Individual Retirement Arrangements*, for more information on traditional IRAs (including limits on how often you can roll over between IRAs).

**DIRECT ROLLOVER to a Plan.** If you are employed by a new employer that has an eligible employer plan, and you want a direct rollover to that plan, ask the plan administrator of that plan whether it will accept your rollover. An eligible employer plan is not legally required to accept a rollover. Even if your new employer's plan does not accept a rollover, you can choose a DIRECT ROLLOVER to a traditional IRA. If the employer plan accepts your rollover, the plan may provide restrictions on the circumstances under which you may later receive a distribution of the rollover amount or may require spousal consent to any subsequent distribution. Check with the plan administrator of that plan before making your decision.

**DIRECT ROLLOVER of a Series of Payments.** If you receive a payment that can be rolled over to a traditional IRA or an eligible employer plan that will accept it, and it is paid in a series of payments for less than 10 years, your choice to make or not make a DIRECT ROLLOVER for a payment will apply to all later payments in the series until you change your election. You are free to change your election for any later payment in the series.

**Change in Tax Treatment Resulting from a DIRECT ROLLOVER.** The tax treatment of any payment from the eligible employer plan or traditional IRA receiving your DIRECT ROLLOVER might be different than if you received your benefit in a taxable distribution directly from the Plan. For example, if you were born before January 1, 1936, you might be entitled to ten-year averaging or capital gain treatment, as explained below. However, if you have your benefit rolled over to a section 403(b) tax-sheltered annuity, a governmental 457 plan, or a traditional IRA in a DIRECT ROLLOVER, your benefit will no longer

be eligible for that special treatment. See the sections below entitled "Additional 10% Tax if You Are under Age 59½" and "Special Tax Treatment if You Were Born before January 1, 1936."

### III. PAYMENT PAID TO YOU

If your payment can be rolled over (see Part I above) and the payment is made to you in cash, it is subject to 20% federal income tax withholding on the taxable portion (state tax withholding may also apply). The payment is taxed in the year you receive it unless, within 60 days, you roll it over to a traditional IRA or an eligible employer plan that accepts rollovers. If you do not roll it over, special tax rules may apply.

#### *Income Tax Withholding:*

**Mandatory Withholding.** If any portion of your payment can be rolled over under Part I above and you do not elect to make a DIRECT ROLLOVER, the Plan is required by law to withhold 20% of the taxable amount. This amount is sent to the IRS as federal income tax withholding. For example, if you can roll over a taxable payment of \$10,000, only \$8,000 will be paid to you because the Plan must withhold \$2,000 as income tax. However, when you prepare your income tax return for the year, unless you make a rollover within 60 days (see "Sixty-Day Rollover Option" below), you must report the full \$10,000 as a taxable payment from the Plan. You must report the \$2,000 as tax withheld, and it will be credited against any income tax you owe for the year. There will be no income tax withholding if your payments for the year are less than \$200.

**Voluntary Withholding.** If any portion of your payment is taxable but cannot be rolled over under Part I above, the mandatory withholding rules described above do not apply. In this case, you may elect not to have withholding apply to that portion. If you do nothing, an amount will be taken out of this portion of your payment for federal income tax withholding. To elect out of withholding, ask the Plan Administrator for the election form and related information.

**Sixty-Day Rollover Option.** If you receive a payment that can be rolled over

under Part I above, you can still decide to roll over all or part of it to a traditional IRA or to an eligible employer plan that accepts rollovers. If you decide to roll over, *you must contribute the amount of the payment you received to a traditional IRA or eligible employer plan within 60 days after you receive the payment.* The portion of your payment that is rolled over will not be taxed until you take it out of the traditional IRA or the eligible employer plan.

You can roll over up to 100% of your payment that can be rolled over under Part I above, including an amount equal to the 20% of the taxable portion that was withheld. If you choose to roll over 100%, you must find other money within the 60-day period to contribute to the traditional IRA or the eligible employer plan, to replace the 20% that was withheld. On the other hand, if you roll over only the 80% of the taxable portion that you received, you will be taxed on the 20% that was withheld.

**Example:** The taxable portion of your payment that can be rolled over under Part I above is \$10,000, and you choose to have it paid to you. You will receive \$8,000, and \$2,000 will be sent to the IRS as income tax withholding. Within 60 days after receiving the \$8,000, you may roll over the entire \$10,000 to a traditional IRA or an eligible employer plan. To do this, you roll over the \$8,000 you received from the Plan, and you will have to find \$2,000 from other sources (your savings, a loan, etc.). In this case, the entire \$10,000 is not taxed until you take it out of the traditional IRA or an eligible employer plan. If you roll over the entire \$10,000, when you file your income tax return you may get a refund of part or all of the \$2,000 withheld.

If, on the other hand, you roll over only \$8,000, the \$2,000 you did not roll over is taxed in the year it was withheld. When you file your income tax return, you may get a refund of part of the \$2,000 withheld. (However, any refund is likely to be larger if you roll over the entire \$10,000.)

**Additional 10% Tax If You Are under Age 59½.** If you receive a payment before you reach age 59½ and you do not roll it over, then, in addition to the regular income tax, you may have to pay an extra tax equal to 10% of the taxable portion of the payment. The additional 10% tax generally does not apply to (1) payments that are paid after you separate from service with your employer during or after the year you reach age 55, (2) payments that are paid because you retire due to disability, (3) payments that are paid as equal (or

almost equal) payments over your life or life expectancy (or your and your beneficiary's lives or life expectancies), (4) dividends paid with respect to stock by an employee stock ownership plan (ESOP) as described in Code section 404(k), (5) payments that are paid directly to the government to satisfy a federal tax levy, (6) payments that are paid to an alternate payee under a qualified domestic relations order, or (7) payments that do not exceed the amount of your deductible medical expenses. See IRS Form 5329 for more information on the additional 10% tax.

The additional 10% tax will not apply to distributions from a governmental 457 plan, except to the extent the distribution is attributable to an amount you rolled over to that plan (adjusted for investment returns) from another type of eligible employer plan or IRA. Any amount rolled over from a governmental 457 plan to another type of eligible employer plan or to a traditional IRA will become subject to the additional 10% tax if it is distributed to you before you reach age 59½, unless one of the exceptions applies.

*Special Tax Treatment If You Were Born before January 1, 1936.* If you receive a payment from a plan qualified under section 401(a) or a section 403(a) annuity plan that can be rolled over under Part I and you do not roll it over to a traditional IRA or an eligible employer plan, the payment will be taxed in the year you receive it. However, if the payment qualifies as a "lump sum distribution," it may be eligible for special tax treatment. (See also "Employer Stock or Securities", below.) A lump sum distribution is a payment, within one year, of your entire balance under the Plan (and certain other similar plans of the employer) that is payable to you after you have reached age 59½ or because you have separated from service with your employer (or, in the case of a self-employed individual, after you have reached age 59½ or have become disabled). For a payment to be treated as a lump sum distribution, you must have been a participant in the plan for at least five years before the year in which you received the distribution. The special tax treatment for lump sum distributions that may be available to you is described below.

*Ten-Year Averaging.* If you receive a lump sum distribution and you were born before January 1, 1936, you can make a one-time election to figure the tax on the payment by using "10-year averaging" (using 1986 tax rates). Ten-year averaging often reduces the tax you owe.

*Capital Gain Treatment.* If you receive a lump sum distribution and you were born before January 1, 1936, and you were a participant in the Plan before 1974, you may elect to have the part of your payment that is attributable to your pre-1974 participation in the Plan taxed as long-term capital gain at a rate of 20%.

There are other limits on the special tax treatment for lump sum distributions. For example, you can generally elect this special tax treatment only once in your lifetime, and the election applies to all lump sum distributions that you receive in that same year. You may not elect this special tax treatment if you rolled amounts into this Plan from a 403(b) tax-sheltered annuity contract, a governmental 457 plan, or from an IRA not originally attributable to a qualified employer plan. If you have previously rolled over a distribution from this Plan (or certain other similar plans of the employer), you cannot use this special averaging treatment for later payments from the Plan. If you roll over your payment to a traditional IRA, governmental 457 plan, or 403(b) tax-sheltered annuity, you will not be able to use special tax treatment for later payments from that IRA, plan, or annuity. Also, if you roll over only a portion of your payment to a traditional IRA, governmental 457 plan, or 403(b) tax-sheltered annuity, this special tax treatment is not available for the rest of the payment. See IRS Form 4972 for additional information on lump sum distributions and how you elect the special tax treatment.

*Employer Stock or Securities.* There is a special rule for a payment from the Plan that includes employer stock (or other employer securities). To use this special rule, 1) the payment must qualify as a lump sum distribution, as described above, except that you do not need five years of plan participation, or 2) the employer stock included in the payment must be attributable to "after-tax" employee contributions, if any. Under this special rule, you may have the option of

not paying tax on the "net unrealized appreciation" of the stock until you sell the stock. Net unrealized appreciation generally is the increase in the value of the employer stock while it was held by the Plan. For example, if employer stock was contributed to your Plan account when the stock was worth \$1,000 but the stock was worth \$1,200 when you received it, you would not have to pay tax on the \$200 increase in value until you later sold the stock.

You may instead elect not to have the special rule apply to the net unrealized appreciation. In this case, your net unrealized appreciation will be taxed in the year you receive the stock, unless you roll over the stock. The stock can be rolled over to a traditional IRA or another eligible employer plan, either in a direct rollover or a rollover that you make yourself. Generally, you will no longer be able to use the special rule for net unrealized appreciation if you roll the stock over to a traditional IRA or another eligible employer plan.

If you receive only employer stock in a payment that can be rolled over, no amount will be withheld from the payment. If you receive cash or property other than employer stock, as well as employer stock, in a payment that can be rolled over, the 20% withholding amount will be based on the entire taxable amount paid to you (including the value of the employer stock determined by excluding the net unrealized appreciation). However, the amount withheld will be limited to the cash or property (excluding employer stock) paid to you.

If you receive employer stock in a payment that qualifies as a lump sum distribution, the special tax treatment for lump sum distributions described above (such as 10-year averaging) also may apply. See IRS Form 4972 for additional information on these rules.

*Repayment of Plan Loans.* If your employment ends and you have an outstanding loan from your Plan, your employer may reduce (or "offset") your balance in the Plan by the amount of the loan you have not repaid. The amount of your loan offset is treated as a distribution to you at the time of the offset and will be taxed unless you roll over an amount equal to the amount of your loan offset to

another qualified employer plan or a traditional IRA within 60 days of the date of the offset. If the amount of your loan offset is the only amount you receive or are treated as having received, no amount will be withheld from it. If you receive other payments of cash or property from the Plan, the 20% withholding amount will be based on the entire amount paid to you, including the amount of the loan offset. The amount withheld will be limited to the amount of other cash or property paid to you (other than any employer securities). The amount of a defaulted plan loan that is a taxable deemed distribution cannot be rolled over.

#### **IV. SURVIVING SPOUSES, ALTERNATE PAYEES, AND OTHER BENEFICIARIES**

In general, the rules summarized above that apply to payments to employees also apply to payments to surviving spouses of employees and to spouses or former spouses who are "alternate payees." You are an alternate payee if your interest in the Plan results from a "qualified domestic relations order," which is an order issued by a court, usually in connection with a divorce or legal separation.

If you are a surviving spouse or an alternate payee, you may choose to have a payment that can be rolled over, as described in Part I above, paid in a DIRECT ROLLOVER to a traditional IRA or to an eligible employer plan or paid to you. If you have the payment paid to you, you can keep it or roll it over yourself to a traditional IRA or to an eligible employer plan. Thus, you have the same choices as the employee.

If you are a beneficiary other than a surviving spouse or an alternate payee, you cannot choose a direct rollover, and you cannot roll over the payment yourself.

If you are a surviving spouse, an alternate payee, or another beneficiary, your payment is generally not subject to the additional 10% tax described in Part III above, even if you are younger than age 59½.

If you are a surviving spouse, an alternate payee, or another beneficiary, you may be able to use the special tax treatment for lump sum distributions and the special rule for payments that include employer stock, as described in Part III

above. If you receive a payment because of the employee's death, you may be able to treat the payment as a lump sum distribution if the employee met the appropriate age requirements, whether or not the employee had 5 years of participation in the Plan.

#### **HOW TO OBTAIN ADDITIONAL INFORMATION**

This notice summarizes only the federal (not state or local) tax rules that might apply to your payment. The rules described above are complex and contain many conditions and exceptions that are not included in this notice. Therefore, you may want to consult with the Plan Administrator or a professional tax advisor before you take a payment of your benefits from your Plan. Also, you can find more specific information on the tax treatment of payments from qualified employer plans in IRS Publication 575, *Pension and Annuity Income*, and IRS Publication 590, *Individual Retirement Arrangements*. These publications are available from your local IRS office, on the IRS's Internet Web Site at [www.irs.gov](http://www.irs.gov), or by calling 1-800-TAX-FORMS.

#### **SAFE HARBOR EXPLANATION FOR GOVERNMENTAL 457 PLANS**

##### **SPECIAL TAX NOTICE REGARDING PLAN PAYMENTS**

This notice explains how you can continue to defer federal income tax on your retirement savings in the [INSERT NAME OF PLAN] (the "Plan") and contains important information you will need before you decide how to receive your Plan benefits.

This notice is provided to you by (your "Plan Administrator") because all or part of the payment that you will soon receive from the Plan may be eligible for rollover by you or your Plan Administrator to a traditional IRA or an eligible employer plan. A rollover is a payment by you or the Plan Administrator of all or part of your benefit to another plan or IRA that allows you to continue to postpone taxation of that benefit until it is paid to you. Your payment cannot be rolled over to a Roth IRA, a SIMPLE IRA, or a Coverdell Education Savings Account (formerly known as an education IRA). An "eligible

employer plan" includes a plan qualified under section 401(a) of the Internal Revenue Code, including a 401(k) plan, profit-sharing plan, defined benefit plan, stock bonus plan, and money purchase plan; a section 403(a) annuity plan; a section 403(b) tax-sheltered annuity; and an eligible section 457(b) plan maintained by a governmental employer (governmental 457 plan). The Plan is a governmental 457 plan.

An eligible employer plan is not legally required to accept a rollover. Before you decide to roll over your payment to another employer plan, you should find out whether the plan accepts rollovers and, if so, the types of distributions it accepts as a rollover. You should also find out about any documents that are required to be completed before the receiving plan will accept a rollover. Even if a plan accepts rollovers, it might not accept rollovers of certain types of distributions. If this is the case, you may wish instead to roll your distribution over to a traditional IRA or to split your rollover amount between the employer plan in which you will participate and a traditional IRA. If an employer plan accepts your rollover, the plan may restrict subsequent distributions of the rollover amount or may require your spouse's consent for any subsequent distribution. A subsequent distribution from the plan that accepts your rollover may also be subject to different tax treatment than distributions from this Plan. Check with the administrator of the plan that is to receive your rollover prior to making the rollover.

If you have additional questions after reading this notice, you can contact your plan administrator at [INSERT PHONE NUMBER OR OTHER CONTACT INFORMATION].

#### **SUMMARY**

There are two ways you may be able to receive a Plan payment that is eligible for rollover:

- (1) certain payments can be made directly to a traditional IRA that you establish or to an eligible employer plan that will accept it and hold it for your benefit ("DIRECT ROLLOVER"), or

(2) the payment can be PAID TO YOU.

If you choose a DIRECT ROLLOVER:

- Your payment will not be taxed in the current year and no income tax will be withheld.
- You choose whether your payment will be made directly to your traditional IRA or to an eligible employer plan that accepts your rollover. Your payment cannot be rolled over to a Roth IRA, a SIMPLE IRA, or a Coverdell Education Savings Account because these are not traditional IRAs.
- Your payment will be taxed later when you take it out of the traditional IRA or the eligible employer plan. Depending on the type of plan, the later distribution may be subject to different tax treatment than it would be if you received a taxable distribution from this Plan.

If you choose to have a Plan payment that is eligible for rollover PAID TO YOU:

- You will receive only 80% of the taxable amount of the payment, because the Plan Administrator is required to withhold 20% of that amount and send it to the IRS as income tax withholding to be credited against your taxes.
- The taxable amount of your payment will be taxed in the current year unless you roll it over.
- You can roll over all or part of the payment by paying it to your traditional IRA or to an eligible employer plan that accepts your rollover within 60 days after you receive the payment. The amount rolled over will not be taxed until you take it out of the traditional IRA or the eligible employer plan.
- If you want to roll over 100% of the payment to a traditional IRA or an eligible employer plan, you must find other money to replace the 20% of the taxable portion that was withheld. If you roll over only the 80% that you received, you will be taxed on the 20% that was withheld and that is not rolled over.

*Your Right to Waive the 30-Day Notice Period.* Generally, neither a direct rollover nor a payment can be made from the plan until at least 30 days after your receipt of this notice. Thus, after receiving this notice, you have at least 30 days to consider whether or not to have your withdrawal directly rolled over. If you do not wish to wait until this 30-day notice period ends before your election is processed, you may waive the notice period by making an affirmative election indicating whether or not you wish to make a direct rollover. Your withdrawal will then be processed in accordance with your election as soon as practical after it is received by the Plan Administrator.

MORE INFORMATION

- I. PAYMENTS THAT CAN AND CANNOT BE ROLLED OVER..... [ ]
- II. DIRECT ROLLOVER..... [ ]
- III. PAYMENT PAID TO YOU..... [ ]
- IV. SURVIVING SPOUSES, ALTERNATE PAYEES, AND OTHER BENEFICIARIES ..... [ ]

I. PAYMENTS THAT CAN AND CANNOT BE ROLLED OVER

Payments from the Plan may be “eligible rollover distributions.” This means that they can be rolled over to a traditional IRA or to an eligible employer plan that accepts rollovers. Payments from a plan cannot be rolled over to a Roth IRA, a SIMPLE IRA, or a Coverdell Education Savings Account. Your Plan administrator should be able to tell you whether your payment is an eligible rollover distribution.

The following types of payments *cannot* be rolled over:

*Payments Spread over Long Periods.* You cannot roll over a payment if it is part of a series of equal (or almost equal) payments that are made at least once a year and that will last for:

- your lifetime (or a period measured by your life expectancy), or
- your lifetime and your beneficiary’s lifetime (or a period measured by your joint life expectancies), or
- a period of 10 years or more.

*Required Minimum Payments.* Beginning when you reach age 70½ or retire,

whichever is later, a certain portion of your payment cannot be rolled over because it is a “required minimum payment” that must be paid to you.

*Unforeseeable Emergency Distributions.* A distribution on account of an unforeseeable emergency cannot be rolled over.

*Distributions of Excess Contributions.* A distribution that is made because legal limits on certain contributions were exceeded cannot be rolled over.

*Loans Treated as Distributions.* The amount of a plan loan that becomes a taxable deemed distribution because of a default cannot be rolled over. However, a loan offset amount is eligible for rollover, as discussed in Part III below. Ask the Plan Administrator of this Plan if distribution of your loan qualifies for rollover treatment.

The Plan Administrator of this Plan should be able to tell you if your payment includes amounts which cannot be rolled over.

II. DIRECT ROLLOVER

A DIRECT ROLLOVER is a direct payment of the amount of your Plan benefits to a traditional IRA or an eligible employer plan that will accept it. You can choose a DIRECT ROLLOVER of all or any portion of your payment that is an eligible rollover distribution, as described in Part I above. You are not taxed on any taxable portion of your payment for which you choose a DIRECT ROLLOVER until you later take it out of the traditional IRA or eligible employer plan. In addition, no income tax withholding is required for any taxable portion of your Plan benefits for which you choose a DIRECT ROLLOVER. This Plan might not let you choose a DIRECT ROLLOVER if your distributions for the year are less than \$200.

*DIRECT ROLLOVER to a Traditional IRA.* You can open a traditional IRA to receive the direct rollover. If you choose to have your payment made directly to a traditional IRA, contact an IRA sponsor (usually a financial institution) to find out how to have your payment made in a direct rollover to a traditional IRA at that institution. If you are unsure of how to invest your money, you can temporarily establish a traditional IRA to receive the



payment. However, in choosing a traditional IRA, you may wish to make sure that the traditional IRA you choose will allow you to move all or a part of your payment to another traditional IRA at a later date, without penalties or other limitations. See IRS Publication 590, *Individual Retirement Arrangements*, for more information on traditional IRAs (including limits on how often you can roll over between IRAs).

**DIRECT ROLLOVER to a Plan.** If you are employed by a new employer that has an eligible employer plan, and you want a direct rollover to that plan, ask the plan administrator of that plan whether it will accept your rollover. An eligible employer plan is not legally required to accept a rollover. Even if your new employer's plan does not accept a rollover, you can choose a DIRECT ROLLOVER to a traditional IRA. If the employer plan accepts your rollover, the plan may provide restrictions on the circumstances under which you may later receive a distribution of the rollover amount or may require spousal consent to any subsequent distribution. Check with the plan administrator of that plan before making your decision.

**DIRECT ROLLOVER of a Series of Payments.** If you receive a payment that can be rolled over to a traditional IRA or an eligible employer plan that will accept it, and it is paid in a series of payments for less than 10 years, your choice to make or not make a DIRECT ROLLOVER for a payment will apply to all later payments in the series until you change your election. You are free to change your election for any later payment in the series.

**Change in Tax Treatment Resulting from a DIRECT ROLLOVER.** The tax treatment of any payment from the eligible employer plan or traditional IRA receiving your DIRECT ROLLOVER might be different than if you received your benefit in a taxable distribution directly from the Plan. See the sections below entitled "Additional 10% Tax May Apply to Certain Distributions."

### III. PAYMENT PAID TO YOU

If your payment can be rolled over (see Part I above) and the payment is made to you in cash, it is subject to 20%

federal income tax withholding on the taxable portion (state tax withholding may also apply). The payment is taxed in the year you receive it unless, within 60 days, you roll it over to a traditional IRA or an eligible employer plan that accepts rollovers. If you do not roll it over, special tax rules may apply.

#### *Income Tax Withholding:*

**Mandatory Withholding.** If any portion of your payment can be rolled over under Part I above and you do not elect to make a DIRECT ROLLOVER, the Plan is required by law to withhold 20% of the taxable amount. This amount is sent to the IRS as federal income tax withholding. For example, if you can roll over a taxable payment of \$10,000, only \$8,000 will be paid to you because the Plan must withhold \$2,000 as income tax. However, when you prepare your income tax return for the year, unless you make a rollover within 60 days (see "Sixty-Day Rollover Option" below) you must report the full \$10,000 as a taxable payment from the Plan. You must report the \$2,000 as tax withheld, and it will be credited against any income tax you owe for the year. There will be no income tax withholding if your payments for the year are less than \$200.

**Voluntary Withholding.** If any portion of your payment is taxable but cannot be rolled over under Part I above, the mandatory withholding rules described above do not apply. In this case, you may elect not to have withholding apply to that portion. If you do nothing, an amount will be taken out of this portion of your payment for federal income tax withholding. To elect out of withholding, ask the Plan Administrator for the election form and related information.

**Sixty-Day Rollover Option.** If you receive a payment that can be rolled over under Part I above, you can still decide to roll over all or part of it to a traditional IRA or to an eligible employer plan that accepts rollovers. If you decide to roll over, you must contribute the amount of the payment you received to a traditional IRA or eligible employer plan within 60 days after you receive the payment. The portion of your payment that is rolled over will not be taxed until you take it out

of the traditional IRA or the eligible employer plan.

You can roll over up to 100% of your payment that can be rolled over under Part I above, including an amount equal to the 20% of the taxable portion that was withheld. If you choose to roll over 100%, you must find other money within the 60-day period to contribute to the traditional IRA or the eligible employer plan, to replace the 20% that was withheld. On the other hand, if you roll over only the 80% of the taxable portion that you received, you will be taxed on the 20% that was withheld.

**Example:** Your payment that can be rolled over under Part I above is \$10,000, and you choose to have it paid to you. You will receive \$8,000, and \$2,000 will be sent to the IRS as income tax withholding. Within 60 days after receiving the \$8,000, you may roll over the entire \$10,000 to a traditional IRA or an eligible employer plan. To do this, you roll over the \$8,000 you received from the Plan, and you will have to find \$2,000 from other sources (your savings, a loan, etc.). In this case, the entire \$10,000 is not taxed until you take it out of the traditional IRA or an eligible employer plan. If you roll over the entire \$10,000, when you file your income tax return you may get a refund of part or all of the \$2,000 withheld.

If, on the other hand, you roll over only \$8,000, the \$2,000 you did not roll over is taxed in the year it was withheld. When you file your income tax return, you may get a refund of part of the \$2,000 withheld. (However, any refund is likely to be larger if you roll over the entire \$10,000.)

**Additional 10% Tax May Apply to Certain Distributions.** Distributions from this Plan are generally not subject to the additional 10% tax that applies to pre-age-59½ distributions from other types of plans. However, any distribution from the Plan that is attributable to an amount you rolled over to the Plan (adjusted for investment returns) from another type of eligible employer plan or IRA amount is subject to the additional 10% tax if it is distributed to you before you reach age 59½, unless an exception applies.

Exceptions to the additional 10% tax generally include (1) payments that are paid as equal (or almost equal) payments over your life or life expectancy (or your and your beneficiary's lives or life expectancies), (2) payments that are paid from an eligible employer plan after you separate from service with your employer during or after the year you reach age 55, (3) payments that are paid because you retire due to disability, (4) payments that

are paid directly to the government to satisfy a federal tax levy, (5) payments that are paid to an alternate payee under a qualified domestic relations order, or (6) payments that do not exceed the amount of your deductible medical expenses. These exceptions may be different for distributions from a traditional IRA. See IRS Form 5329 for more information on the additional 10% tax.

The additional 10% tax does not apply to distributions from the Plan or any other governmental 457 plan, except to the extent the distribution is attributable to an amount you rolled over to the governmental 457 plan (adjusted for investment returns) from another type of eligible employer plan or IRA.

In addition, any amount rolled over from the Plan to another type of eligible employer plan or to a traditional IRA will be subject to the additional 10% tax if it is distributed to you before you reach age 59½, unless an exception applies.

**Repayment of Plan Loans.** If your employment ends and you have an outstanding loan from your Plan, your employer may reduce (or “offset”) your balance in the Plan by the amount of the loan you have not repaid. The amount of your loan offset is treated as a distribution to you at the time of the offset and will be taxed unless you roll over an amount equal to the amount of your loan offset to another qualified employer plan or a traditional IRA within 60 days of the date of the offset. If the amount of your loan offset is the only amount you receive or are treated as having received, no amount will be withheld from it. If you receive other payments of cash or property from the Plan, the 20% withholding amount will be based on the entire amount paid to you, including the amount of the loan offset. The amount withheld will be limited to the amount of other cash or property paid to you. The amount of a defaulted plan loan that is a taxable deemed distribution cannot be rolled over.

#### IV. SURVIVING SPOUSES, ALTERNATE PAYEES, AND OTHER BENEFICIARIES

In general, the rules summarized above that apply to payments to employees also apply to payments to surviving spouses of employees and to spouses or

former spouses who are “alternate payees.” You are an alternate payee if your interest in the Plan results from a “qualified domestic relations order,” which is an order issued by a court, usually in connection with a divorce or legal separation.

If you are a surviving spouse or an alternate payee, you may choose to have a payment that can be rolled over, as described in Part I above, paid in a DIRECT ROLLOVER to a traditional IRA or to an eligible employer plan or paid to you. If you have the payment paid to you, you can keep it or roll it over yourself to a traditional IRA or to an eligible employer plan. Thus, you have the same choices as the employee.

If you are a beneficiary other than a surviving spouse or an alternate payee, you cannot choose a direct rollover, and you cannot roll over the payment yourself.

If you are a surviving spouse, an alternate payee, or another beneficiary, your payment is generally not subject to the additional 10% tax described in Part III above, even if you are younger than age 59½.

#### HOW TO OBTAIN ADDITIONAL INFORMATION

This notice summarizes only the federal (not state or local) tax rules that might apply to your payment. The rules described above are complex and contain many conditions and exceptions that are not included in this notice. Therefore, you may want to consult with the Plan Administrator or a professional tax advisor before you take a payment of your benefits from your Plan. Also, you can find more specific information on the tax treatment of payments from qualified employer plans in IRS Publication 575, *Pension and Annuity Income*, and IRS Publication 590, *Individual Retirement Arrangements*. These publications are available from your local IRS office, on the IRS’s Internet Web Site at [www.irs.gov](http://www.irs.gov), or by calling 1-800-TAX-FORMS.

## Guidance on Certain Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001

### Notice 2002-4

#### I. PURPOSE

This notice provides guidance with respect to the effect on distributions from a section 401(k) plan of §§ 636(a) and 646 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”), Pub. L. 107-16. Section 636(a) of EGTRRA provides that the Secretary shall revise the regulations relating to hardship distributions under § 401(k)(2)(B)(i)(IV) of the Internal Revenue Code. Section 646 of EGTRRA amends the provisions of Code § 401(k)(2) and (10) to permit a plan to provide for distributions on severance from employment. This notice also provides guidance under Code § 414(v), added by § 631 of EGTRRA, on the application of the universal availability requirement under Code § 414(v)(4) in the case of an applicable employer plan (within the meaning of § 414(v)(6)(A)) that is also qualified under Puerto Rico law and provides a transition rule for satisfying the universal availability requirement for 2002.

Specifically this notice provides that:

- A plan may be amended to provide for distributions on severance from employment under § 401(k)(2)(B)(i)(I), as amended by EGTRRA, on or after January 1, 2002, regardless of whether the severance from employment occurred before, on, or after January 1, 2002.
- Beginning in 2002, for a plan that uses the safe harbor hardship provisions of § 1.401(k)-1(d)(2)(iv)(B) of the Income Tax Regulations, the amount of elective contributions that a participant is permitted to make in the year following a hardship distribution is no longer required to be limited to the amount of elective contributions permitted under Code § 402(g) for that year minus the amount of the elective contributions made in the year of the hardship.

- A plan will not be treated as failing to satisfy the requirements of § 414(v)(4) for 2002 solely because different plans maintained by the same employer (as defined in Regulations § 1.410(b)-9) adopt catch-up contributions beginning on different dates during 2002, provided that all such plans begin offering catch-up contributions no later than October 1, 2002.
- Until the issuance of further guidance, an applicable employer plan that permits catch-up contributions will not fail to satisfy the requirements of Code § 414(v)(4) or § 1.414(v)-1(e) of the Proposed Income Tax Regulations solely because another applicable employer plan maintained by the employer that is qualified under Puerto Rico law does not provide for catch-up contributions.

## II. BACKGROUND

### A. Distributions from a Section 401(k) Plan

Code § 401(k)(2) as in effect prior to EGTRRA provides that elective contributions under a qualified cash or deferred arrangement subject to § 401(k) may not be distributed prior to the occurrence of certain events, including the employee's separation from service, the occurrence of an event described in § 401(k)(10), and in the event of a hardship. The events listed in § 401(k)(10) are the termination of the plan without establishment or maintenance of another defined contribution plan (other than an employee stock ownership plan as defined in § 4975(e)(7)), the disposition by a corporation of substantially all of the assets used by the corporation in a trade or business of such corporation, and the disposition by a corporation of such corporation's interest in a subsidiary. Distributions may be made in connection with a sale of assets or interest in a subsidiary only with respect to an employee who continues employment with the corporation acquiring the assets or with the subsidiary, as applicable, and only if the seller continues to maintain the plan.

Section 646 of EGTRRA amended Code § 401(k)(2)(B)(i)(I) by replacing "separation from service" with "severance from employment." In addition,

§ 646 of EGTRRA amended Code § 401(k)(10) by deleting disposition by a corporation of substantially all of the assets of a trade or business and disposition of a corporation's interest in a subsidiary, leaving termination of a plan as the only distributable event described in § 401(k)(10). The amendments made by § 646 apply to distributions made after December 31, 2001.

Under Regulations § 1.401(k)-1(d)(2)(iv), a distribution is treated as made on account of hardship if it is made on account of an immediate and heavy financial need and is necessary to satisfy the financial need. Section 1.401(k)-1(d)(2)(iv)(B) provides that a distribution is deemed necessary to satisfy an immediate and heavy financial need if certain requirements are met. One such requirement is that, after receipt of the hardship distribution, a participant is prohibited from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for a period of at least 12 months (the "elective contribution prohibition period"). Another requirement is that the plan, and all other plans maintained by the employer, limit the employee's elective contributions for the next taxable year to the applicable limit under Code § 402(g) for that year minus the employee's elective contributions for the year of the hardship distribution (the "post-hardship contribution limit").

Section 636(a) of EGTRRA directs the Secretary of the Treasury to revise the regulations relating to distributions under Code § 401(k)(2)(B)(i)(IV) to provide that the period during which an employee is prohibited from making elective and employee contributions following a hardship distribution is 6 months, instead of 12 months, as required under Regulations § 1.401(k)-1(d)(2)(iv)(B)(4). Section 636(a) is effective for years beginning after December 31, 2001. Notice 2001-56 (2001-38 I.R.B. 277) provides guidance on § 636(a) of EGTRRA.

Code §§ 401(k)(12) and 401(m)(11) provide design-based safe harbor methods for satisfying the actual deferral percentage ("ADP") test contained in § 401(k)(3)(A)(ii) and the actual contribution percentage ("ACP") test contained in § 401(m)(2) based on matching contributions that meet certain conditions and

that satisfy certain notice requirements. Section V.B.1.c.iv of Notice 98-52 (1998-2 C.B. 632) provides that a plan will not fail to satisfy the ADP matching contribution safe harbor merely because an eligible employee's ability to make elective contributions is suspended for 12 months following a hardship distribution. Section VI.B.3 of Notice 98-52 provides that a plan will not fail to satisfy the ACP matching contribution safe harbor merely because an eligible employee's ability to make employee contributions is suspended for 12 months following a hardship distribution. Notice 2001-56 provides that, in order to continue to rely on the matching contribution safe harbors, a plan must reduce the period during which elective contributions and employee contributions are suspended following a hardship distribution from 12 months to 6 months for calendar years beginning after December 31, 2001.

### B. Universal Availability of Catch-up Contributions under § 414(v)

Section 631 of EGTRRA added § 414(v) to the Code. Under § 414(v), an individual age 50 or over is permitted to make catch-up contributions (up to a dollar limit provided in § 414(v)(2)) under an applicable employer plan if certain requirements provided in § 414(v) are satisfied. Section 414(v) also provides that a plan generally will not violate any provision of the Code by permitting these catch-up contributions to be made. Proposed regulations under § 414(v) were published in the Federal Register on October 23, 2001 (66 FR 53555). Section 414(v) is effective for contributions in taxable years beginning after December 31, 2001. The regulations are proposed to apply as of this effective date.

Section 414(v)(4)(A) provides that an applicable employer plan shall be treated as failing to meet the nondiscrimination requirements under § 401(a)(4) with respect to benefits, rights, and features unless the plan allows all eligible participants to make the same election with respect to catch-up contributions. Section 414(v)(4)(B) provides that, for this purpose, all plans maintained by employers who are treated as a single employer under subsection (b), (c), (m), or (o) of § 414 shall be treated as one plan.

Proposed Regulations § 1.414(v)-1(e) provides that an applicable employer plan that offers catch-up contributions will not satisfy the requirements of Code § 401(a)(4) unless all catch-up eligible participants who participate under any applicable employer plan maintained by the employer are provided with the effective opportunity to make the same dollar amount of catch-up contributions. Proposed Regulations § 1.414(v)-1(a)(4) provides that a catch-up eligible participant is an employee who is eligible to make elective deferrals during the plan year under an applicable employer plan (without regard to Code § 414(v) or the proposed regulations) and is age 50 or over (or is treated as age 50 as of January 1 of a year in accordance with Proposed Regulations § 1.414(v)-1(a)(4)(ii)). An applicable employer plan is a section 401(k) plan, a SIMPLE IRA plan, a simplified employee pension, a plan or contract that satisfies the requirements of Code § 403(b), or a § 457 eligible governmental plan. The term "employer" under the proposed regulations has the same meaning as this term under Regulations § 1.410(b)-9. Under § 1.410(b)-9, the definition of employer includes the employer maintaining the plan and those employers required to be aggregated with the employer under Code § 414(b), (c), (m), or (o).

### **C. Remedial Amendment Period for EGTRRA**

Notice 2001-42 (2001-30 I.R.B. 70) provides a remedial amendment period under Code § 401(b) ending not prior to the last day of the first plan year beginning on or after January 1, 2005, in which any needed retroactive remedial amendment with regard to EGTRRA may be adopted. The availability of this remedial amendment period is conditioned on the adoption of a good faith EGTRRA plan amendment no later than the later of: (i) the end of the plan year in which the EGTRRA change in the qualification requirement is required to be, or is optionally, put into effect under the plan; or (ii) the end of the GUST remedial amendment period for the plan. Notice 2001-57 (2001-38 I.R.B. 279) provides sample good faith amendments with

respect to several provisions of EGTRRA, including §§ 631, 636(a), and 646.

### **III. DISTRIBUTIONS ON SEVERANCE FROM EMPLOYMENT**

Under Code § 401(k)(2)(B)(i)(I), as amended by § 646 of EGTRRA, amounts attributable to elective contributions may be distributed upon the employee's severance from employment with the employer maintaining the plan. For this purpose, the employer includes all corporations and other entities treated as the same employer under Code § 414(b), (c), (m), or (o). An employee does not have a severance from employment if, in connection with a change of employment, the employee's new employer maintains the section 401(k) plan with respect to the employee (for example, by assuming sponsorship of the plan or by accepting a transfer of plan assets and liabilities (within the meaning of Code § 414(l)) with respect to the employee). Thus, for example, if all employees of a controlled group of corporations (within the meaning of § 414(b)) are covered by a section 401(k) plan and a transaction occurs such that one subsidiary corporation in the group is no longer aggregated with other members in the group under § 414(b), (c), (m), or (o), and in connection with the transaction no assets are transferred from the section 401(k) plan to a plan maintained by the former subsidiary corporation, then, participants in the section 401(k) plan who continue employment with the subsidiary corporation will have a severance from employment with the employer maintaining the section 401(k) plan and may receive a distribution of amounts attributable to elective contributions from that plan. However, if the subsidiary corporation maintained a section 401(k) plan for its employees before the transaction and continues to maintain the section 401(k) plan following the transaction, the employees who continue employment with the subsidiary do not have a severance from employment with the employer maintaining the plan.

The amendments to Code §§ 401(k)(2) and 401(k)(10) made by § 646 of EGTRRA are effective for distributions made after December 31, 2001. A plan sponsor of a section 401(k) plan that intends to permit distributions following

an employee's severance from employment must amend the plan to substitute severance from employment for separation from service. A plan may provide for distributions on severance from employment under Code § 401(k)(2)(B)(i)(I), as amended, on or after January 1, 2002, regardless of whether the severance from employment occurred before, on, or after January 1, 2002, and regardless of whether the distribution would satisfy the requirements of pre-EGTRRA § 401(k)(2)(B) and the regulations thereunder (including the 2-year rule in Regulations § 1.401(k)-1(d)(4)(iii)). Alternatively, the plan could provide for distributions on or after January 1, 2002, to participants who have a severance from employment on or after January 1, 2002 (or on or after another date specified in the plan). For the rules regarding the timing of the adoption of such an amendment, see Notices 2001-42 and 2001-57.

A section 401(k) plan will not fail to comply with Code § 401(k)(2)(B), as amended by § 646 of EGTRRA, merely because it does not permit distributions in all situations in which a participant has a severance from employment. Thus, for example, a plan could limit distributions to situations in which a participant has a separation from service or following a disposition of assets or disposition of a subsidiary under circumstances under which a distribution is permitted under Code § 401(k)(2)(B)(i)(II) and § 401(k)(10)(A)(ii) and (iii) as in effect prior to the EGTRRA amendments (see Rev. Rul. 2000-27, 2000-21 I.R.B. 1016). Accordingly, a section 401(k) plan need not be amended to provide for distributions upon severance from employment. However, if the plan is not amended to provide for distributions following a severance from employment, elective contributions can be distributed only to the extent permitted by the plan.

### **IV. DISTRIBUTIONS ON HARDSHIP**

In response to the direction in § 636(a) of EGTRRA, the safe harbor provisions of Regulations § 1.401(k)-1(d)(2)(iv)(B) will be revised. The requirement in § 1.401(k)-1(d)(2)(iv)(B)(4) will be revised to reduce the elective contribution prohibition period from a period of at least 12 months to a period of at least 6 months. In addition, the post-hardship

contribution limit in § 1.401(k)–1(d)(2)(iv)(B)(3) will be eliminated. Until the issuance of further guidance, taxpayers can rely on the rules in this section IV.

This revised safe harbor will be effective for calendar years beginning after December 31, 2001. Accordingly, the requirement that a participant's elective contributions under a plan (and all other plans maintained by the employer) be limited to the post-hardship contribution limit is permitted to be eliminated effective for calendar years beginning after December 31, 2001, for participants who received hardship distributions during 2001. A section 401(k) plan will not fail to comply with the hardship distribution safe harbor provisions under Regulations § 1.401(k)–1(d)(2)(iv)(B) solely because it retains its existing post-hardship contribution limit. However, in order to continue to rely on the matching contribution safe harbor under Code § 401(k)(12) or § 401(m)(11), a plan must eliminate the post-hardship contribution limit, effective for calendar years beginning after December 31, 2001, for participants who receive a hardship distribution after December 31, 2000.

Amendments related to the changes in the safe harbor for hardship distributions addressed in this notice are integral to a qualification requirement that has been changed by EGTRRA. For purposes of determining whether a plan provision is a disqualifying provision under Notice 2001–42, a plan sponsor will not fail to have adopted a timely good faith amendment with respect to the hardship distribution safe harbor even though the amendment does not specifically eliminate the post-hardship contribution limit. However, if the plan sponsor does not adopt a good faith amendment changing the elective contribution prohibition period (or adopts such a change effective for a year different from the year in which the post-hardship contribution limit is eliminated under the plan), the plan sponsor must adopt a timely good faith amendment eliminating the post-hardship contribution limit in order for the provision to be a disqualifying provision for purposes of the remedial amendment period under Notice 2001–42.

For example, a plan (other than a plan that relies on the matching contribution safe harbor under Code § 401(k)(12) or

§ 401(m)(11)) will not fail to comply with the revised safe harbor if it continues to prohibit elective and employee contributions for 12 months following a hardship distribution and, therefore, there is no requirement that a good faith amendment be adopted changing this period from 12 months to 6 months. However, in such case, a timely good faith amendment eliminating the post-hardship contribution limit is required for there to be a remedial amendment period with respect to the elimination of the limit.

#### V. CATCH-UP CONTRIBUTIONS UNDER § 414(v)

Under Code § 414(v)(4), a plan will not satisfy § 401(a)(4) unless all the catch-up eligible participants in any applicable employer plan maintained by the employer are provided with the effective opportunity to make the same dollar amount of catch-up contributions. Under the proposed regulations, an applicable employer plan would fail to comply with this provision unless all other applicable employer plans maintained by the same employer begin offering catch-up contributions as of the same effective date. Otherwise, there will be a period during which catch-up contributions are offered to some catch-up eligible participants but not to all. In contrast, a plan does not fail to satisfy the requirements of § 414(v)(4) and the proposed regulations solely because catch-up contributions are administered differently under different plans, provided that the administrative method under each plan satisfies the basic requirement that it provide the catch-up eligible participants in that plan with the effective opportunity to make the same dollar amount of catch-up contributions as the catch-up eligible participants in other plans maintained by the same employer.

The Service has received comments since the issuance of the proposed regulations indicating that it will be difficult for employers to comply with the universal availability requirement as of the beginning of 2002. These comments point out that this is a new section of the Code, so that plan administrative systems must be modified to allow for catch-up contributions. In addition, employers have expressed concern that there may be some plans that have difficulty with these new

provisions, and that, as a result, plans maintained by the same employer may adopt and implement catch-up contributions as of different dates.

The Service has also received comments regarding compliance with Code § 414(v)(4) by an employer that maintains a plan that is qualified under Puerto Rico tax law as well as under the Code (pursuant to § 1022(i)(2) of ERISA). Puerto Rico law does not provide for catch-up contributions. If an employer maintains a plan qualified both under Puerto Rico law and under the Code, the employer could be effectively prohibited from offering catch-up contributions to catch-up eligible participants in other applicable employer plans maintained by the employer.

In response to these concerns and to ease the administrative burden of the initial implementation of Code § 414(v), this notice provides that a plan will not be treated as failing to satisfy the requirements of § 414(v)(4) for 2002 solely because different plans maintained by the same employer (as defined in Regulations § 1.410(b)–9) adopt catch-up contributions beginning on different dates during 2002, provided that all such plans begin offering catch-up contributions no later than October 1, 2002.

In addition, until the issuance of further guidance, an applicable employer plan (within the meaning of Code § 414(v)(6)(A)) that permits catch-up contributions will not fail to satisfy the requirements of Code § 414(v)(4) or Proposed Regulations § 1.414(v)–1(e) solely because another applicable employer plan maintained by the employer that is qualified under Puerto Rico law does not provide for catch-up contributions.

#### DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact 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. Kuehnle can be reached at 1–202–283–9888 (not a toll-free number).

## Part IV. Items of General Interest

### Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

### Disclosure of Returns and Return Information by Other Agencies

#### REG-105344-01

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In the Rules and Regulations section of the December 13, 2001, issue of the Federal Register, the IRS is issuing a temporary regulation to enable the Commissioner to authorize federal, state and local agencies with access to returns and return information under section 6103 of the Internal Revenue Code to redisclose such returns and return information, with the Commissioner's approval, to any authorized recipient set forth in section 6103 of the Internal Revenue Code, subject to the same restrictions and for the same purposes, as if the recipient had received the information from the IRS directly.

DATES: Written comments and electronic comments and requests for a public hearing must be received by February 14, 2002.

ADDRESSES: Send submissions to CC:ITA:RU (REG-105344-01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:ITA:RU (REG-105344-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site: [http://www.irs.gov/prod/tax\\_regs/comments/html](http://www.irs.gov/prod/tax_regs/comments/html).

FOR FURTHER INFORMATION CONTACT: Julie C. Schwartz, 202-622-4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224. Comments on the collection of information should be received by February 14, 2002. Comments are specifically requested concerning:

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

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

How the quality, utility, and clarity of the information to be collected may be enhanced; How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

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

The collection of information in this proposed regulation is in 26 CFR 301.6103(p)(2)(B)-1T. This information is required for the Commissioner to authorize agencies with access to returns and return information under section 6103 to disclose such to other authorized recipients of returns and return informa-

tion in accordance with section 6103. The collection of information is required to obtain a benefit. The likely respondents and recordkeepers are federal agencies and state or local governments.

Estimated total annual reporting and/or recordkeeping burden: 11 hours.

Estimated average annual burden hours per respondent and/or recordkeeper: 1 hour.

Estimated number of respondents and/or recordkeepers: 11.

Estimated annual frequency of responses: once.

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

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

#### Background

Section 6103(p)(2)(B) provides that return information disclosed pursuant to the Code may be disclosed by any mode or means that the Secretary determines necessary or appropriate. 26 CFR 301.6103(p)(2)(B)-1 currently permits certain recipients of returns and return information under section 6103, with the Commissioner's approval, to disclose returns and return information to certain other permissible recipients under section 6103. Specifically, the existing regulation permits disclosure by Federal agencies, with the Commissioner's approval, to 1) other Federal agencies, 2) state tax agencies, 3) the General Accounting Office, 4) Federal, state and local child support enforcement agencies, 5) persons described in section 6103(c) (person designated in a taxpayer consent), and 6) persons described in section 6103(e) (person with a material interest).

The Consolidated Appropriations Act, 2001, Pub. L. No. 106-554 (114 Stat. 2763), was signed into law on December 21, 2000. Section 1 of that Act enacted

into law H.R. 5662, the Community Renewal Tax Relief Act of 2000. Section 310 of the Community Renewal Tax Relief Act of 2000 added section 6103(j)(6) to the Code, authorizing the Commissioner to disclose return information to the Congressional Budget Office (CBO) for the purpose of, but only to the extent necessary for, long term models of the Social Security and Medicare programs. The conference report, H.R. Conf. Rep. No. 106-1033, at 1020-21 (2000), provides that it is the intent of Congress that all requests for information made by CBO under this provision be made to the Commissioner, who will use his authority under section 6103(p)(2) such that the Social Security Administration (SSA) or other agency can furnish the information directly to CBO for the purpose of CBO's long term models of Social Security and Medicare. SSA, not IRS, collects and maintains much of the information sought by CBO and also receives the tax information CBO seeks under other provisions of section 6103. However, section 301.6103(p)(2)(B)-1 in its current form would not allow the Commissioner to authorize SSA to redisclose return information properly in its possession to CBO, an authorized recipient of the information under section 6103(j)(6). Updating the regulation would allow SSA to make return information in its possession available to CBO to the extent authorized by section 6103(j)(6).

There are other situations, similar to that found under section 6103(j)(6), where it is more efficient for returns and return information in the possession of one authorized agency recipient, to be disclosed by such agency to another statutorily authorized recipient. The inability of agencies, including Federal, state and local agencies, to share returns and return information between themselves or even inside a single agency, even where the information is more readily available from an agency other than the IRS, was highlighted by the Department of the Treasury on pages 89-90 of its October 2000 Report to the Congress on the Scope and Use of Taxpayer Confidentiality and Disclosure Provisions. The report notes, for example, that currently a single agency within a state (or even a single caseworker) may be administering both child support under Title IV-D of the

Social Security Act and welfare under Title IV-A of the Social Security Act. The agency may receive return information under both section 6103(l)(6) and section 6103(l)(7) to aid the agency in making determinations of eligibility for these programs, but the current regulation does not permit even intra-agency pooling or sharing of these data. The report notes that both intra- and inter-agency data sharing with respect to common data elements could be authorized by amendment to the Treasury regulations. Updating the regulation would allow the IRS to authorize such redisclosure in appropriate situations.

The text of the proposed temporary regulation also serves as the text of this proposed regulation. The preamble to the temporary regulation contains a full explanation of the reasons underlying the issuance of the proposed regulation.

### Special Analyses

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

### Comments and Request for a Public Hearing

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

### Drafting Information

The principal author of this regulation is Julie C. Schwartz, Office of the Associate Chief Counsel (Procedure and Administration), Disclosure and Privacy Law Division.

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### Amendments to the Regulations

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

#### PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read as follows:

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

Section 301.6103(p)(2)(B)-1 also issued under 26 U.S.C. 6103(p)(2);\*\*\*

#### § 301.6103(p)(2)(B)-1 [Removed]

Par. 2. Section 301.6103(p)(2)(B)-1 is removed.

Par. 3. Section 301.6103(p)(2)(B)-1T is added to read as follows:

[The text of this proposed section is the same as the text of § 301.6103(p)(2)(B)-1T published elsewhere in this issue of the **Federal Register**].

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

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

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

Par. 5. In § 602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows:

[The text of this proposed section is the same as the text of § 602.101 published elsewhere in this issue of the **Federal Register**].

Robert E. Wenzel,  
*Deputy Commissioner of  
Internal Revenue.*

(Filed by the Office of the Federal Register on December 12, 2001, 8:45 a.m., and published in the issue of the Federal Register for December 13, 2001, 65 F.R. 64386)

## **Elimination of User Fees for Certain Determination Letter Requests Pursuant to Section 620 of the Economic Growth and Tax Relief Reconciliation Act of 2001**

### **Announcement 2002-1**

Q&A-15 of Notice 2002-1, page 283, this Bulletin, describes a revised Form 8717 that is to be used with section 620 applications, *i.e.*, certain Employee Plans determination letter requests, that are filed after December 31, 2001. The revised form will not be available on the IRS Web Site until late in January 2002. Accordingly, prior to that time employers that meet the requirements described in the notice may use the draft Form 8717 and the related instructions that are being made available through the Employee Plans Newsletter and the various tax services.

#### **DRAFTING INFORMATION**

The principal author of this announcement is Michael Rubin of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this announcement, 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. Rubin can be reached at 1-202-283-9888 (not a toll-free number).

## **Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties Under § 6662 of the Internal Revenue Code**

### **Announcement 2002-2**

The Internal Revenue Service (IRS) announces a disclosure initiative to encourage taxpayers to disclose their tax treatment of tax shelters and other items for which the imposition of the accuracy-related penalty may be appropriate if

there is an underpayment of tax. If a taxpayer discloses any item in accordance with the provisions of this announcement before April 23, 2002, the IRS will waive the accuracy-related penalty under § 6662(b)(1), (2), (3), and (4) for any underpayment of tax attributable to that item.

This disclosure initiative covers all items except items resulting from a transaction that (1) did not in fact occur, in whole or in part, but for which the taxpayer claimed a tax benefit on its return; (2) involved the taxpayer's fraudulent concealment of the amount or source of any item of gross income; (3) involved the taxpayer's concealment of its interest in, or signature or other authority over a financial account in a foreign country; (4) involved the taxpayer's concealment of a distribution from, a transfer of assets to, or that the taxpayer was a grantor of a foreign trust; or (5) involved the treatment of personal, household, or living expenses as deductible trade or business expenses.

#### **SCOPE OF THE WAIVER**

Under this disclosure initiative, the IRS will waive the accuracy-related penalty under § 6662(b) for that portion of an underpayment attributable to the disclosed item and due to one or more of the following: (1) negligence or disregard of rules or regulations; (2) any substantial understatement of income tax; (3) any substantial or gross valuation misstatement under chapter 1 of the Code, except for any portion of an underpayment attributable to a net § 482 transfer price adjustment, unless the standards of § 6662(e)(3)(B) regarding documentation are met; and (4) any substantial overstatement of pension liabilities.

Disclosure under this initiative does not affect whether the IRS will impose, as appropriate, any other civil penalty that may be applicable under the Code or will investigate any associated criminal conduct or recommend prosecution for violation of any criminal statute.

#### **PERIOD OF DISCLOSURE**

The IRS will waive the accuracy-related penalty if the taxpayer discloses the item before the earlier of (1) the date

the item or another item arising from the same transaction is an issue raised during an examination, or (2) April 23, 2002. For purposes of this disclosure initiative, an item is an issue raised during an examination if the person examining the return (the examiner) communicates to the taxpayer knowledge about the specific item or on or before December 21, 2001, the examiner has made a request to the taxpayer for information, and the taxpayer could not make a complete response to that request without giving the examiner knowledge of the specific item.

#### **INFORMATION REQUIRED TO MAKE A DISCLOSURE**

To disclose an item under this initiative, a taxpayer must provide the following:

- (1) A statement describing the material facts of the item;
- (2) A statement describing the taxpayer's tax treatment of the item;
- (3) The taxable years affected by the item;
- (4) If the taxpayer is a Coordinated Industry Case (CIC) taxpayer, a statement that the taxpayer will agree to address the disclosed item under the Accelerated Issue Resolution process described in Rev. Proc. 94-67 (1994-2 C.B. 800) if requested to do so by the IRS;
- (5) The names and addresses of (a) any parties who promoted, solicited, or recommended the taxpayer's participation in the transaction underlying the item and who had a financial interest, including the receipt of fees, in the taxpayer's decision to participate, and (b) if known to the taxpayer, any parties who advised the promoter, solicitor or recommender with respect to that transaction;
- (6) A statement agreeing to provide, if requested, copies of all of the following:
  - (a) All transactional documents, including agreements, contracts, instruments, schedules, and, if the taxpayer's participation in the transaction was promoted, solicited or recommended by any other party, all material received from that other party or that party's advisor(s);



(b) All internal documents or memoranda used by the taxpayer in its decision-making process, including, if applicable, information presented to the taxpayer's board of directors; and

(c) All opinions and memoranda that provide a legal analysis of the item, whether prepared by the taxpayer or a tax professional on behalf of the taxpayer; and

(7) A penalty of perjury statement that the person signing the disclosure has examined the disclosure and that to the best of that person's knowledge and belief, the information provided as part of the disclosure contains all relevant facts and is true, correct, and complete. In the case of an individual taxpayer, the declaration must be signed and dated by the taxpayer, and not the taxpayer's representative. In the case of a corporate taxpayer, the declaration must be signed and dated by an officer of the corporate taxpayer who has personal knowledge of the facts. If the corporate taxpayer is a member of an affiliated group filing consolidated returns, a penalties of perjury statement also must be signed, dated, and submitted by an officer of the common parent of the group. The person signing for a trust, a state law partnership, or a limited liability company must be, respectively, a trustee, general partner, or member-manager who has personal knowledge of the facts. A stamped signature is not permitted.

#### PROCEDURE FOR MAKING THE DISCLOSURE

A CIC taxpayer must submit the disclosure information to the assigned team manager and send a copy of the information to the Office of Tax Shelter Analysis.

A non-CIC taxpayer not under examination as of December 21, 2001, must send the disclosure information to the Office of Tax Shelter Analysis.

A non-CIC taxpayer under examination as of December 21, 2001, must submit the disclosure information to the examiner and send a copy of the information to the Office of Tax Shelter Analysis.

The address for the Office of Tax Shelter Analysis is LM:PFTG:OTSA, 1111 Constitution Ave, NW, Washington, DC 20224.

#### MISCELLANEOUS

The IRS is committed to considering and resolving disclosed items promptly. A taxpayer's disclosure of an item creates no inference that the taxpayer's tax treatment of the item was improper or that the accuracy-related penalty would apply if there is an underpayment of tax. Furthermore, taxpayers that do not disclose under this initiative are not prevented from demonstrating that they satisfy the reasonable cause exception under § 6664(c) and the regulations thereunder with respect to any portion of an underpayment of tax.

#### PAPERWORK REDUCTION ACT

The collection of information contained in this announcement 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 1545-1764. 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 announcement is in the section titled INFORMATION REQUIRED TO MAKE A DISCLOSURE. This information is required to assess the item the taxpayer is disclosing under the initiative. This information will be used to determine whether the taxpayer has reported the disclosed item properly for income tax purposes. The collection of information is required to obtain the benefit described in this announcement. The likely respondents are businesses or other for-profit institutions, small businesses or organizations, and individuals.

The estimated total annual reporting burden is 450 hours.

The estimated annual burden per respondent varies from 2 hours to 4 hours, depending on individual circumstances, with an estimated average of 3 hours. The estimated number of respondents is 150.

The estimated frequency of responses is one time per respondent.

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.

#### CONTACT INFORMATION

For further information regarding this announcement, contact Jozef Chilinski of the Office of Tax Shelter Analysis at (202) 283-8425 (not a toll-free call).

### Form 1065 Electronic Filing Waiver Request Procedures

#### Announcement 2002-3

Section 6011(e) of the Internal Revenue Code and section 301.6011-3(a) of the Regulations on Procedure and Administration require partnerships with more than 100 partners to file their partnership returns (Form 1065 series) on magnetic media. The regulations define "magnetic media" to include electronic filing, if electronic filing is required by the Internal Revenue Service (Service).

Beginning with taxable years ending on or after December 31, 2000, the Service will require partnerships with more than 100 partners to file their partnership returns electronically. IRS Publication 1524 contains instructions for filing partnership returns electronically, and excludes certain partnerships from the electronic filing requirement. For Tax Year 2001, the IRS has excluded Partnerships with the following type of returns from the electronic filing requirement:

- 1) Fiscal Year Filers
- 2) Foreign Address Partnerships
- 3) Amended Returns
- 4) Delinquent Returns

**(Note: For a detailed list of the exclusions, refer to Publication 1524.)**

Section 301.6011-3(b) of the regulations permits the Commissioner of Internal Revenue to waive the electronic filing requirement if the partnership demonstrates that a hardship would result if it

were required to file its return electronically. The regulations require partnerships seeking a waiver to request one in the manner prescribed by the Service.

To request a waiver for the taxable year ending December 31, 2001, partnerships must file a written request containing the following information:

(1) A notation at the top of the request stating, in large letters, “**Form 1065 e-file Waiver Request: IRC Section 6011 (e)(2)**”;

(2) The name, federal tax identification number, and mailing address of the partnership;

(3) The taxable year for which the waiver is requested;

(4) A detailed statement which lists:

a) the steps the partnership has taken in an attempt to meet its requirement to file its return electronically,

b) why the steps were unsuccessful,

c) the hardship that would result, including any incremental cost to the partnership of complying with the electronic filing requirements. Incremental costs are those costs that are above and beyond the costs to file on paper. The incremental costs must be supported by a detailed computation. The detailed computation must include a schedule detailing the costs to file on paper and the costs to file electronically.

(5) A statement as to what steps the partnership will take to assure its ability to electronically file its partnership return for the next tax year.

(6) A statement (signed by the Tax Matters Partner, as defined in section 6231(a)(7) of the Code) indicating:

“Under penalties of perjury, I declare that the information contained in this waiver request is true, correct and complete to the best of my knowledge and belief.”

All requests for waiver must be filed with the Ogden Submission Processing Center during one of the following periods:

1) For returns due April 15, 2002 (Form 8736 Extension not filed); January 15, 2002, to March 1, 2002.

2) For returns due July 15, 2002 (Form 8736 Extension filed); January 15, 2002, to June 1, 2002.

3) For returns due October 15, 2002 (Form 8800 Extension filed and approved); January 15, 2002, to September 15, 2002.

Requests from the partnership’s tax advisor/preparer must be accompanied by a valid power of attorney. The address for the Ogden Submission Processing Center:

Internal Revenue Service  
Ogden Submission Processing Center  
P.O. Box 9941  
Ogden, UT 84409  
Attn: Form 1065 e-file Waiver Request,  
Stop 1057

Fax: 801-620-7622

**(Note: Do not attach the waiver request to the partnership’s paper tax return. Also, do not file extension requests with the waiver.)**

The Service will approve or deny waiver requests based on the facts and circumstances of each request. In determining whether to approve or deny a waiver request, the Service will consider the ability of the partnership to file its return electronically without incurring an undue economic hardship.

Within 30 days after receipt of the waiver request, the Service will send a letter to the partnership either approving or denying the request for waiver. Partnerships may not appeal a denial of a waiver request. However, partnerships may request a waiver of any penalty imposed by the Service for failing to file their partnership returns electronically. For further information regarding penalty waivers, see IRS Notice 746.

For questions concerning a request for waiver, contact the Ogden Submission Processing Center 801-620-7444 (not a toll-free call).

## Effect of the Family and Medical Leave Act on the Operation of Cafeteria Plans; Correction

### Announcement 2002-4

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Correction to final regulations.

SUMMARY: This document contains a correction to final regulations (T.D. 8966, 2001-45 I.R.B. 422) that were published in the **Federal Register** on October 17, 2001 (66 FR 52676). These regulations relate to cafeteria plans that reflect changes made by the Family and Medical Act of 1993 (Act).

DATES: This correction is effective October 17, 2001.

FOR FURTHER INFORMATION CONTACT: Shoshanna Chaiton (202) 622-6080 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

The final regulations that are the subject of this correction are under section 125 of the Internal Revenue Code.

##### Need for Correction

As published, the final regulations (T.D. 8966) contains errors that may prove to be misleading and are in need of clarification.

##### Correction of Publication

Accordingly, final regulations (T.D. 8966), (FR. Doc 01-25909), published October 17, 2001, is corrected as follows:

##### § 1.125-3 [Corrected]

On page 52677, column 3, § 1.125-3, line 3, the language “Family and Medical Leave Act (FMLA)” is corrected to read “Family and Medical Leave Act (FMLA), 29 U.S.C. 2601 *et seq.*,”

On page 52677, column 3, §1.125-3, Q-1, line 4 and 5, the language “when taking unpaid Family and Medical Leave Act (FMLA), 29 U.S.C., is corrected to read “when taking unpaid FMLA, 29 U.S.C.”

LaNita Van Dyke,  
Acting Chief, Regulations Unit,  
*Associate Chief Counsel*  
*(Income Tax and Accounting).*

(Filed by the Office of the Federal Register on December 10, 2001, 8:45 a.m., and published in the issue of the Federal Register for December 11, 2001, 66 F.R. 63920)

# 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.  
FR.—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.

## Numerical Finding List<sup>1</sup>

Bulletin 2002-1

### Revenue Procedures:

2002-1, 2002-1 I.R.B. *1*  
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<sup>1</sup> A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2001-27 through 2001-53 is in Internal Revenue Bulletin 2002-1, dated January 7, 2002.

## **Finding List of Current Actions on Previously Published Items<sup>2</sup>**

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### **Revenue Procedures:**

#### **84-37**

Modified by  
Rev. Proc. 2002-1, 2002-1 I.R.B. *I*

#### **Rev. Proc. 96-13**

Modified by  
Rev. Proc. 2002-1, 2002-1 I.R.B. *I*

#### **2000-20**

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#### **2001-1**

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#### **2001-2**

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Rev. Proc. 2002-2, 2002-1 I.R.B. *82*

#### **2001-3**

Superseded by  
Rev. Proc. 2002-3, 2002-1 I.R.B. *117*

#### **2001-4**

Superseded by  
Rev. Proc. 2002-4, 2002-1 I.R.B. *127*

#### **2001-5**

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Rev. Proc. 2002-5, 2002-1 I.R.B. *173*

#### **2001-6**

Superseded by  
Rev. Proc. 2002-6, 2002-1 I.R.B. *203*

#### **2001-7**

Superseded by  
Rev. Proc. 2002-7, 2002-1 I.R.B. *249*

#### **2001-8**

Superseded by  
Rev. Proc. 2002-8, 2002-1 I.R.B. *252*

#### **2001-36**

Superseded by  
Rev. Proc. 2002-3, 2002-1 I.R.B. *117*

#### **2001-41**

Superseded by  
Rev. Proc. 2002-2, 2002-1 I.R.B. *82*

#### **2001-51**

Superseded by  
Rev. Proc. 2002-3, 2002-1 I.R.B. *117*

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<sup>2</sup> A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2001-27 through 2001-53 is in Internal Revenue Bulletin 2002-1, dated January 7, 2002.