Internal Revenue
bulletin

Bulletin No. 2005-2
January 10, 2005

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. 2005–1, page 258.

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period January through March 2005. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2005.

Rev. Rul. 2005–2, page 259.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for January 2005.

Notice 2005–1, page 274.

This notice provides general and transitional guidance relating to new section 409A of the Code, added as part of the American Jobs Creation Act of 2004. Section 409A provides certain rules relating to nonqualified deferred compensation plans, which generally are effective as of January 1, 2005. This notice provides general guidance with respect to what arrangements are covered by section 409A. In addition, this notice provides transitional guidance generally covering the calendar year 2005.

EMPLOYEE PLANS

Notice 2005–1, page 274.

This notice provides general and transitional guidance relating to new section 409A of the Code, added as part of the American Jobs Creation Act of 2004. Section 409A provides certain rules relating to nonqualified deferred compensation plans, which generally are effective as of January 1, 2005. This notice provides general guidance with respect to what arrangements are covered by section 409A. In addition, this notice provides transitional guidance generally covering the calendar year 2005.

EMPLOYMENT TAX

T.D. 9167, page 261.

Final regulations under sections 3121(b)(10) and 3306(c)(10)(B) of the Code provide guidance on the student services exception from Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes. The regulations provide guidance on whether an employer is considered a "school, college, or university," and whether an employee is considered a "student" for purposes of the student exceptions from FICA and FUTA taxes. Schools, colleges, and universities are affected by this regulation.

Rev. Proc. 2005–11, page 307.

This procedure provides a safe harbor that certain institutions of higher education and certain affiliated organizations can use in applying the exception for services performed by students provided under section 3121(b)(10) of the Code. Rev. Proc. 98–16 modified and superseded.

(Continued on the next page)

Announcements of Disbarments and Suspensions begin on page 319.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

EXCISE TAX

Notice 2005–4, page 289.
This notice provides guidance on certain excise tax provisions in section 4081 of the Code that were added or affected by the American Jobs Creation Act of 2004. These provisions relate to alcohol and biodiesel fuels, the definition of off-highway vehicles, aviation-grade kerosene, claims related to diesel fuel used in certain buses, the display of registration on certain vessels, claims related to sales of gasoline to state and local governments and nonprofit educational organizations, two party exchanges of taxable fuel, and the classification of transmix and certain diesel fuel blendstocks as diesel fuel. Also, this notice requests comments from the public on these provisions, as well as other excise tax provisions, that were added or affected by the Act. Notices 88–30, 88–132, 89–29, and 89–38 obsoleted.

TAX CONVENTIONS

Announcement 2005–3, page 270.
U.S. and Swiss pension plans for tax treaty benefits. A copy of the news release issued by the Director, International (U.S. Competent Authority), on December 10, 2004, is set forth.

ADMINISTRATIVE

Rev. Proc. 2005–9, page 303.
This document provides administrative procedures under which a taxpayer may obtain automatic consent to change to a method of accounting provided in sections 1.263(a)–4, 1.263(a)–5, and 1.167(a)–3(b) of the regulations for the taxpayer's second taxable year ending on or after December 31, 2003. Rev. Proc. 2002–9 modified and amplified.

Rev. Proc. 2005–12, page 311.
This procedure permits a taxpayer under the jurisdiction of the Large and Mid-Size Business Division (LMSB) to enter into an LMSB Pre-Filing Agreement (PFA), an agreement that determines certain issues before the taxpayer files any return relating to those issues. This procedure expands the scope of the current PFA program. Rev. Proc. 2001–22 superseded.

Announcement 2005–4, page 319.
This document corrects a clerical error in Rev. Proc. 2004–35, 2004–23 I.R.B. 1029. Specifically, the document changes the estimated total annual reporting burden under the Paperwork Reduction Act to 200 hours. Rev. Proc. 2004–35 corrected.

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 compiled 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 last 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 last Bulletin of each semiannual period.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

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 2005. See Rev. Rul. 2005-2, page 259.

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period January through March 2005. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2005.

Rev. Rul. 2005–1

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of bond factor amounts for dispositions occurring during each calendar month.

Rev. Proc. 99–11, 1999–1 C.B. 275, established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of the low-income housing tax credits under § 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99–11 for dispositions of qualified low-income buildings or interests therein during the period January through March 2005.

Table 1
Rev. Rul. 2005–1
Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Jan '05	14.99	27.92	39.03	48.55	56.77	56.71	56.86	57.15	57.52	58.00	58.83
Feb '05	14.99	27.92	39.03	48.55	56.77	56.59	56.74	57.04	57.41	57.89	58.72
Mar '05	14.99	27.92	39.03	48.55	56.77	56.47	56.63	56.93	57.30	57.79	58.61

Table 1 (cont'd)
Rev. Rul. 2005–1
Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	2002	2003	2004	2005							
Jan '05	59.92	61.22	62.49	62.68							
Feb '05	59.80	61.09	62.33	62.68							
Mar '05	59.69	60.97	62.19	62.68							

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see: Rev. Rul. 98–3, 1998–1 C.B. 248; Rev. Rul. 2001–2, 2001–1 C.B. 255; Rev. Rul. 2001–53, 2001–2 C.B. 488; Rev. Rul. 2002–72, 2002–2 C.B. 759; Rev. Rul. 2003–117, 2003–2 C.B. 1051; and Rev. Rul. 2004–100, 2004–44 I.R.B. 718.

DRAFTING INFORMATION

The principal author of this revenue ruling is David McDonnell of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. McDonnell at (202) 622–3040 (not a toll-free call).

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of January 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

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, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for January 2005.

Rev. Rul. 2005–2

This revenue ruling provides various prescribed rates for federal income tax purposes for January 2005 (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 2005 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 was made.

REV. RUL. 2005–2 TABLE 1

Applicable Federal Rates (AFR) for January 2005

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	2.78%	2.76%	2.75%	2.74%
110% AFR	3.06%	3.04%	3.03%	3.02%
120% AFR	3.34%	3.31%	3.30%	3.29%
130% AFR	3.62%	3.59%	3.57%	3.56%
Mid-term				
AFR	3.76%	3.73%	3.71%	3.70%
110% AFR	4.14%	4.10%	4.08%	4.07%
120% AFR	4.53%	4.48%	4.46%	4.44%
130% AFR	4.91%	4.85%	4.82%	4.80%
150% AFR	5.68%	5.60%	5.56%	5.54%
175% AFR	6.64%	6.53%	6.48%	6.44%
Long-term				
AFR	4.76%	4.70%	4.67%	4.65%
110% AFR	5.24%	5.17%	5.14%	5.12%
120% AFR	5.72%	5.64%	5.60%	5.57%
130% AFR	6.20%	6.11%	6.06%	6.03%

REV. RUL. 2005–2 TABLE 2

Adjusted AFR for January 2005

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	2.01%	2.00%	2.00%	1.99%
Mid-term adjusted AFR	2.97%	2.95%	2.94%	2.93%
Long-term adjusted AFR	4.27%	4.23%	4.21%	4.19%

REV. RUL. 2005–2 TABLE 3

Rates Under Section 382 for January 2005

Adjusted federal long-term rate for the current month	4.27%
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.)	4.27%

REV. RUL. 2005–2 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for January 2005

Appropriate percentage for the 70% present value low-income housing credit	7.99%
Appropriate percentage for the 30% present value low-income housing credit	3.42%

REV. RUL. 2005–2 TABLE 5	
Rate Under Section 7520 for January 2005	
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	4.60%

REV. RUL. 2005–2 TABLE 6	
Deemed Rate for Transfers to New Pooled Income Funds During 2005	
Deemed rate of return for transfers during 2005 to pooled income funds that have been in existence for less than 3 taxable years	4.0%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2005. See Rev. Rul. 2005-2, page 259.

Section 3121.—Definitions

26 CFR 31.3121(b)(10)–2: Services performed by certain students in the employ of a school, college, or university, or of a nonprofit organization auxiliary to a school, college, or university.

T.D. 9167

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 31

Student FICA Exception

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulation.

SUMMARY: This document contains final regulations providing guidance regarding the employment tax exceptions for student services. These regulations affect schools, colleges, and universities and their employees.

DATES: *Effective Date*: December 21, 2004.

Applicability Date: These regulations are applicable for services performed on or after April 1, 2005.

FOR FURTHER INFORMATION CONTACT: John Richards of the Office of Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622–6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 31 under sections 3121(b)(10) and 3306(c)(10)(B) of the Internal Revenue Code (Code). These sections except from "employment" for Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) purposes, respectively, service performed in the employ of a school, college, or university by a student who is enrolled and regularly attending classes at such school, college, or university. In addition, this document contains amendments to 26 CFR part 31 under section 3121(b)(2). This section excepts from employment for FICA purposes domestic service performed in a local college club, or local chapter of a college fraternity or sorority, by a student who is enrolled and is regularly attending cases at a school, college, or university.

Proposed regulations under sections 3121(b)(2), 3121(b)(10), and 3306(c)(10)(B) were published in the **Federal Register** on February 25, 2004 (REG–156421–03, 2004–10 I.R.B. 571 [69 FR 8604]). Written and electronic comments responding to the notice of proposed rulemaking were received. A public hearing was held on June 16, 2004. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

Explanation of Provisions and Summary of Comments

The final regulations provide rules for determining whether an organization is a school, college, or university (SCU) and whether an employee is a student for purposes of sections 3121(b)(10), 3121(b)(2), and 3306(c)(10)(B) of the Code. Many comments were received on the proposed regulations and several witnesses testified at the hearing which was held June 16, 2004. After consideration of the comments and testimony, the Treasury department and the IRS decided to make several significant changes described below.

1. *School, College, or University*

The exceptions from employment for student services apply only if the employee is a student enrolled and regularly attending classes at a SCU. Under the proposed regulations, whether an organization is a SCU is determined with reference to the organization's primary function. An organization whose primary function is to carry on educational activities qualifies as a SCU for purposes of the student exceptions from employment.

A few commentators suggested that an organization, such as a teaching hospital, that has embedded within it a division or function that carries on educational activities should be treated as a SCU for purposes of the student exceptions from employment.

The final regulations retain the primary function standard as described in the proposed regulations. As discussed in the preamble to the proposed regulations, the primary function standard is based upon the existing statutory and regulatory language under section 3121(b)(10), as well as the

legislative history relating to the student exception from employment under section 3121(b)(10).

2. *Enrolled and Regularly Attending Classes*

The exceptions from employment for student services require that an employee be "enrolled and regularly attending classes" in order to have the status of a student. Under the proposed regulations, "a class is an instructional activity led by a knowledgeable *faculty member* for identified students following an established curriculum."

Commentators requested clarification regarding whether an instructional activity must be led by a regular faculty member in order to be considered a class, or whether an activity led by an adjunct faculty member, graduate teaching assistant, or other qualified individual hired to lead the activity could be considered a class.

The final regulations clarify that a class is an instructional activity led by a faculty member "or other qualified individual" following an established curriculum. Thus, an instructional activity led by an adjunct faculty member, graduate assistant, or other qualified individual can qualify as a class for purposes of the student exceptions from employment.

3. *Student Status*

The existing student FICA regulations provide that an employee whose services are incident to and for the purpose of pursuing a course of study has the status of a student. §31.3121(b)(10)–2(c). The proposed regulations provide that in order for an employee's services to be considered incident to and for the purpose of pursuing a course of study, the educational aspect of the relationship between the employee and the employer, as compared to the service aspect, must be predominant. Under the proposed regulations, if an employee is a "career employee," then the service aspect of the employee's relationship with the employer is considered predominant, and thus the employee's services are not considered incident to and for the purpose of pursuing a course of study. The proposed regulations provide that the following employees are considered career employees: (1) employees who regularly perform services 40 hours or more per week; (2) professional employees; (3) employees who receive certain employment benefits; and (4) employees required to be licensed to work in the field in which the employees are performing services. The IRS requested comments on the criteria used to identify employees having the status of a career employee.

Commentators expressed concern about using these criteria to make certain employees automatically ineligible for the student FICA exception. Rather, according to commentators, whether an employee's services are incident to and for the purpose of pursuing a course of study should be based upon all the relevant facts and circumstances.

The final regulations provide that the educational and service aspects of an employee's relationship with the employer are generally evaluated for an academic term based upon all the relevant facts and circumstances. Similar criteria to those identified in the proposed regulations are described in the final regulations as relevant factors, not dispositive criteria, in determining whether the educational or service aspect of an employee's relationship with the employer is predominant. Nevertheless, under the final regulations, if an employee is a "full-time employee," then the employee's services are not incident to and for the purpose of pursuing a course of study. In addition, based upon comments received, the criteria identified in the proposed regulations have been modified as described below.

A. *Full-Time Employee and Hours Worked*

The proposed regulations provide that an employee who "regularly performs services 40 hours or more per week" is a career employee, and is thus ineligible for the student exception from employment. Commentators expressed concern that the 40 hour criterion would be administratively impracticable because it would be difficult to monitor an employee's actual hours worked during an academic term. In addition, commentators expressed concern that the meaning of "regularly" is unclear, making it difficult to assess the effect of changes in hours worked from week to week. Commentators also requested clarification on whether an employee's number of hours worked during academic breaks is considered in determining whether the employee is eligible for the student FICA exception.

The final regulations modify the hours worked criterion. The final regulations provide that the services of a "full-time employee" are not incident to and for the purpose of pursuing a course of study. Under the final regulations, a full-time employee is an employee who is considered a full-time employee based upon the employer's standards and practices, except that an employee whose "normal work schedule is 40 hours or more per week" is considered a full-time employee. This standard is intended to improve administrability for employers. Whether an employee is a full-time employee based upon the employer's standards and practices, or based upon the employee's normal work schedule, should be determinable by employers at the start of an academic term, thus reducing instances where an employee's status shifts from student to non-student during an academic term. An employee's normal work schedule does not change, for example, based upon changes in work demands that are unforeseen at the start of an academic term causing the employee to work additional hours beyond his normal work schedule. In addition, time spent performing services that have an educational or instructional aspect is considered in determining an employee's normal work schedule. Finally, the final regulations provide that an employee's work schedule during an academic break is not considered in determining whether the employee's normal work schedule is 40 hours or more per week.

The final regulations provide that if an employee does not have the status of a full-time employee, then the employee's normal work schedule and actual number of hours worked per week are relevant factors in determining whether the service aspect or educational aspect of the employee's relationship with the employer is predominant. Thus, if an employee is normally scheduled to work 20 hours per week, but consistently works more than 40 hours per week, the amount of time actually worked is taken into account in determining whether or not the employee qualifies as a student.

B. *Professional Employee and Licensure*

1. *Professional Employee*

The proposed regulations provide that a "professional employee" is a career employee, and is thus ineligible for the student exception from employment. Under the proposed regulations, a professional employee is an employee who performs work: (1) requiring knowledge of an advanced type in a field of science or learning, (2) requiring the consistent exercise of discretion and judgment, and (3) that is predominantly intellectual and varied in character.

Commentators expressed concern that the professional employee criterion would inappropriately disqualify the services of many graduate research and teaching assistants from eligibility for the student exceptions from employment. Commentators maintained that graduate research and teaching assistants are primarily students, and thus their services should not automatically be ineligible for the student exceptions based upon the professional employee criterion.

The final regulations provide that whether an employee is a professional employee is a relevant factor, not a dispositive criterion, in evaluating the service aspect of the employee's relationship with the employer. Under the final regulations, if an employee has the status of a professional employee, then that suggests the service aspect of the employee's relationship with the employer is predominant. Whether a professional employee is a student will depend upon all the facts and circumstances. Thus, under the final regulations, those graduate assistants and other employees whose work is described under the professional employee standard are not automatically ineligible for the student exception.

2. *Licensure*

The proposed regulations provide that an employee who is required to be licensed under state or local law to work in the field in which the employee performs services is a career employee, and is thus ineligible for the student exception. The preamble to the proposed regulations requested comments on the licensure criterion and whether this criterion should be further refined or clarified.

Commentators expressed concern that the licensure criterion under the proposed regulations is overly broad because it would cause employees licensed for health and safety reasons, such as van drivers and life guards, to be ineligible for student status.

Under the final regulations, an employee's licensure status is not a dispositive criterion. Instead, the final regulations provide if an employee is a professional employee, then whether the employee is licensed is a relevant factor in determining whether the service aspect of the employee's relationship with the employer is predominant. The final regulations provide that if an employee has the status of a licensed, professional employee, then that fact further suggests that the service aspect of the employee's relationship with the employer is predominant. However, a worker who is a licensed, professional employee could be considered a student based upon all the relevant facts and circumstances.

C. *Employment Benefits*

The proposed regulations provide that an employee who is eligible to receive certain employment benefits is considered a career employee, and is thus ineligible for the student exception.

Commentators expressed concern that eligibility to receive employment benefits should not disqualify an individual from the student exception. Commentators noted that some state statutes make student employees eligible for retirement and other benefits, meaning that student employees in those states could not qualify as students under the proposed regulations. In addition, commentators noted that many colleges and universities permit student employees to make elective contributions to section 403(b) arrangements. Under the proposed regulations, offering this benefit would prohibit student employees from qualifying as students for purposes of the student exceptions from employment.

The final regulations provide that eligibility to receive employment benefits is a relevant factor, not a dispositive criterion, in determining whether the service aspect of an employee's relationship with the employer is predominant. Thus, an employee who is eligible for employment benefits can still qualify as a student for purposes of the student exceptions from employment. In addition, the final regulations provide that eligibility to receive health insurance benefits is not considered in determining whether the service aspect is predominant, and eligibility for benefits mandated by state or local law is given less weight in determining whether the service aspect is predominant.

4. *Effective Date*

Commentators objected to the proposed effective date of February 25, 2004, asserting that it would take some time to adjust to the new rules set forth in the proposed regulations. In response to these comments, the final regulations are applicable with respect to services performed on or after April 1, 2005.

5. *Revenue Procedure Replacing Rev. Proc. 98–16*

When the IRS issued the proposed regulations, it also issued Notice 2004–12, 2004–10 I.R.B. 556, suspending Rev. Proc. 98–16, 1998–1 C.B. 403, and proposing to replace it with a revenue procedure that is consistent with the proposed regulations. The IRS solicited comments on the proposed revenue procedure. Comments were received and considered in conjunction with the comments on the proposed regulations. The proposed revenue procedure has been modified in response to comments, and in order to provide guidance that is consistent with the final regulations, is being issued in final form in Rev. Proc. 2005–11 (to be published in I.R.B. 2005–2) modifying and superseding Rev. Proc. 98–16. Rev. Proc. 2005–11 is applicable with respect to services performed on or after April 1, 2005. Taxpayers may rely upon Rev. Proc. 98–16 with respect to services performed prior to April 1, 2005.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. In

addition, because no collection of information is imposed on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small business.

Drafting Information

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

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

Part 31—EMPLOYMENT TAXES

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

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

Par. 2. In § 31.3121(b)(2)–1, paragraph (d) is revised to read as follows:

§ 31.3121(b)(2)–1 Domestic service performed by students for certain college organizations.

* * * * *

(d) An organization is a *school, college, or university* within the meaning of section 3121(b)(2) if its primary function is the presentation of formal instruction, it normally maintains a regular faculty and curriculum, and it normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. See section 170(b)(1)(A)(ii) and the regulations thereunder.

* * * * *

Par. 3. Section 31.3121(b)(10)–2 is amended by:

1. Revising paragraphs (a), (b), (c) and (d).

2. Redesignating paragraph (e) as (g).

3. Adding paragraphs (e) and (f).

The revisions and additions read as follows:

§ 31.3121(b)(10)–2 Services performed by certain students in the employ of a school, college, or university, or of a nonprofit organization auxiliary to a school, college, or university.

(a) *General rule*. (1) Services performed in the employ of a school, college, or university within the meaning of paragraph (c) of this section (whether or not the organization is exempt from income tax) are excepted from employment, if the services are performed by a student within the meaning of paragraph (d) of this section who is enrolled and is regularly attending classes at the school, college, or university.

(2) Services performed in the employ of an organization which is—

(i) Described in section 509(a)(3) and §1.509(a)–4;

(ii) Organized, and at all times thereafter operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of a school, college, or university within the meaning of paragraph (c) of this section; and

(iii) Operated, supervised, or controlled by or in connection with the school, college, or university; are excepted from employment, if the services are performed by a student who is enrolled and regularly attending classes within the meaning of paragraph (d) of this section at the school, college, or university. The preceding sentence shall not apply to services performed in the employ of a school, college, or university of a State or a political subdivision thereof by a student referred to in section 218(c)(5) of the Social Security Act (42 U.S.C. 418(c)(5)) if such services are covered under the agreement between the Commissioner of Social Security and such State entered into pursuant to section 218 of such Act. For the definitions of "operated, supervised, or controlled by", "supervised or controlled in connection with", and "operated in connection with", see paragraphs (g), (h), and (i), respectively, of §1.509(a)–4.

(b) *Statutory tests*. For purposes of this section, if an employee has the status of a student within the meaning of paragraph (d) of this section, the amount of remuneration for services performed by the employee, the type of services performed by the employee, and the place where the services are performed are not material. The statutory tests are:

(1) The character of the organization in the employ of which the services are performed as a school, college, or university within the meaning of paragraph (c) of this section, or as an organization described in paragraph (a)(2) of this section, and

(2) The status of the employee as a student enrolled and regularly attending classes within the meaning of paragraph (d) of this section at the school, college, or university within the meaning of paragraph (c) of this section by which the employee is employed or with which the employee's employer is affiliated within the meaning of paragraph (a)(2) of this section.

(c) *School, College, or University*. An organization is a *school, college, or university* within the meaning of section 3121(b)(10) if its primary function is the presentation of formal instruction, it normally maintains a regular faculty and curriculum, and it normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. See section 170(b)(1)(A)(ii) and the regulations thereunder.

(d) *Student Status—general rule*. Whether an employee has the status of a student performing the services shall be determined based on the relationship of the employee with the organization employing the employee. In order to have the status of a student, the employee must perform services in the employ of a school, college, or university within the meaning of paragraph (c) of this section at which the employee is enrolled and regularly attending classes in pursuit of a course of study within the meaning of paragraphs (d)(1) and (2) of this section. In addition, the employee's services must be incident to and for the purpose of pursuing a course of study within the meaning of paragraph (d)(3) of this section at such school, college, or university. An employee who performs services in the employ of an affiliated organization within the meaning of paragraph (a)(2) of this section must be enrolled and regularly attending classes at the affiliated school, college, or university

within the meaning of paragraph (c) of this section in pursuit of a course of study within the meaning of paragraphs (d)(1) and (2) of this section. In addition, the employee's services must be incident to and for the purpose of pursuing a course of study within the meaning of paragraph (d)(3) of this section at such school, college, or university.

(1) *Enrolled and regularly attending classes*. An employee must be enrolled and regularly attending classes at a school, college, or university within the meaning of paragraph (c) of this section at which the employee is employed to have the status of a student within the meaning of section 3121(b)(10). An employee is enrolled within the meaning of section 3121(b)(10) if the employee is registered for a course or courses creditable toward an educational credential described in paragraph (d)(2) of this section. In addition, the employee must be regularly attending classes to have the status of a student. For purposes of this paragraph (d)(1), a class is an instructional activity led by a faculty member or other qualified individual hired by the school, college, or university within the meaning of paragraph (c) of this section for identified students following an established curriculum. Traditional classroom activities are not the sole means of satisfying this requirement. For example, research activities under the supervision of a faculty advisor necessary to complete the requirements for a Ph.D. degree may constitute classes within the meaning of section 3121(b)(10). The frequency of these and similar activities determines whether an employee may be considered to be regularly attending classes.

(2) *Course of study*. An employee must be pursuing a course of study in order to have the status of a student. A course of study is one or more courses the completion of which fulfills the requirements necessary to receive an educational credential granted by a school, college, or university within the meaning of paragraph (c) of this section. For purposes of this paragraph, an educational credential is a degree, certificate, or other recognized educational credential granted by an organization described in paragraph (c) of this section. A course of study also includes one or more courses at a school, college or university within the meaning of paragraph (c) of this section the completion of which fulfills the requirements necessary for the employee to sit for an examination required to receive certification by a recognized organization in a field.

(3) *Incident to and for the purpose of pursuing a course of study*. (i) *General rule*. An employee's services must be incident to and for the purpose of pursuing a course of study in order for the employee to have the status of a student. Whether an employee's services are incident to and for the purpose of pursuing a course of study shall be determined on the basis of the relationship of the employee with the organization for which such services are performed as an employee. The educational aspect of the relationship between the employer and the employee, as compared to the service aspect of the relationship, must be predominant in order for the employee's services to be incident to and for the purpose of pursuing a course of study. The educational aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The service aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the employee's employment. The evaluation of the service aspect of the relationship is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect. Except as provided in paragraph (d)(3)(iii) of this section, whether the educational aspect or the service aspect of an employee's relationship with the employer is predominant is determined by considering all the relevant facts and circumstances. Relevant factors in evaluating the educational and service aspects of an employee's relationship with the employer are described in paragraphs (d)(3)(iv) and (v) of this section respectively. There may be facts and circumstances that are relevant in evaluating the educational and service aspects of the relationship in addition to those described in paragraphs (d)(3)(iv) and (v) of this section.

(ii) *Student status determined with respect to each academic term*. Whether an employee's services are incident to and for the purpose of pursuing a course of study is determined separately with respect to each academic term. If the relevant facts and circumstances with respect to an employee's relationship with the employer change significantly during an academic term, whether the employee's services are incident to and for the purpose of pursuing a course of study is reevaluated with respect to services performed during the remainder of the academic term.

(iii) *Full-time employee*. The services of a full-time employee are not incident to and for the purpose of pursuing a course of study. The determination of whether an employee is a full-time employee is based on the employer's standards and practices, except regardless of the employer's classification of the employee, an employee whose normal work schedule is 40 hours or more per week is considered a full-time employee. An employee's normal work schedule is not affected by increases in hours worked caused by work demands unforeseen at the start of an academic term. However, whether an employee is a full-time employee is reevaluated for the remainder of the academic term if the employee changes employment positions with the employer. An employee's work schedule during academic breaks is not considered in determining whether the employee's normal work schedule is 40 hours or more per week. The determination of an employee's normal work schedule is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect.

(iv) *Evaluating educational aspect*. The educational aspect of an employee's relationship with the employer is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The educational aspect of an employee's relationship with the employer is generally evaluated based on the employee's course workload. Whether an employee's course workload is sufficient in order for the employee's employment to be incident to and for the purpose of pursuing a course of study depends on the particular facts and circumstances. A relevant factor in evaluating an employee's course workload is the employee's course workload relative to a full-time course workload at the school, college or university within the meaning of paragraph (c) of this section at which the employee is enrolled and regularly attending classes.

(v) *Evaluating service aspect*. The service aspect of an employee's relationship with the employer is evaluated based on

the facts and circumstances related to the employee's employment. Services of an employee with the status of a full-time employee within the meaning of paragraph (d)(3)(iii) of this section are not incident to and for the purpose of pursuing a course of study. Relevant factors in evaluating the service aspect of an employee's relationship with the employer are described in paragraphs (d)(3)(v)(A), (B), and (C) of this section.

(A) *Normal work schedule and hours worked*. If an employee is not a full-time employee within the meaning of paragraph (d)(3)(iii) of this section, then the employee's normal work schedule and number of hours worked per week are relevant factors in evaluating the service aspect of the employee's relationship with the employer. As an employee's normal work schedule or actual number of hours worked approaches 40 hours per week, it is more likely that the service aspect of the employee's relationship with the employer is predominant. The determination of an employee's normal work schedule and actual number of hours worked is not affected by the fact that some of the services performed by the employee may have an educational, instructional, or training aspect.

(B) *Professional employee*.

(*1*) If an employee has the status of a professional employee, then that suggests the service aspect of the employee's relationship with the employer is predominant. A professional employee is an employee—

(i) Whose primary duty consists of the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study, as distinguished from a general academic education, from an apprenticeship, and from training in the performance of routine mental, manual, or physical processes;

(ii) Whose work requires the consistent exercise of discretion and judgment in its performance; and

(iii) Whose work is predominantly intellectual and varied in character (as opposed to routine mental, manual, mechanical, or physical work) and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

(2) Licensed, professional employee. If an employee is a licensed, professional employee, then that further suggests the service aspect of the employee's relationship with the employer is predominant. An employee is a licensed, professional employee if the employee is required to be licensed under state or local law to work in the field in which the employee performs services and the employee is a professional employee within the meaning of paragraph (d)(3)(v)(B)(1) of this section.

(C) *Employment Benefits*. Whether an employee is eligible to receive one or more employment benefits is a relevant factor in evaluating the service aspect of an employee's relationship with the employer. For example, eligibility to receive vacation, paid holiday, and paid sick leave benefits; eligibility to participate in a retirement plan or arrangement described in sections 401(a), 403(b), or 457(a); or eligibility to receive employment benefits such as reduced tuition (other than qualified tuition reduction under section 117(d)(5) provided to a teaching or research assistant who is a graduate student), or benefits under sections 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), or 137 (adoption assistance) suggest that the service aspect of an employee's relationship with the employer is predominant. Eligibility to receive health insurance employment benefits is not considered in determining whether the service aspect of an employee's relationship with the employer is predominant. The weight to be given the fact that an employee is eligible for a particular employment benefit may vary depending on the type of benefit. For example, eligibility to participate in a retirement plan is generally more significant than eligibility to receive a dependent care employment benefit. Additional weight is given to the fact that an employee is eligible to receive an employment benefit if the benefit is generally provided by the employer to employees in positions generally held by non-students. Less weight is given to the fact that an employee is eligible to receive an employment benefit if eligibility for the benefit is mandated by state or local law.

(e) *Examples*. The following examples illustrate the principles of paragraphs (a) through (d) of this section:

Example 1. (i) Employee C is employed by State University T to provide services as a clerk in T's administrative offices, and is enrolled and regularly attending classes at T in pursuit of a B.S. degree in biology. C has a course workload during the academic term which constitutes a full-time course workload at T. C is considered a part-time employee by T during the academic term, and C's normal work schedule is 20 hours per week, but occasionally due to work demands unforeseen at the start of the academic term C works 40 hours or more during a week. C is compensated by hourly wages, and receives no other compensation or employment benefits.

(ii) In this *example*, C is employed by T, a school, college, or university within the meaning of paragraph (c) of this section. C is enrolled and regularly attending classes at T in pursuit of a course of study. C is not a full-time employee based on T's standards, and C's normal work schedule does not cause C to have the status of a full-time employee, even though C may occasionally work 40 hours or more during a week due to unforeseen work demands. C's part-time employment relative to C's full-time course workload indicates that the educational aspect of C's relationship with T is predominant. Additional facts supporting this conclusion are that C is not a professional employee, and C does not receive any employment benefits. Thus, C's services are incident to and for the purpose of pursuing a course of study. Accordingly, C's services are excepted from employment under section 3121(b)(10).

Example 2. (i) Employee D is employed in the accounting department of University U, and is enrolled and regularly attending classes at U in pursuit of an M.B.A. degree. D has a course workload which constitutes a half-time course workload at U. D is considered a full-time employee by U under U's standards and practices.

(ii) In this *example*, D is employed by U, a school, college, or university within the meaning of paragraph (c) of this section. In addition, D is enrolled and regularly attending classes at U in pursuit of a course of study. However, because D is considered a full-time employee by U under its standards and practices, D's services are not incident to and for the purpose of pursuing a course of study. Accordingly, D's services are not excepted from employment under section 3121(b)(10).

Example 3. (i) The facts are the same as in *Example 2*, except that D is not considered a full-time employee by U, and D's normal work schedule is 32 hours per week. In addition, D's work is repetitive in nature and does not require the consistent exercise of discretion and judgment, and is not predominantly intellectual and varied in character. However, D receives vacation, sick leave, and paid holiday employment benefits, and D is eligible to participate in a retirement plan maintained by U described in section 401(a).

(ii) In this *example*, D's half-time course workload relative to D's hours worked and eligibility for employment benefits indicates that the service aspect of D's relationship with U is predominant, and thus D's services are not incident to and for the purpose of pursuing a course of study. Accordingly, D's ser-

vices are not excepted from employment under section 3121(b)(10).

Example 4. (i) Employee E is employed by University V to provide patient care services at a teaching hospital that is an unincorporated division of V. These services are performed as part of a medical residency program in a medical specialty sponsored by V. The residency program in which E participates is accredited by the Accreditation Counsel for Graduate Medical Education. Upon completion of the program, E will receive a certificate of completion, and be eligible to sit for an examination required to be certified by a recognized organization in the medical specialty. E's normal work schedule, which includes services having an educational, instructional, or training aspect, is 40 hours or more per week.

(ii) In this *example*, E is employed by V, a school, college, or university within the meaning of paragraph (c) of this section. However, E's normal work schedule calls for E to perform services 40 or more hours per week. E is therefore a full-time employee, and the fact that some of E's services have an educational, instructional, or training aspect does not affect that conclusion. Thus, E's services are not incident to and for the purpose of pursuing a course of study. Accordingly, E's services are not excepted from employment under section 3121(b)(10) and there is no need to consider other relevant factors, such as whether E is a professional employee or whether E is eligible for employment benefits.

Example 5. (i) Employee F is employed in the facilities management department of University W. F has a B.S. degree in engineering, and is completing the work experience required to sit for an examination to become a professional engineer eligible for licensure under state or local law. F is not attending classes at W.

(ii) In this *example*, F is employed by W, a school, college, or university within the meaning of paragraph (c) of this section. However, F is not enrolled and regularly attending classes at W in pursuit of a course of study. F's work experience required to sit for the examination is not a course of study for purposes of paragraph (d)(2) of this section. Accordingly, F's services are not excepted from employment under section 3121(b)(10).

Example 6. (i) Employee G is employed by Employer X as an apprentice in a skilled trade. X is a subcontractor providing services in the field in which G wishes to specialize. G is pursuing a certificate in the skilled trade from Community College C. G is performing services for X pursuant to an internship program sponsored by C under which its students gain experience, and receive credit toward a certificate in the trade.

(ii) In this *example*, G is employed by X. X is not a school, college or university within the meaning of paragraph (c) of this section. Thus, the exception from employment under section 3121(b)(10) is not available with respect to G's services for X.

Example 7. (i) Employee H is employed by a cosmetology school Y at which H is enrolled and regularly attending classes in pursuit of a certificate of completion. Y's primary function is to carry on educational activities to prepare its students to work in the field of cosmetology. Prior to issuing a certificate, Y requires that its students gain experience in cosmetology services by performing services for the general public on Y's premises. H is scheduled to work and in fact works significantly less than 30 hours per week. H's work does not require knowledge of an advanced type in a field of science or learning, nor is it predominantly intellectual and varied in character. H receives remuneration in the form of hourly compensation from Y for providing cosmetology services to clients of Y, and does not receive any other compensation and is not eligible for employment benefits provided by Y.

(ii) In this *example*, H is employed by Y, a school, college or university within the meaning of paragraph (c) of this section, and is enrolled and regularly attending classes at Y in pursuit of a course of study. Factors indicating the educational aspect of H's relationship with Y is predominant are that H's hours worked are significantly less than 30 per week, H is not a professional employee, and H is not eligible for employment benefits. Based on the relevant facts and circumstances, the educational aspect of H's relationship with Y is predominant. Thus, H's services are incident to and for the purpose of pursuing a course of study. Accordingly, H's services are excepted from employment under section 3121(b)(10).

Example 8. (i) Employee J is a graduate teaching assistant at University Z. J is enrolled and regularly attending classes at Z in pursuit of a graduate degree. J has a course workload which constitutes a full-time course workload at Z. J's normal work schedule is 20 hours per week, but occasionally due to work demands unforeseen at the start of the academic term J works more than 40 hours during a week. J's duties include grading quizzes and exams pursuant to guidelines set forth by the professor, providing class and laboratory instruction pursuant to a lesson plan developed by the professor, and preparing laboratory equipment for demonstrations. J receives a cash stipend and employment benefits in the form of eligibility to make elective employee contributions to an arrangement described in section 403(b). In addition, J receives qualified tuition reduction benefits within the meaning of section 117(d)(5) with respect to the tuition charged for the credits earned for being a graduate teaching assistant.

(ii) In this *example*, J is employed by Z, a school, college, or university within the meaning of paragraph (c) of this section, and is enrolled and regularly attending classes at Z in pursuit of a course of study. J's full-time course workload relative to J's normal work schedule of 20 hours per week indicates that the educational aspect of J's relationship with Z is predominant. In addition, J is not a professional employee because J's work does not require the consistent exercise of discretion and judgment in its performance. On the other hand, the fact that J receives employment benefits in the form of eligibility to make elective employee contributions to an arrangement described in section 403(b) indicates that the employment aspect of J's relationship with Z is predominant. Balancing the relevant facts and circumstances, the educational aspect of J's relationship with Z is predominant. Thus, J's services are incident to and for the purpose of pursuing a course of study. Accordingly, J services are excepted from employment under section 3121(b)(10).

(f) *Effective date*. Paragraphs (a), (b), (c), (d) and (e) of this section apply to services performed on or after April 1, 2005.

* * * * *

Par. 4. In §31.3306(c)(10)–2:

1. Paragraph (c) is revised.

2. Paragraphs (d) and (e) are added.

The revision and addition read as follows:

§ 31.3306(c)(10)–2 Services of student in employ of a school, college, or university.

* * * * *

(c) *General rule*. (1) For purposes of this section, the tests are the character of the organization in the employ of which the services are performed and the status of the employee as a student enrolled and regularly attending classes at the school, college, or university described in paragraph (c)(2) of this section, in the employ of which the employee performs the services. If an employee has the status of a student within the meaning of paragraph (d) of this section, the type of services performed by the employee, the place where the services are performed, and the amount of remuneration for services performed by the employee are not material.

(2) *School, college, or university*. An organization is a *school, college, or university* within the meaning of section 3306(c)(10)(B) if its primary function is the presentation of formal instruction, it normally maintains a regular faculty and curriculum, and it normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. See section 170(b)(1)(A)(ii) and the regulations thereunder.

(d) *Student Status—general rule*. Whether an employee has the status of a student within the meaning of section 3306(c)(10)(B) performing the services shall be determined based on the relationship of the employee with the organization for which the services are performed. In order to have the status of a student within the meaning of section 3306(c)(10)(B), the employee must perform services in the employ of a school, college, or university described in paragraph (c)(2) of this section at which the employee is enrolled and regularly attending classes in pursuit of a course of study within the meaning of paragraphs (d)(1) and (2) of this section. In addition, the employee's services must be incident to and for the purpose of pursuing a course of study at such school,

college, or university within the meaning of paragraph (d)(3) of this section.

(1) *Enrolled and regularly attending classes*. An employee must be enrolled and regularly attending classes at a school, college, or university within the meaning of paragraph (c)(2) of this section at which the employee is employed to have the status of a student within the meaning of section 3306(c)(10)(B). An employee is enrolled within the meaning of section 3306(c)(10)(B) if the employee is registered for a course or courses creditable toward an educational credential described in paragraph (d)(2) of this section. In addition, the employee must be regularly attending classes to have the status of a student. For purposes of this paragraph (d)(1), a class is an instructional activity led by a faculty member or other qualified individual hired by the school, college, or university within the meaning of paragraph (c)(2) of this section for identified students following an established curriculum. The frequency of these and similar activities determines whether an employee may be considered to be regularly attending classes.

(2) *Course of study*. An employee must be pursuing a course of study in order to have the status of a student within the meaning of section 3306(c)(10)(B). A course of study is one or more courses the completion of which fulfills the requirements necessary to receive an educational credential granted by a school, college, or university within the meaning of paragraph (c)(2) of this section. For purposes of this paragraph, an educational credential is a degree, certificate, or other recognized educational credential granted by an organization described in paragraph (c)(2) of this section. In addition, a course of study is one or more courses at a school, college or university within the meaning of paragraph (c)(2) of this section the completion of which fulfills the requirements necessary for the employee to sit for an examination required to receive certification by a recognized organization in a field.

(3) *Incident to and for the purpose of pursuing a course of study*. (i) *General rule*. An employee's services must be incident to and for the purpose of pursuing a course of study in order for the employee to have the status of a student. Whether an employee's services are incident to and for the purpose of pursuing a course of study shall be determined on the basis of the relationship of the employee with the organization for which such services are performed as an employee. The educational aspect of the relationship between the employer and the employee, as compared to the service aspect of the relationship, must be predominant in order for the employee's services to be incident to and for the purpose of pursuing a course of study. The educational aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The service aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the employee's employment. The evaluation of the service aspect of the relationship is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect. Except as provided in paragraph (d)(3)(iii) of this section, whether the educational aspect or the service aspect of an employee's relationship with the employer is predominant is determined by considering all the relevant facts and circumstances. Relevant factors in evaluating the educational and service aspects of an employee's relationship with the employer are described in paragraphs (d)(3)(iv) and (v) of this section respectively. There may be facts and circumstances that are relevant in evaluating the educational and service aspects of the relationship in addition to those described in paragraphs (d)(3)(iv) and (v) of this section.

(ii) *Student status determined with respect to each academic term*. Whether an employee's services are incident to and for the purpose of pursuing a course of study is determined separately with respect to each academic term. If the relevant facts and circumstances with respect to an employee's relationship with the employer change significantly during an academic term, whether the employee's services are incident to and for the purpose of pursuing a course of study is reevaluated with respect to services performed during the remainder of the academic term.

(iii) *Full-time employee*. The services of a full-time employee are not incident to and for the purpose of pursuing a course of study. The determination of whether an employee is a full-time employee is based on the employer's standards and practices, except regardless of the employer's classification of the employee, an employee whose normal work schedule is 40 hours or more per week is considered a full-time employee. An employee's normal work schedule is not affected by increases in hours worked caused by work demands unforeseen at the start of an academic term. However, whether an employee is a full-time employee is reevaluated for the remainder of the academic term if the employee changes employment positions with the employer. An employee's work schedule during academic breaks is not considered in determining whether the employee's normal work schedule is 40 hours or more per week. The determination of the employee's normal work schedule is not affected by the fact that the services performed by the individual may have an educational, instructional, or training aspect.

(iv) *Evaluating educational aspect*. The educational aspect of an employee's relationship with the employer is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The educational aspect of an employee's relationship with the employer is generally evaluated based on the employee's course workload. Whether an employee's course workload is sufficient in order for the employee's employment to be incident to and for the purpose of pursuing a course of study depends on the particular facts and circumstances. A relevant factor in evaluating an employee's course workload is the employee's course workload relative to a full-time course workload at the school, college or university within the meaning of paragraph (c)(2) of this section at which the employee is enrolled and regularly attending classes.

(v) *Evaluating service aspect*. The service aspect of an employee's relationship with the employer is evaluated based on the facts and circumstances related to the employee's employment. Services of an employee with the status of a full-time employee within the meaning of paragraph (d)(3)(iii) of this section are not incident to and for the purpose of pursuing a course of study. Relevant factors in evaluating the service aspect of an employee's relationship with the employer are described in paragraphs (d)(3)(v)(A), (B), and (C) of this section.

(A) *Normal work schedule and hours worked*. If an employee is not a full-time employee within the meaning of paragraph (d)(3)(iii) of this section, then the employee's normal work schedule and number of hours worked per week are relevant factors in evaluating the service aspect of the employee's relationship with the employer. As an employee's normal work schedule or actual number of hours worked approaches 40 hours per week, it is more likely that the service aspect of the employee's relationship with the employer is predominant. The determination of the employee's normal work schedule and actual number of hours worked is not affected by the fact that some of the services performed by the individual may have an educational, instructional, or training aspect.

(B) *Professional employee*.

(1) If an employee has the status of a professional employee, then that suggests that the service aspect of the employee's relationship with the employer is predominant. A professional employee is an employee—

(i) Whose primary duty consists of the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study, as distinguished from a general academic education, from an apprenticeship, and from training in the performance of routine mental, manual, or physical processes;

(ii) Whose work requires the consistent exercise of discretion and judgment in its performance; and

(iii) Whose work is predominantly intellectual and varied in character (as opposed to routine mental, manual, mechanical, or physical work) and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

(2) Licensed, professional employee. If an employee is a licensed, professional employee, then that further suggests the service aspect of the employee's relationship with the employer is predominant. An employee is a licensed, professional employee if the employee is required to be licensed under state or local law to work in the field in which the employee performs services and the employee is a professional employee within the meaning of paragraph (d)(3)(v)(B)(1) of this section.

(C) *Employment Benefits*. Whether an employee is eligible to receive employment benefits is a relevant factor in evaluating the service aspect of an employee's relationship with the employer. For example, eligibility to receive vacation, paid holiday, and paid sick leave benefits; eligibility to participate in a retirement plan described in section 401(a); or eligibility to receive employment benefits such as reduced tuition, or benefits under section 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), or 137 (adoption assistance) suggest that the service aspect of an employee's relationship with the employer is predominant. Eligibility to receive health insurance employment benefits is not considered in determining whether the service aspect of an employee's relationship with the employer is predominant. The weight to be given the fact that an employee is eligible for a particular benefit may vary depending on the type of employment benefit. For example, eligibility to participate in a retirement plan is generally more significant than eligibility to receive a dependent care employment benefit. Additional weight is given to the fact that an employee is eligible to receive an employment benefit if the benefit is generally provided by the employer to employees in positions generally held by non-students.

(e) *Effective date*. Paragraphs (c) and (d) of this section apply to services performed on or after April 1, 2005.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved December 15, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 20, 2004, 8:45 a.m., and published in the issue of the Federal Register for December 21, 2004, 69 F.R 76404)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2005. See Rev. Rul. 2005-2, page 259.

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 2005. See Rev. Rul. 2005-2, page 259.

Part II. Treaties and Tax Legislation
Subpart A.—Tax Conventions and Other Related Items

Swiss Pension MAP Agreement

Announcement 2005–3

Following is a copy of the News Release issued by the Director, International (U.S. Competent Authority) on December 10, 2004 (IR–2004–146).

Agreement Identifies U.S. and Swiss Pension Plans for Tax Treaty Benefits

IR–2004–146, Dec. 10, 2004

WASHINGTON — The Competent Authorities of Switzerland and the United States have reached a mutual agreement on the qualification of certain Swiss and U.S. pensions for treaty benefits under paragraph 3 of Article 10 (Dividends) of the U.S.-Switzerland income tax treaty. The agreement also specifies the procedures for claiming treaty benefits in each country and the methods each country uses to grant treaty benefits.

The agreement constitutes a Mutual Agreement in accordance with the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income signed at Washington, D.C., on October 2, 1996.

The text of the Agreement is as follows:

COMPETENT AUTHORITY AGREEMENT

The competent authorities of the United States and Switzerland hereby enter into the following agreement ("the Agreement") regarding the qualification of certain U.S. and Swiss pension or other retirement arrangements for benefits under paragraph 3 of Article 10 (Dividends) of the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income signed at Washington on October 2, 1996 ("the Treaty"). The Agreement specifies the procedures for claiming Treaty benefits in each country and the methods each country will use to grant Treaty benefits. The Agreement is entered into under paragraph 3 of Article 25 (Mutual Agreement Procedure).

1) *Definitions*

It is understood that for the purposes of this Agreement:

"Article" refers to an Article of the Treaty;

"Code section" refers to a section of the U.S. Internal Revenue Code of 1986, as amended;

"IRS" refers to the U.S. Internal Revenue Service; and

"trust" includes a custodial account treated as a trust for U.S. federal income tax purposes.

2) *Qualification for benefits under Article 10(3)*

Article 10(3) provides that dividends may not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends is a resident of the other Contracting State described in subparagraph 4(b) of Article 28 (Miscellaneous) that does not control the company paying the dividends.

Under subparagraph 1(c) of Article 4 (Resident), the term "resident of a Contracting State" includes a pension trust or other organization established in a Contracting State and maintained exclusively to administer or provide pensions, retirement or employee benefits, provided the pension trust or other organization is established or sponsored by a person resident in that State under Article 4.

The residents described in Article 28(4)(b) are pension or other retirement arrangements that are established and maintained and recognized for tax purposes in one Contracting State, provided that the competent authority of the other Contracting State has agreed that such pension or other retirement arrangement generally corresponds to a pension or other retirement arrangement recognized for tax purposes by that other State.

Paragraph 2 of Article 22 (Limitation on Benefits) provides that the entity described in Article 4(1)(c) may claim benefits under the Treaty only if more than half of its beneficiaries, members, or participants are persons that are entitled to benefits under Article 22.

3) *Qualified U.S. pension or other retirement arrangements*

Subject to the conditions of Article 22(2), the following types of U.S. pension or other retirement arrangements are treated as the beneficial owners of dividends paid to them by Swiss corporations and are considered to qualify for benefits under Article 10(3):

a) a U.S. resident tax-exempt trust providing pension or retirement benefits under a Code section 401(a) qualified pension plan, profit sharing plan or stock bonus plan (including Code section 401(k) arrangements);

b) a U.S. resident tax-exempt trust described in Code section 457(g) providing pension or retirement benefits under a Code section 457(b) plan;

c) a U.S. resident tax-exempt trust providing pension or retirement benefits under a Code section 403(b) plan;

d) a group trust described in IRS Revenue Ruling 81–100 (as modified by IRS Revenue Ruling 2004–67), with respect only to participants that are trusts mentioned under subparagraphs (a), (b) or (c) above;

e) a U.S. common trust fund (Code section 584), to the extent that the participants are trusts described under subparagraphs (a), (b), (c) or (d) above; and

f) the Thrift Savings Fund (Code section 7701(j)).

As reflected in the U.S. Treasury Department Technical Explanation, the U.S. pension or other retirement arrangements that are considered to qualify for benefits under Article 10(3) do not include individual retirement accounts under Code section 408 or Roth IRAs under Code section 408A.

Above list is not exclusive. The listing of pension or other retirement arrangements described in subparagraphs (a) through (f) above is not intended to be exclusive. Any type of U.S. pension or other retirement arrangement not mentioned above, including any such arrangement established pursuant to legislation enacted after the date of signature of this Agreement, that considers itself to qualify for benefits under Article 10(3) must present its case to the Swiss competent authority under Article 28(4)(b) or seek a bilateral mutual agreement between the U.S. and Swiss competent authorities.

Verification. The status of any U.S. pension or other retirement arrangement claiming benefits under Article 10(3) is subject to verification by the Swiss tax authorities. The Swiss tax authorities may, if they consider it necessary, request information under Article 26 (Exchange of Information).

4) *Qualified Swiss pension or other retirement arrangements*

Subject to the conditions of Article 22(2), the following types of Swiss pension or other retirement arrangements are treated as the beneficial owners of dividends paid to them by U.S. corporations and are considered to qualify for benefits under Article 10(3):

a) a Swiss resident pension or other retirement arrangement that has been established in accordance with the Swiss Federal Act on Professional Old-Age, Survivors' and Disabled Persons' Pension Plans (Bundesgesetz über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge), but not including any form of contributory private savings plans or other individual savings plans; and

b) a Swiss resident investment foundation for pension funds ("Anlagestiftung"), if all of the participants in the investment foundation are pension or other retirement arrangements mentioned under subparagraph (a) above.

Above list is not exclusive. The listing of pension or other retirement arrangements described in subparagraphs (a) and (b) above is not intended to be exclusive. Any type of Swiss pension or other retirement arrangement not mentioned above, including any such arrangement established pursuant to legislation enacted after the date of signature of this Agreement, that considers itself to qualify for benefits under Article 10(3) must present its case to the U.S. competent authority under Article 28(4)(b) or seek a bilateral mutual agreement between the U.S. and Swiss competent authorities.

Verification. The status of any Swiss pension or other retirement arrangement claiming benefits under Article 10(3) is subject to verification by the U.S. tax authorities. The U.S. tax authorities may, if they consider it necessary, request information under Article 26.

5) *Appropriate procedure for filing a request with the United States for a grant of Treaty benefits by the United States*

The United States has two methods for granting benefits under Article 10(3) with respect to dividends paid by U.S. companies to Swiss pension or other retirement arrangements that qualify for benefits under this Agreement. These methods are the "at-source" method and the "refund" method.

a) *At-source method.* No tax will be withheld from a dividend paid by a U.S. company to a Swiss tax-exempt pension or other retirement arrangement described in this Agreement that provides any properly completed IRS Form W–8BEN to the withholding agent or payer of such dividend before the dividend is paid or credited to the Swiss pension or other retirement arrangement. A Swiss pension or other retirement arrangement filing Form W–8BEN must cite Articles 10(3) and 28(4) on line 10 thereof, and state that it is a Swiss pension or other retirement arrangement described in this Agreement that does not control the company paying the dividend and that satisfies the requirement of Article 22(2).

b) *Refund method.* If the Swiss pension or other retirement arrangement does not provide a properly completed Form W–8BEN before the dividend is paid or credited, the U.S. company withholds at the full U.S. statutory rate of withholding tax. Later, upon receiving a claim for refund from the Swiss pension or other retirement arrangement, the U.S. tax authorities refund the full amount of the tax that was withheld. The Swiss pension or other retirement arrangement must file its claim for refund on a Form 1120F U.S. income tax return. The Swiss pension or other retirement arrangement must include with that income tax return adequate proof of payment of the U.S. tax (*e.g.*, IRS Form 1042–S or any other appropriate income statement issued by a bank containing a reference to such payment), and attach to such return an IRS Form 8833 (Treaty Based Return Position) that:

i) cites Articles 10(3) and 28(4);

ii) states that it is a Swiss tax-exempt pension or other retirement arrangement covered under this Agreement; and

iii) states that it satisfies the requirements of Article 22(2).

A QI may act to recover over-withholding of payments on behalf of multiple Swiss pension or other retirement arrangements entitled to the benefits of this Agreement, by using the appropriate procedure under the terms of Section 9 of its Qualified Intermediary Withholding Agreement with the United States.

6) *Appropriate procedure for filing a request with Switzerland for a grant of Treaty benefits by Switzerland*

Switzerland has only one method for granting benefits under Article 10(3) with respect to dividends paid by Swiss companies to U.S. pension or other retirement arrangements that qualify for benefits under this Agreement. That method is the "refund" method. The Swiss company withholds at the full Swiss statutory rate of withholding tax. Later, upon receiving a claim for refund from the U.S. pension or other retirement arrangement, the Swiss tax authorities refund the full amount of the tax that was withheld.

The Swiss tax authority will grant benefits under Article 10(3) if the U.S. pension or other retirement arrangement provides:

a) a certification letter (Form 6166) issued by the IRS Philadelphia Service Center for the taxable year(s) in question (Example attached); and

b) a Swiss Form 82 E to which the U.S. pension or other retirement arrangement has attached a statement that it does not control the company paying the dividends and that it satisfies the requirements of Articles 10(3), 28(4) and 22(2).

7) *Effective date*

Upon signature by both competent authorities, this Agreement is effective retroactive to February 1, 1998, the date the Treaty is effective for taxes withheld at source under Article 29(2)(a).

Agreed to by the undersigned competent authorities:

Robert H. Green	Robert Waldburge
U. S. competent authority	Swiss competent authority
_____	_____
Date	Date

Attachment: Example of U.S. Certification (Form 6166) for a pension or other retirement arrangement

CERTIFICATION
PROGRAM

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
PHILADELPHIA, PA 19255

Date 01/20/2004

Taxpayer: ABC Retirement Plan
TIN: 23-XXXXXXX
Tax Year: 2003

I certify that, to the best of our knowledge, the above-named entity is a trust forming part of a pension, profit sharing, or stock bonus plan qualified under section 401(a) of the U.S. Internal Revenue Code, which is exempt from U.S. taxation under section 501(a), and is a resident of the United States of America for purposes of U.S. taxation.

Certified for Switzerland

Daniel J. Nally
Director, Philadelphia Customer Service Center

Form 6166 (Rev. 6-2003)
Catalog Number 43134V

Part III. Administrative, Procedural, and Miscellaneous

Guidance Under § 409A of the Internal Revenue Code

Notice 2005–1

I. Purpose and Overview

Section 885 of the recently enacted American Jobs Creation Act of 2004, Pub. Law No. 108–357, 118 Stat. 1418 (the Act), added § 409A to the Internal Revenue Code (Code). Section 409A provides that all amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are met. Section 409A also includes rules applicable to certain trusts or similar arrangements associated with nonqualified deferred compensation, where such arrangements are located outside of the United States or are restricted to the provision of benefits in connection with a decline in the financial health of the sponsor.

As explained more fully below, this notice provides the first part of what is expected to be a series of guidance with respect to the application of § 409A. The Treasury Department and the Internal Revenue Service (Service) intend to incorporate the principles of this notice into additional, more comprehensive guidance in 2005.

Taxpayers should note that although the statute makes a number of fundamental changes, § 409A does not alter or affect the application of any other provision of the Code or common law tax doctrine. Accordingly, deferred compensation not required to be included in income under § 409A may nevertheless be required to be included in income under § 451, the constructive receipt doctrine, the cash equivalency doctrine, § 83, the economic benefit doctrine, the assignment of income doctrine or any other applicable provision of the Code or common law tax doctrine.

A. Definitions and Coverage

This notice generally outlines the scope of coverage of § 409A. The notice first provides definitions of a nonqualified deferred compensation plan, a plan and the deferral of compensation. Guidance is provided on the application of § 409A to welfare plans, plans covered by § 457, stock appreciation rights, and arrangements between partners and partnerships. This notice provides a definition of a substantial risk of forfeiture.

The definition of nonqualified deferred compensation contains an exception for amounts actually or constructively received by the service provider within a short period following the lapse of a substantial risk of forfeiture. The exception is intended to address multi-year compensation arrangements, where the right to the compensation is or may be earned over multiple years but is payable at the end of the earning period. For example, a three-year bonus program requiring the performance of services over three years and entitling the service provider to a payment within a short specified period following the end of the third year generally would not constitute a deferral of compensation. The Treasury Department and the Service are, however, concerned about arrangements purported to involve a substantial risk of forfeiture and fixed payment date where the parties do not intend for the substantial risk of forfeiture or fixed payment date to be enforced. Accordingly, the Treasury Department and the Service are considering a more restrictive rule under which arrangements involving payments in later taxable years structured to coincide with a lapse in a substantial risk of forfeiture would constitute deferrals of compensation subject to § 409A. However, even under a more restrictive rule, the Treasury Department and the Service anticipate that a payment within a short period following a scheduled vesting date and, in specified circumstances, within a short period following an accelerated vesting date, would be permitted under the statutory authority provided to permit accelerated payments that are not inconsistent with the purposes of the statute. Comments are requested with respect to these issues and the extent to which additional guidance is required to prevent arrangements designed to evade application of § 409A.

This notice does not provide generally applicable methods for calculating the amount of deferrals for a given year. However, a rule is provided for calculation of the amount of deferrals before January 1, 2005 for purposes of applying the effective date provisions. The Treasury Department and the Service anticipate issuing guidance in 2005 providing methods for calculating the amount of deferrals for purposes of all deferrals to which § 409A applies, including deferrals preceding the issuance of the guidance. Until such guidance is issued, certain transition relief is provided to address information reporting and withholding requirements. However, nothing in this guidance should be interpreted to exempt amounts actually distributed to the taxpayer in 2005 from inclusion in income or from applicable reporting or withholding requirements.

B. Nonstatutory Stock Options and Stock Appreciation Rights

The definition of nonqualified deferred compensation contains an exception that generally excludes certain nonstatutory stock options from coverage under § 409A. This exception is consistent with the further exception covering transfers of restricted property, as the taxation of transfers of nonstatutory stock options and transfers of restricted property generally both are governed by § 83. Commentators have pointed out that under certain conditions, stock appreciation rights yield economically equivalent results to nonstatutory stock options exercised in a cashless transaction, and have requested that stock appreciation rights be treated similarly. However, the Treasury Department and the Service are concerned that a general exception for stock appreciation rights may be exploited as a method to avoid application of § 409A, particularly in regard to valuation of the underlying stock where the value is not established by and in an established securities market. In many respects, stock appreciation rights are similar to other forms of nonqualified deferred compensation, particularly where the recipient of a stock appreciation right may receive cash. In such cases, the taxation of stock appreciation rights generally is governed by § 451 and the constructive

receipt doctrine. See Rev. Rul. 80–300, 1980–2 C.B. 165.

Accordingly, this notice provides limited exceptions from coverage under § 409A for certain stock appreciation rights which do not present potential for abuse or intentional circumvention of the purposes of § 409A. Under this exception, a stock appreciation right will not constitute a deferral of compensation if (1) the value of the stock the excess over which the right provides for payment upon exercise (the SAR exercise price) may never be less than the fair market value of the underlying stock on the date the right is granted, (2) the stock of the service recipient subject to the right is traded on an established securities market, (3) only such traded stock of the service recipient may be delivered in settlement of the right upon exercise, and (4) the right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the right. In addition, until further guidance is issued, a payment of stock or cash pursuant to the exercise of a stock appreciation right (or economically equivalent right), or the cancellation of such a right for consideration, where such right is granted pursuant to a program in effect on or before October 3, 2004 will not be treated as a payment of a deferral of compensation subject to the requirements of § 409A if: (1) the SAR exercise price may never be less than the fair market value of the underlying stock on the date the right is granted, and (2) the right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the right. The Treasury Department and the Service request comments on the extent to which stock appreciation rights should be excepted from coverage under § 409A, in light of the statutory purpose.

The Treasury Department and the Service also are concerned about the potential for taxpayers to avoid application of § 409A by combining an exception from coverage under § 409A for nonstatutory stock options or stock appreciation rights with a requirement or right that the stock acquired by the service provider be repurchased by the service recipient. Accordingly, the Treasury Department and the Service are considering a restriction on the exception from coverage under § 409A for nonstatutory stock options or stock appreciation rights, to options or rights that are not accompanied by an arrangement or agreement under which the service recipient has an obligation or right to repurchase the acquired shares (including repurchases for an amount other than fair market value). In this context, the Treasury Department and the Service also request comments on appropriate techniques for valuation of stock subject to options or stock appreciation rights where the value of such stock is not established by and in an established securities market, in order to ensure that such valuation reflects the actual fair market value of the stock.

To the extent the additional guidance adopts a position on an issue addressed in this notice with respect to stock options or stock appreciation rights that is less favorable to taxpayers than provided in this notice, the Treasury Department and the Service anticipate that such a position will be applied only on a prospective basis with adequate transition relief to allow modification of plans to comply on a prospective basis.

C. Change in Control Events

This notice next addresses what constitutes a change in ownership or effective control of a corporation, or in the ownership of a substantial portion of the assets of a corporation (Change in Control Event) for purposes of § 409A. Section 885(e) of the Act requires that within 90 days of the enactment of the legislation, the Treasury Department and the Service issue guidance on what constitutes a Change in Control Event. Section 409A provides that, to the extent provided by the Treasury Department and the Service in guidance, a nonqualified deferred compensation plan may permit amounts deferred under the plan to be distributed upon a Change in Control Event.

D. Acceleration of Payments

Except under circumstances specified by the Treasury Department and the Service in guidance, a nonqualified deferred compensation plan may not permit the acceleration of payments under the plan. This notice provides circumstances under which payments under the plan may be accelerated, such as to meet the requirements of a domestic relations order or conflict of interest divestiture requirements. Comments are requested as to other circumstances under which a plan should be allowed to accelerate payments under the plan.

E. Effective Dates and Transition Relief

The notice provides guidance on the effective date provisions and transition relief. Section 409A generally is effective with respect to amounts deferred after December 31, 2004. Section 409A also is effective with respect to amounts deferred in taxable years beginning before January 1, 2005 if the plan under which the deferral is made is materially modified after October 3, 2004. This notice addresses what amounts will be considered deferred after December 31, 2004, generally providing that an amount will be treated as deferred on or before December 31, 2004 only if the service recipient has a binding legal obligation to pay an amount in a future taxable year and the service provider's right to the amount is earned and vested as of December 31, 2004. Methods of calculating amounts treated as deferred on or before December 31, 2004 are provided. This notice also addresses when a plan under which a deferral is made will be considered materially modified after October 3, 2004.

This notice addresses the requirements of § 885(f) of the Act, which provides that within 60 days of the enactment of the legislation, the Treasury Department and the Service must issue guidance providing that for a limited period and under certain conditions, a nonqualified deferred compensation plan may be amended without violating certain provisions of § 409A to (i) allow a participant to terminate participation in the plan, or cancel an outstanding deferral election with respect to amounts deferred after December 31, 2004, or (ii) conform the plan to the provisions of § 409A with respect to amounts deferred after December 31, 2004. This notice provides certain relief addressing the application of the initial deferral election requirements to compensation attributable, in whole or in part, to the performance of services in the years 2004 or 2005. This includes, for example, provisions addressing the deferral of bonuses, including bonuses for services performed in 2004.

F. Application of Information Reporting and Wage Withholding Requirements

This notice next addresses certain information reporting and wage withholding requirements imposed by § 885(b) of the Act with respect to deferred amounts. For information reporting purposes, the Act amends §§ 6041 and 6051 to require that all deferrals for the year under a nonqualified deferred compensation plan be separately reported on a Form 1099 *(Miscellaneous Income)* or a Form W–2 *(Wage and Tax Statement)*. For wage withholding purposes, the Act amends § 3401(a) to provide that the term "wages" includes any amount includible in gross income of an employee under § 409A. Finally, for purposes of reporting nonemployee compensation, the Act further amends § 6041 to require that amounts includible in gross income under § 409A that are not treated as wages under § 3401(a) must be reported as gross income. This notice does not provide methods for calculating the amount of deferrals for the year or the amounts includible in gross income under § 409A and in wages under § 3401(a). Consequently, interim guidance is provided with respect to an employer's withholding and reporting obligations where the employer furnishes an expedited Form W–2 prior to the issuance of additional guidance providing such methods.

II. Reliance on Transition Guidance; Good Faith, Reasonable Interpretation

This notice provides rules governing the application of § 409A. The Treasury Department and the Service anticipate issuing additional guidance that incorporates this notice. To the extent the additional guidance adopts a position on an issue addressed in this notice that is less favorable to taxpayers than provided in this notice, the Treasury Department and the Service anticipate that such a position will be applied only on a prospective basis with adequate transition relief to allow modification of plans to comply on a prospective basis.

This notice does not provide comprehensive guidance with respect to the application of § 409A. Until additional guidance is issued, to comply with the requirements of § 409A with respect to issues not addressed in this notice, taxpayers should base their positions upon a good faith, reasonable interpretation of the statute and its purpose, which includes consideration of the legislative history. Whether a taxpayer position constitutes a good faith, reasonable interpretation of the statutory language generally will be determined based upon all of the relevant facts and circumstances, including whether the taxpayer has applied the position consistently and the extent to which the taxpayer has resolved unclear issues in the taxpayer's favor. In addition, certain provisions of § 409A provide definitive rules, but allow the Treasury Department and the Service to issue guidance providing exceptions to such rules. For example, § 409A(a)(3) provides that the Treasury Department and the Service may issue guidance providing an exception to the general prohibition against the acceleration of the time or schedule of any payment under a nonqualified deferred compensation plan. A taxpayer position based on an expected exception that the taxpayer speculates that the Treasury Department and the Service will adopt in future guidance is not a good faith, reasonable interpretation of the statutory language. In addition, as discussed above, the Treasury Department and the Service intend to issue guidance in 2005 providing methods for calculating the amount of deferrals for a year for purposes of all amounts of deferrals to which § 409A applies, including deferrals predating the issuance of the anticipated guidance. Accordingly, taxpayers will not be able to rely upon methods of calculation that differ from the methods provided in the 2005 guidance.

III. Request for Comments on Anticipated Guidance

A. Request for Comments

The Treasury Department and the Service request comments on all aspects of the application of § 409A, including but not limited to the topics addressed in this notice. The Treasury Department and the Service specifically request comments with respect to the following:

(1) The application of § 409A to severance plans, including whether to exclude any specific types of severance plans or arrangements (see Q&A 19).

(2) Funding arrangements for nonqualified deferred compensation that involve foreign trusts or similar arrangements, and identification of arrangements that will not result in an improper deferral of United States tax and will not result in assets being effectively beyond the reach of creditors for purposes of the potential exemption from the provisions of § 409A(b) that the Treasury Department and the Service are authorized to provide under § 409A(e)(3).

(3) The application of § 409A to arrangements involving partners and partnerships. Comments are specifically requested with respect to the applicability of § 409A to arrangements subject to § 736, and whether there should be a distinction between payments subject to § 736(a) and (b) and the coordination of the timing rules of § 1.736–1(b)(5) with the rules of § 409A for nonqualified deferred compensation plans. Comments are also specifically requested on whether there should be special rules in applying § 409A in the case of a putative allocation and distribution which is recast, under § 707(a)(2)(A), as a payment to a nonpartner under § 707(a)(1).

(4) Potential additional exclusions from coverage under § 409A with respect to contractual arrangements between businesses (see Q&A 8).

(5) Situations where the acceleration of benefits should be permitted under § 409A(a)(3) (see Q&A 15), particularly in light of the legislative history regarding accelerated payments required for reasons beyond the control of the participant.

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

B. Submission of Comments

Comments may be submitted to Internal Revenue Service, CC:PA:LPD:RU (Notice 2005–1), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW, Washington DC 20224, Attn: CC:PA:LPD:RU (Notice 2005–1), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov.* Include the notice number (Notice 2005–1) in the subject line.

IV. Guidance

A. Definitions and Coverage

Q–1 What does § 409A provide, in general?

A–1 Section 409A provides that all amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are satisfied. Section 409A also includes rules applicable to certain trusts or similar arrangements associated with nonqualified deferred compensation, where such arrangements are located outside of the United States or are restricted to the provision of benefits in connection with a decline in the financial health of the sponsor.

Q–2 What are the federal income tax consequences of a failure to satisfy the requirements of § 409A?

A–2 Generally, if at any time during a taxable year a nonqualified deferred compensation plan fails to meet the requirements of § 409A, or is not operated in accordance with those requirements, all amounts deferred under the plan for the taxable year and all preceding taxable years, by any participant with respect to whom the failure relates, are includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income. If a deferred amount is required to be included in income under § 409A, the amount also is subject to interest and an additional income tax. The interest imposed is equal to the interest at the underpayment rate plus one percentage point, imposed on the underpayments that would have occurred had the compensation been includible in income for the taxable year when first deferred, or if later, when not subject to a substantial risk of forfeiture. The additional income tax is equal to 20 percent of the compensation required to be included in gross income.

Q–3 What is a nonqualified deferred compensation plan?

A–3 (a) In general. Except as otherwise provided in this A–3, the term nonqualified deferred compensation plan means any plan (within the meaning of Q&A 9) that provides for the deferral of compensation (within the meaning of Q&A 4). The application of § 409A is not limited to arrangements between an employer and an employee. For example, § 409A may apply to arrangements between a service recipient and an independent contractor, or arrangements between a partner and a partnership (see Q&A 7 and Q&A 8).

(b) Qualified employer plans. The term nonqualified deferred compensation plan does not include (i) any plan, contract, pension, account, or trust described in subparagraph (A) or (B) of § 219(g)(5) (without regard to subparagraph (A)(iii)), (ii) any eligible deferred compensation plan (within the meaning of § 457(b)), and (iii) any plan described in § 415(m). Accordingly, the term nonqualified deferred compensation plan does not include a qualified retirement plan, tax-deferred annuity, simplified employee pension, SIMPLE or § 501(c)(18) trust.

(c) Certain welfare benefits. The term nonqualified deferred compensation plan does not include any *bona fide* vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. For these purposes, the term disability pay has the same meaning as provided in § 31.3121(v)(2)–1(b)(4)(iv)(C) of the Employment Tax Regulations, and the term death benefit plan refers to a plan providing death benefits as defined in § 31.3121(v)(2)–1(b)(4)(iv)(C). The term nonqualified deferred compensation plan also does not include any Archer Medical Savings Account as described in § 220, any Health Savings Account as described in § 223, or any other medical reimbursement arrangement, including a health reimbursement arrangement, that satisfies the requirements of § 105 and § 106.

Q–4 What constitutes a deferral of compensation?

A–4 (a) Deferral of compensation defined. A plan provides for the deferral of compensation only if, under the terms of the plan and the relevant facts and circumstances, the service provider has a legally binding right during a taxable year to compensation that has not been actually or constructively received and included in gross income, and that, pursuant to the terms of the plan, is payable to (or on behalf of) the service provider in a later year. A service provider does not have a legally binding right to compensation if that compensation may be unilaterally reduced or eliminated by the service recipient or other person after the services creating the right to the compensation have been performed. However, if the facts and circumstances indicate that the discretion to reduce or eliminate the compensation is available or exercisable only upon a condition that is unlikely to occur, or the discretion to reduce or eliminate the compensation is unlikely to be exercised, a service provider will be considered to have a legally binding right to the compensation. For this purpose, compensation is not considered subject to unilateral reduction or elimination merely because it may be reduced or eliminated by operation of the objective terms of the plan, such as the application of an objective provision creating a substantial risk of forfeiture (within the meaning of Q&A 10). Similarly, a service provider does not fail to have a legally binding right to compensation merely because the amount of compensation is determined under a formula that provides for benefits to be offset by benefits provided under a plan that is qualified under § 401(a), or because benefits are reduced due to actual or notional investment losses, or in a final average pay plan, subsequent decreases in compensation.

(b) Compensation payable pursuant to the service recipient's customary payment timing arrangement. A deferral of compensation does not occur solely because compensation is paid after the last day of the service provider's taxable year pursuant to the timing arrangement under which the service recipient normally compensates service providers for services performed during a payroll period described in § 3401(b), or with respect to a non-employee service provider, a period not longer than the payroll period described in § 3401(b).

(c) Short-term deferrals. Until additional guidance is issued, a deferral of compensation does not occur if, absent an election to otherwise defer the payment to a later period, at all times the terms of the plan require payment by, and an amount is actually or constructively received by the service provider by, the later of (i) the date that is 2½ months from the end of the service provider's first taxable year in which the amount is no longer

subject to a substantial risk of forfeiture (as defined in Q&A 10) or (ii) the date that is 2½ months from the end of the service recipient's first taxable year in which the amount is no longer subject to a substantial risk of forfeiture (as defined in Q&A 10). For these purposes, an amount that is never subject to a substantial risk of forfeiture is considered to be no longer subject to a substantial risk of forfeiture on the date the service provider has a legally binding right to the amount. For example, an employer with a calendar year taxable year who on November 1, 2006 awards a bonus so that the employee is considered to have a legally binding right to the payment as of November 1, 2006, will not be considered to have provided for a deferral of compensation if, in accordance with the terms of the bonus plan, the amount is paid or made available to the employee on or before March 15, 2007. An employer with a September 1 to August 31 taxable year who on November 1, 2006 awards a bonus so that the employee is considered to have a legally binding right to the payment as of November 1, 2006, will not be considered to have provided for a deferral of compensation if, in accordance with the terms of the bonus plan, the amount is paid or made available to the employee on or before November 15, 2007. Notwithstanding the foregoing, if an election is provided to the service provider with respect to the taxable year in which payment of the compensation will occur, and the service provider elects a taxable year later than the taxable year in which he or she obtained a legally binding right to the payment, the arrangement constitutes a deferral of compensation subject to § 409A, including the deferral election timing rules of § 409A(a)(4). In addition, the arrangement continues to be subject to applicable U.S. Federal tax principles which may require immediate income inclusion.

(d) Stock options, stock appreciation rights, and other equity-based compensation. (i) Except as provided in paragraphs (ii), (iii) and (iv), the grant of a stock option, stock appreciation right or other equity-based compensation provides for a deferral of compensation subject to § 409A. Stock appreciation rights generally will be covered by § 409A; however, stock appreciation rights may be structured to comply with the provisions of § 409A. For example, the terms of a stock appreciation right with a fixed payment date generally will comply with the provisions of § 409A.

(ii) Nonstatutory stock options. An option to purchase stock of the service recipient, other than an incentive stock option described in § 422 or an option granted under an employee stock purchase plan described in § 423, does not provide for a deferral of compensation if: (1) the amount required to purchase stock under the option (the exercise price) may never be less than the fair market value of the underlying stock on the date the option is granted, (2) the receipt, transfer or exercise of the option is subject to taxation under § 83, and (3) the option does not include any feature for the deferral of compensation other than the deferral of recognition of income until the later of exercise or disposition of the option under § 1.83–7. For purposes of the preceding sentence, the right to receive substantially nonvested stock (as defined in § 1.83–3(b)) upon the exercise of a stock option does not constitute a feature for the deferral of compensation. If under the terms of the option, the amount required to purchase the stock is or could become less than the fair market value of the stock on the date of grant, the grant of the stock option may provide for the deferral of compensation within the meaning of this A–4. For purposes of determining the fair market value of the stock at the date of grant, any reasonable valuation method may be used. Such methods include, for example, the valuation method described in § 20.2031–2 of the Estate Tax Regulations. To the extent an arrangement grants the recipient a right other than to purchase stock at a defined price and such additional rights allow for the deferral of compensation (for example, tandem arrangements involving options and stock appreciation rights), the entire arrangement provides for the deferral of compensation. If the requirements of § 1.424–1 would be met if the nonstatutory option were a statutory option, the substitution of a new option pursuant to a corporate transaction for an outstanding option or the assumption of an outstanding option will not be treated as the grant of a new option or a change in the form of payment for purposes of § 409A. For purposes of the preceding sentence, the requirement of § 1.424–1(a)(5)(iii) will be deemed to be satisfied if the ratio of the option price to the fair market value of the shares subject to the option immediately after the substitution or assumption is not greater than the ratio of the option price to the fair market value of the shares subject to the option immediately before the substitution or assumption.

(iii) Statutory stock options. The grant of an incentive stock option as described in § 422, or the grant of an option under an employee stock purchase plan described in § 423 (including the grant of an option with an exercise price discounted in accordance with § 423(b)(6) and the accompanying regulations), does not constitute a deferral of compensation.

(iv) Certain stock appreciation rights. A stock appreciation right with respect to stock of the service recipient does not provide for a deferral of compensation if: (1) the value of the stock the excess over which the right provides for payment upon exercise (the SAR exercise price) may never be less than the fair market value of the underlying stock on the date the right is granted, (2) the stock of the service recipient subject to the right is traded on an established securities market, (3) only such traded stock of the service recipient may be delivered in settlement of the right upon exercise, and (4) the right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the right. For purposes of the preceding sentence, the right to receive substantially nonvested stock (as defined in § 1.83–3(b)) upon the exercise of a stock appreciation right does not constitute a feature for the deferral of compensation. If, under the terms of the stock appreciation right, the SAR exercise price is or could become less than the fair market value of the underlying stock on the date of grant, the right may be settled upon exercise in a medium other than the traded stock of the service recipient, or there is an agreement or arrangement under which the service recipient will purchase the stock delivered in settlement of the right upon exercise, then the grant of the stock appreciation right may provide for the deferral of compensation within the meaning of this A–4. In addition, until further guidance is issued, a payment of stock or cash pursuant to the exercise of a stock appreciation right (or economically equivalent right), or the cancellation of such right for consideration, where such right is granted pursuant to a program in

effect on or before October 3, 2004 will not be treated as a payment of a deferral of compensation subject to the requirements of § 409A if: (1) the SAR exercise price may never be less than the fair market value of the underlying stock on the date the right is granted, and (2) the right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the right.

(e) Restricted property. If a service provider receives property from, or pursuant to, a plan maintained by a service recipient, there is no deferral of compensation merely because the value of the property is not includible in income (under § 83) in the year of receipt by reason of the property being nontransferable and subject to a substantial risk of forfeiture, or is includible in income (under § 83) solely due to a valid election under § 83(b). However, a plan under which a service provider obtains a legally binding right to receive property (whether or not the property is restricted property) in a future year may provide for the deferral of compensation and, accordingly, may constitute a nonqualified deferred compensation plan. For purposes of this paragraph, a transfer of property includes the transfer of a beneficial interest in a trust or annuity plan, or a transfer to or from a trust or under an annuity plan, to the extent such a transfer is subject to § 83, § 402(b) or § 403(c).

(f) Earnings. References to the deferral of compensation include references to income (whether actual or notional) attributable to such compensation or such income.

Q–5 Who is the service recipient?

A–5 For purposes of § 409A, the service recipient refers to the person for whom the services are performed, and all persons with whom such person would be considered a single employer under § 414(b) (employees of controlled group of corporations), and all persons with whom such person would be considered a single employer under § 414(c) (employees of partnerships, proprietorships, etc., which are under common control).

Q–6 How Does § 409A Apply to Arrangements Covered by § 457?

A–6 The rules of § 409A apply to nonqualified deferred compensation plans under § 457(f) in addition to any requirements already applicable to such plans under § 457(f). Eligible plans under § 457(b) are not subject to the requirements of § 409A. However, nonelective deferred compensation of nonemployees described in § 457(e)(12) and grandfathered plans under prior § 457 transition rules generally are subject to § 409A. Pending additional guidance, length of service awards to *bona fide* volunteers under § 457(e)(11)(A)(ii) are not subject to § 409A. Further, pending additional guidance, State and local government and tax exempt entities may rely on the definitions of *bona fide* vacation leave, sick leave, compensatory time, disability pay, and death benefit plans for purposes of § 457(f) as applicable for purposes of applying § 409A to nonqualified deferred compensation plans under § 457(f). However, State and local government and tax exempt entities may not rely upon the definition of a deferral of compensation for purposes of § 409A as applicable for purposes of the § 457(f) definition of a deferral of compensation. For example, for purposes of § 457(f), a deferral of compensation includes stock options (whether nonstatutory or under § 422 or § 423) and arrangements in which an employee or independent contractor of a State or local government or tax-exempt entity earns the right to future payments for services, even if those amounts are paid immediately upon vesting.

Q–7 How Does § 409A Apply to Arrangements Between a Partnership and a Partner of the Partnership?

A–7 The application of § 409A is not limited to arrangements between an employer and employee. Accordingly, § 409A may apply to arrangements between a partner and a partnership which provides for the deferral of compensation under a nonqualified deferred compensation plan. However, until additional guidance is issued, for purposes of § 409A taxpayers may treat the issuance of a partnership interest (including a profits interest), or an option to purchase a partnership interest, granted in connection with the performance of services under the same principles that govern the issuance of stock (see Q&A 4). Specifically, until additional guidance is issued, for purposes of § 409A, taxpayers may treat an issuance of a profits interest in connection with the performance of services that is properly treated under applicable guidance as not resulting in inclusion of income by the service provider at the time of issuance, as also not resulting in the deferral of compensation. Similarly, until additional guidance is issued, for purposes of § 409A, taxpayers may treat an issuance of a capital interest in connection with the performance of services in the same manner as an issuance of stock. The § 409A rules governing other stock-based compensation may be applied by analogy to grants of equity-based compensation where the compensation is determined by reference to partnership equity. In addition, until further guidance is issued, taxpayers may treat arrangements providing for payments subject to § 736 as not being subject to § 409A, except that an arrangement providing for payments which qualify as payments to a partner under § 1402(a)(10) are subject to § 409A. Finally, § 409A may apply to payments covered by § 707(a)(1) (partner not acting in capacity as partner), if such payments otherwise would constitute a deferral of compensation under a nonqualified deferred compensation plan.

Q–8 To Which Service Providers Does § 409A Apply?

A–8 Until additional guidance is issued, a service provider for purposes of § 409A includes (i) an individual, (ii) a personal service corporation (as defined in § 269A(b)(1)), or a noncorporate entity that would be a personal service corporation if it were a corporation, or (iii) a qualified personal service corporation (as defined in § 448(d)(2)), or a noncorporate entity that would be a qualified personal service corporation if it were a corporation. Section 409A does not apply to arrangements between taxpayers all of whom use the accrual method of accounting. Section 409A also does not apply to arrangements between a service provider and a service recipient if (a) the service provider is actively engaged in the trade or business of providing substantial services, other than (I) as an employee or (II) as a director of a corporation; and (b) the service provider provides such services to two or more service recipients to which the service provider is not related and that are not related to one another. For purposes of the preceding sentence, a person is related to another person if (i) the persons

bear a relationship to each other that is specified in § 267(b) or 707(b)(1), subject to the modifications that the language "20 percent" is used instead of "50 percent" each place it appears in §§ 267(b) and 707(b)(1), and § 267(c)(4) is applied as if the family of an individual includes the spouse of any member of the family; or (ii) the persons are engaged in trades or businesses under common control (within the meaning of § 52(a) and (b)). The Treasury Department and the Service intend to issue additional guidance addressing types of service providers not subject to § 409A.

Q–9 What constitutes a plan?

A–9 A plan includes any agreement, method or arrangement, including an agreement, method or arrangement that applies to one person or individual. A plan may be adopted unilaterally by the service recipient or may be negotiated among or agreed to by the service recipient and one or more service providers or service provider representatives. An agreement, method or arrangement may constitute a plan regardless of whether it is an employee benefit plan under § 3(3) of the Employee Retirement Income Security Act of 1974 (ERISA), as amended (29 U.S.C. 1002(3)). Unless otherwise specified in this notice, the requirements of § 409A are applied as if (a) a separate plan or plans is maintained for each service provider, and (b) all compensation deferred with respect to a particular service provider under an account balance plan (as defined in § 31.3121(v)(2)–1(c)(1)(ii)(A)) is treated as deferred under a single plan, all compensation deferred under a nonaccount balance plan (as defined in § 31.3121(v)(2)–1(c)(2)(i)) is treated as deferred under a separate single plan, and all compensation deferred under a plan that is neither an account balance plan nor a nonaccount balance plan (for example, discounted stock options, stock appreciation rights or other equity-based compensation described in § 31.3121(v)(2)–1(b)(4)(ii)) is treated as deferred under a separate single plan. For these purposes a severance plan is either an account balance plan or a nonaccount balance plan, determined in accordance with the rules of this A–9.

Q–10 When is an amount subject to a substantial risk of forfeiture?

A–10 (a) Definition. Compensation is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned on the performance of substantial future services by any person or the occurrence of a condition related to a purpose of the compensation, and the possibility of forfeiture is substantial. For purposes of this A–10, a condition related to a purpose of the compensation must relate to the service provider's performance for the service recipient or the service recipient's business activities or organizational goals (for example, the attainment of a prescribed level of earnings, equity value or a liquidity event). Any addition of a substantial risk of forfeiture after the beginning of the service period to which the compensation relates, or any extension of a period during which compensation is subject to a substantial risk of forfeiture, in either case whether elected by the service provider, service recipient or other person (or by agreement of two or more of such persons), is disregarded for purposes of determining whether such compensation is subject to a substantial risk of forfeiture. An amount is not subject to a substantial risk of forfeiture merely because the right to the amount is conditioned, directly or indirectly, upon the refraining from performance of services. For purposes of § 409A, an amount will not be considered subject to a substantial risk of forfeiture beyond the date or time at which the recipient otherwise could have elected to receive the amount of compensation, unless the amount subject to a substantial risk of forfeiture (ignoring earnings) is materially greater than the amount the recipient otherwise could have elected to receive. For example, a salary deferral generally may not be made subject to a substantial risk of forfeiture. However, where an election is granted to receive a materially greater bonus amount in a future year rather than a materially lesser bonus amount in an earlier year, the materially greater bonus may be made subject to a substantial risk of forfeiture.

(b) Enforcement of forfeiture condition. In determining whether the possibility of forfeiture is substantial in the case of rights to compensation granted to a service provider by the service recipient corporation, where the service provider owns a significant amount of the total combined voting power or value of all classes of stock of the service recipient corporation or of its parent corporation, there will be taken into account (i) the service provider's relationship to other stockholders and the extent of their control, potential control and possible loss of control of the corporation, (ii) the position of the service provider in the corporation and the extent to which the service provider is subordinate to other service providers, (iii) the service provider's relationship to the officers and directors of the corporation, (iv) the person or persons who must approve the service provider's discharge, and (v) past actions of the service recipient in enforcing the restrictions. For example, if a service provider would be considered as having deferred compensation subject to a substantial risk of forfeiture, but for the fact that the service provider owns 20 percent of the single class of stock in the transferor corporation, and if the remaining 80 percent of the class of stock is owned by an unrelated individual (or members of such an individual's family) so that the possibility of the corporation enforcing a restriction on such rights is substantial, then such rights are subject to a substantial risk of forfeiture. On the other hand, if 4 percent of the voting power of all the stock of a corporation is owned by the president of such corporation and the remaining stock is so diversely held by the public that the president, in effect, controls the corporation, then the possibility of the corporation enforcing a restriction on the right to deferred compensation of the president is not substantial, and such rights are not subject to a substantial risk of forfeiture.

B. Change in Control Events

Q–11 Under what circumstances will payments be permitted upon a change in the ownership or effective control of a corporation, or a change in the ownership of a substantial portion of the assets of a corporation?

A–11 (a) In general. Pursuant to § 409A(a)(2)(A)(v), a plan may permit a payment upon the occurrence of a change in the ownership of the corporation (as defined in Q&A 12), a change in effective control of the corporation (as defined in Q&A 13), or a change in the ownership of a substantial portion of the assets of the corporation (as defined in Q&A 14) (collectively referred to as a Change in

Control Event). To qualify as a Change in Control Event, the occurrence of the event must be objectively determinable and any requirement that any other person, such as a plan administrator or board of directors compensation committee, certify the occurrence of a Change in Control Event must be strictly ministerial and not involve any discretionary authority. For purposes of this paragraph (a), a payment also will be treated as occurring upon a Change in Control Event if the right to the payment arises due to the corporation's exercise of discretion under the terms of the plan to terminate the plan and distribute the compensation deferred thereunder within 12 months of the Change in Control Event. The plan may provide for a payment on any Change in Control Event, and need not provide for a payment on all such events, provided that each event upon which a payment is provided qualifies as a Change in Control Event.

(b) Identification of relevant corporation(s). To constitute a Change in Control Event as to the plan participant, the Change in Control Event must relate to (i) the corporation for whom the participant is performing services at the time of the Change in Control Event, (ii) the corporation that is liable for the payment of the deferred compensation (or all corporations liable for the payment if more than one corporation is liable), or (iii) a corporation that is a majority shareholder of a corporation identified in (i) or (ii), or any corporation in a chain of corporations in which each corporation is a majority shareholder of another corporation in the chain, ending in a corporation identified in (i) or (ii). For example, assume Corporation A is a majority shareholder of Corporation B, which is a majority shareholder of Corporation C. A change in ownership of Corporation B will constitute a Change in Control Event to plan participants performing services for Corporation B or Corporation C, and to plan participants for which Corporation B or Corporation C is solely liable for payments under the plan (for example, former employees), but will not constitute a Change in Control Event as to Corporation A or any other corporation of which Corporation A is a majority shareholder. Notwithstanding the foregoing, a sale of Corporation B may constitute an independent Change in Control Event for Corporation A, Corporation B and Corporation C if the sale constitutes a change in the ownership of a substantial portion of Corporation A's assets (see Q&A 14). For purposes of this paragraph, a majority shareholder is a shareholder owning more than 50% of the total fair market value and total voting power of such corporation.

(c) Attribution of stock ownership. For purposes of this A–11, Q&A 12, Q&A 13 and Q&A 14, § 318(a) applies to determine stock ownership. Stock underlying a vested option is considered owned by the individual who holds the vested option (and the stock underlying an unvested option is not considered owned by the individual who holds the unvested option). For purposes of the preceding sentence, however, if a vested option is exercisable for stock that is not substantially vested (as defined by §§ 1.83–3(b) and (j)), the stock underlying the option is not treated as owned by the individual who holds the option. In addition, mutual and cooperative corporations are treated as having stock for purposes of this paragraph (c).

Q–12 What is a change in the ownership of a corporation?

A–12 (a) Change in the ownership of a corporation. For purposes of § 409A, a change in the ownership of a corporation occurs on the date that any one person, or more than one person acting as a group (as defined in paragraph (b)), acquires ownership of stock of the corporation that, together with stock held by such person or group, constitutes more than 50 percent of the total fair market value or total voting power of the stock of such corporation. However, if any one person or more than one person acting as a group, is considered to own more than 50 percent of the total fair market value or total voting power of the stock of a corporation, the acquisition of additional stock by the same person or persons is not considered to cause a change in the ownership of the corporation (or to cause a change in the effective control of the corporation (within the meaning of Q&A 13)). An increase in the percentage of stock owned by any one person, or persons acting as a group, as a result of a transaction in which the corporation acquires its stock in exchange for property will be treated as an acquisition of stock for purposes of this section. This A–12 applies only when there is a transfer of stock of a corporation (or issuance of stock of a corporation) and stock in such corporation remains outstanding after the transaction (see Q&A 14 for rules regarding the transfer of assets of a corporation).

(b) Persons acting as a group. For purposes of paragraph (a), persons will not be considered to be acting as a group solely because they purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation. If a person, including an entity, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation. *See* § 1.280G–1, Q&A 27(d), Example 4.

(c) Stock ownership. For purposes of determining stock ownership, see Q&A 11.

Q–13 What is a change in the effective control of a corporation?

A–13 (a) Change in the effective control of the corporation. For purposes of § 409A, notwithstanding that a corporation has not undergone a change in ownership under Q&A 12, a change in the effective control of a corporation occurs on the date that either —

(i) Any one person, or more than one person acting as a group (as determined under paragraph (iv)), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) ownership of stock of the corporation possessing 35 percent or more of the total voting power of the stock of such corporation; or

(ii) a majority of members of the corporation's board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the corporation's board of directors prior to the date of the appointment or election, provided that for purposes of this paragraph (ii) the term corporation refers solely to the relevant corporation identi-

fied in Q&A 11, paragraph (b) for which no other corporation is a majority shareholder for purposes of that paragraph (for example, if Corporation A is a publicly held corporation with no majority shareholder, and Corporation A is the majority shareholder of Corporation B, which is the majority shareholder of Corporation C, the term corporation for purposes of this paragraph (ii) would refer solely to Corporation A).

In the absence of an event described in paragraph (i) or (ii), a change in the effective control of a corporation will not have occurred.

(b) Multiple Change in Control Events. A change in effective control also may occur in any transaction in which either of the two corporations involved in the transaction has a Change in Control Event under A–12 or A–14. Thus, for example, assume Corporation P transfers more than 40 percent of the total gross fair market value of its assets to Corporation O in exchange for 35 percent of O's stock. P has undergone a change in ownership of a substantial portion of its assets under A–14 and O has a change in effective control under this A–13.

(c) Acquisition of additional control. If any one person, or more than one person acting as a group, is considered to effectively control a corporation (within the meaning of this A–13), the acquisition of additional control of the corporation by the same person or persons is not considered to cause a change in the effective control of the corporation (or to cause a change in the ownership of the corporation within the meaning of Q&A 12).

(d) Persons acting as a group. Persons will not be considered to be acting as a group solely because they purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation. If a person, including an entity, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation only with respect to the ownership in that corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation.

(e) Stock ownership. For purposes of determining stock ownership, see Q&A 11.

Q–14 What is a change in the ownership of a substantial portion of a corporation's assets?

A–14 (a) Change in the ownership of a substantial portion of a corporation's assets. For purposes of § 409A, a change in the ownership of a substantial portion of a corporation's assets occurs on the date that any one person, or more than one person acting as a group (as determined in paragraph (c)), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the corporation that have a total gross fair market value equal to or more than 40 percent of the total gross fair market value of all of the assets of the corporation immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the corporation, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

(b) Transfers to a related person. There is no Change in Control Event under this A–14 when there is a transfer to an entity that is controlled by the shareholders of the transferring corporation immediately after the transfer, as provided in this paragraph (b). A transfer of assets by a corporation is not treated as a change in the ownership of such assets if the assets are transferred to —

(i) A shareholder of the corporation (immediately before the asset transfer) in exchange for or with respect to its stock;

(ii) An entity, 50 percent or more of the total value or voting power of which is owned, directly or indirectly, by the corporation;

(iii) A person, or more than one person acting as a group, that owns, directly or indirectly, 50 percent or more of the total value or voting power of all the outstanding stock of the corporation; or

(iv) An entity, at least 50 percent of the total value or voting power of which is owned, directly or indirectly, by a person described in paragraph (iii).

For purposes of this paragraph (b) and except as otherwise provided, a person's status is determined immediately after the transfer of the assets. For example, a transfer to a corporation in which the transferor corporation has no ownership interest before the transaction, but which is a majority-owned subsidiary of the transferor corporation after the transaction is not treated as a change in the ownership of the assets of the transferor corporation.

(c) Persons acting as a group. Persons will not be considered to be acting as a group solely because they purchase assets of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of assets, or similar business transaction with the corporation. If a person, including an entity shareholder, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation only to the extent of the ownership in that corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation.

(d) Stock ownership. For purposes of determining stock ownership, see Q&A 11.

C. Acceleration of Payments

Q–15 Under what conditions may a plan permit the acceleration of the time or schedule of any payment under the plan?

A–15 (a) In general. Except as provided in paragraphs (b) through (f) below, a plan may not permit the acceleration of the time or schedule of any payment under the plan. It is not an acceleration of the time or schedule of payment of a deferral of compensation if a service recipient waives or accelerates the satisfaction of a condition constituting a substantial risk of forfeiture applicable to such deferral of compensation, provided that the requirements of § 409A are otherwise satisfied with respect to such deferral of compensation. For example, if a nonqualified deferred compensation plan provides for a lump sum payment of the vested benefit

upon separation from service, and the benefit vests under the plan only after 10 years of service, it is not a violation of the requirements of § 409A if the service recipient reduces the vesting requirement to 5 years of service, even if a service provider becomes vested as a result and qualifies for a payment in connection with a separation from service.

(b) Domestic relations order. A plan may permit such acceleration of the time or schedule of a payment under the plan to an individual other than the plan participant as may be necessary to fulfill a domestic relations order (as defined in § 414(p)(1)(B)).

(c) Conflicts of interest. A plan may permit such acceleration of the time or schedule of a payment under the plan as may be necessary to comply with a certificate of divestiture (as defined in § 1043(b)(2)).

(d) Section 457 plans. A plan subject to § 457(f) may permit an acceleration of the time or schedule of a payment to a participant to pay income taxes due upon a vesting event, provided that the amount of such payment is not more than an amount equal to the income tax withholding that would have been remitted by the employer if there had been a payment of wages equal to the income includible by the participant under § 457(f) at the time of the vesting.

(e) *De minimis* and specified amounts. A plan that does not otherwise provide for *de minimis* cashout payments may be amended to permit the acceleration of the time or schedule of a payment to a participant under the plan, provided that (i) the payment accompanies the termination of the entirety of the participant's interest in the plan; (ii) the payment is made on or before the later of (A) December 31 of the calendar year in which occurs the participant's separation from service from the service recipient or (B) the date 2½ months after the participant's separation from service from the service recipient; and (iii) the payment is not greater than $10,000. Such an amendment may be made with respect to previously deferred amounts under the plan as well as amounts to be deferred in the future. In addition, a nonqualified deferred compensation plan that otherwise complies with § 409A may be amended with regard to future deferrals to provide that, if a participant's interest under the plan has a value below an amount specified by the plan at the time that amounts are payable under the plan, then the participant's entire interest under the plan shall be distributed as a lump sum payment.

(f) Payment of employment taxes. A plan may permit the acceleration of the time or schedule of a payment to pay the Federal Insurance Contributions Act (FICA) tax imposed under § 3101 and § 3121(v)(2) on compensation deferred under the plan (the FICA Amount). Additionally, a plan may permit the acceleration of the time or schedule of a payment to pay the income tax at source on wages imposed under § 3401 on the FICA Amount, and to pay the additional income tax at source on wages attributable to the pyramiding § 3401 wages and taxes. However, the total payment under this acceleration provision must not exceed the aggregate of the FICA Amount, and the income tax withholding related to such FICA amount.

(g) Definition of plan. For purposes of this A–15, the term plan has the meaning provided in Q&A 9, except that the provisions treating all account balance plans under which compensation is deferred as a single plan, all nonaccount balance plans under which compensation is deferred as a separate single plan, and all other nonqualified deferred compensation plans as a separate single plan, does not apply.

D. Effective Dates and Transition Guidance

Q–16 When does section 409A become effective?

A–16 (a) In general. Except as provided in Q&As 19 through 23, § 409A is effective with respect to (i) amounts deferred in taxable years beginning after December 31, 2004; and (ii) amounts deferred in taxable years beginning before January 1, 2005 if the plan under which the deferral is made is materially modified after October 3, 2004. Section 409A is effective with respect to earnings on amounts deferred only to the extent that § 409A is effective with respect to the amounts deferred. Accordingly, § 409A is not effective with respect to earnings on amounts deferred before January 1, 2005 unless § 409A is effective with respect to the amounts deferred.

(b) Date of deferral for effective date purposes. For purposes of determining whether § 409A is effective with respect to an amount, the amount is considered deferred before January 1, 2005 if (i) the service provider has a legally binding right to be paid the amount and (ii) the right to the amount is earned and vested. For purposes of this A–16, a right to an amount is earned and vested only if the amount is not subject to either a substantial risk of forfeiture (as defined in § 1.83–3(c)) or a requirement to perform further services. Accordingly, amounts to which the service provider does not have a legally binding right before January 1, 2005 (for example because the service recipient retains discretion to reduce the amount), will not be considered deferred before January 1, 2005. In addition, amounts to which the service provider has a legally binding right before January 1, 2005, but the right to which is subject to a substantial risk of forfeiture or a requirement to perform further services after December 31, 2004 are not considered deferred before January 1, 2005 for purposes of the effective date. Notwithstanding the foregoing, an amount to which the service provider has a legally binding right before January 1, 2005, but for which the service provider must continue performing services to retain the right only through the completion of the payroll period (as defined in Q&A 4) which includes December 31, 2004, shall not be treated as subject to a requirement to perform further services (or a substantial risk of forfeiture) for purposes of the effective date.

Q–17 For purposes of the effective date, how is the amount of compensation deferred under a nonqualified deferred compensation plan before January 1, 2005 determined?

A–17 (a) Nonaccount balance plans. The amount of compensation deferred before January 1, 2005 under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in § 31.3121(v)(2)–1(c)(2)(i)) equals the present value as of December 31, 2004 of the amount to which the participant would be entitled under the plan if the participant voluntarily terminated services without cause on December 31 of that taxable year, and received a full payment of benefits from the plan on the earliest possible date allowed under the plan following the termination of services, to the extent the

right to the benefit is earned and vested (as defined in Q&A 16) as of December 31, 2004. For purposes of determining the present value of the benefit, the actuarial assumptions contained within the plan are used provided such assumptions are reasonable; otherwise, reasonable actuarial assumptions must be used. Amounts to which the participant would not be entitled upon termination, such as early retirement subsidies for which the participant would not have attained sufficient service if he or she terminated services on December 31, 2004, are not includible as compensation deferred under the plan as of December 31, 2004.

(b) Account balance plans. The amount of compensation deferred before January 1, 2005 under a nonqualified deferred compensation plan that is an account balance plan (as defined in § 31.3121(v)(2)–1(c)(1)(ii)) equals the portion of the participant's account balance as of December 31, 2004 the right to which is earned and vested (as defined in Q&A 16) as of December 31, 2004.

(c) Equity-based compensation plans. For purposes of determining the amounts deferred before January 1, 2005 under an equity-based compensation plan, the rules of paragraph (b) governing account balance plans are applied except that the account balance is deemed to be the amount of the payment available to the participant on December 31, 2004 (or that would be available to the participant if the right were immediately exercisable) the right to which is earned and vested (as defined in Q&A 16) as of December 31, 2004. For this purpose, the payment available to the participant excludes any exercise price or other amount which must be paid by the participant.

(d) Earnings. Earnings on amounts deferred under a plan before January 1, 2005 include only income (whether actual or notional) attributable to the amounts deferred under a plan as of December 31, 2004 or such income. For example, notional interest earned under the plan on amounts deferred in an account balance plan as of December 31, 2004 generally will be treated as earnings on amounts deferred under the plan before January 1, 2005. Similarly, an increase in the amount of payment available under a stock option, stock appreciation right or other equity-based compensation above the amount of payment available as of December 31, 2004, due to appreciation in the underlying stock after December 31, 2004, is treated as earnings on the amount deferred. In the case of a nonaccount balance plan, earnings include the increase, due solely to the passage of time, in the present value of the future payments to which the service provider has obtained a legally binding right, the present value of which constituted the amounts deferred under the plan before January 1, 2005. Thus, for each year, there will be an increase (determined using the same interest rate used to determine the amounts deferred under the plan before January 1, 2005) resulting from the shortening of the discount period before the future payments are made, plus, if applicable, an increase in the present value resulting from the service provider's survivorship during the year. However, an increase in the potential benefits under a nonaccount balance plan due to, for example, an application of an increase in compensation after December 31, 2004 to a final average pay plan or subsequent eligibility for an early retirement subsidy, does not constitute earnings on the amounts deferred under the plan before January 1, 2005.

(e) Definition of plan. For purposes of this A–17, the term plan has the same meaning provided in Q&A 9, except that the provisions treating all nonaccount balance plans under which compensation is deferred as a single plan does not apply for purposes of the actuarial assumptions used in paragraph (b). Accordingly, different reasonable actuarial assumptions may be used to calculate the amounts deferred by a participant in two different arrangements each of which constitutes a nonaccount balance plan.

Q–18 When is a plan materially modified?

A–18 (a) In general. Except as otherwise provided in this A–18 and Q&A 19, a modification of a plan is a material modification if a benefit or right existing as of October 3, 2004 is enhanced or a new benefit or right is added. Such benefit enhancement or addition is a material modification whether it occurs pursuant to an amendment or the service recipient's exercise of discretion under the terms of the plan. For example, an amendment to a plan to add a provision that payments may be allowed upon request if participants are required to forfeit 10 percent of the amount of the payment (a "haircut") would be a material modification to the plan. Similarly, a material modification would occur if a service recipient exercised discretion to accelerate vesting of a benefit under the plan to a date on or before December 31, 2004. However, it is not a material modification for a service recipient to exercise discretion over the time and manner of payment of a benefit to the extent such discretion is provided under the terms of the plan as of October 3, 2004. Also, it is not a material modification to change a notional investment measure to, or to add, an investment measure that qualifies as a predetermined actual investment within the meaning of § 31.3121(v)(2)–1(d)(2). It is not a material modification for a participant to exercise a right permitted under the plan as in effect on October 3, 2004. The amendment of a plan to bring the plan into compliance with the provisions of § 409A will not be treated as a material modification. However, a plan amendment or the exercise of discretion under the terms of the plan that enhances an existing benefit or right or adds a new benefit or right will be considered a material modification even if the enhanced or added benefit would be permitted under § 409A. For example, the addition of a right to a payment upon an unforeseeable emergency would be considered a material modification. The reduction of an existing benefit is not a material modification. For example, the removal of a "haircut" provision generally would not constitute a material modification.

(b) Adoption of new arrangement. It is presumed that the adoption of a new arrangement or the grant of an additional benefit under an existing arrangement after October 3, 2004 will constitute a material modification of a plan. However, the presumption may be rebutted by demonstrating that the adoption of the arrangement or grant of the additional benefit is consistent with the service recipient's historical compensation practices. For example, the presumption that the grant of a stock appreciation right on November 1, 2004 is a material modification of a plan may be rebutted by demonstrating that the grant was consistent with the historic practice of granting substantially similar stock appreciation rights (both as to terms and

amounts) each November for a significant number of years. Notwithstanding paragraph (a) and this paragraph (b), the grant of an additional benefit under an existing arrangement that consists solely of a deferral of additional compensation not otherwise provided under the plan as of October 3, 2004 will be treated as a material modification of the plan only as to the additional deferral of compensation, if the plan explicitly identifies the additional deferral of compensation and provides that the additional deferral of compensation is subject to § 409A. A plan may be amended to comply with the provisions of the preceding sentence in accordance with the rules of Q&A 19.

(c) Suspension or termination of a plan. Amending an arrangement to stop future deferrals thereunder is not a material modification of the arrangement or the plan. Amending an arrangement on or before December 31, 2005 to terminate the arrangement and distribute the amounts of deferred compensation thereunder will not be treated as a material modification, provided that all amounts deferred under the plan are included in income in the taxable year in which the termination occurs.

(d) Equity-based compensation. Provided that the cancellation and reissuance occurs on or before December 31, 2005, it will not be a material modification to replace a stock option or stock appreciation right otherwise providing for a deferral of compensation under Q&A 4 with a stock option or stock appreciation right that would not have constituted a deferral of compensation under § 409A if it had been granted upon the original date of grant of the replaced stock option or stock appreciation right. The preceding sentence only applies if (i) the number of shares which form the basis of the new stock option or new stock appreciation right corresponds directly to the number of shares subject to the original stock option or stock appreciation right; and (ii) the new stock option or new stock appreciation right does not provide any additional benefit to the service recipient (other than the benefit directly due to a change in form of the award to a form not treated as a deferral of compensation). A replacement stock option or replacement stock appreciation right will be treated as meeting the requirements of clause (i) of the preceding sentence if the new grant is made in accordance with the principles of § 1.424–1(a)(5) except to the extent necessary to ensure that the new grant does not violate § 409A. For example, a stock option originally issued with an exercise price discounted below the value of the shares subject to the option on the date of grant could be amended, without causing a material modification of the option, to be excluded from the definition of deferral of compensation by eliminating the discount on the exercise price below the value of the shares subject to the option on the original date of grant. Similarly, a stock appreciation right could be converted to a stock option or stock appreciation right that, based on its terms, would be excluded from the definition of deferral of compensation.

(e) Definition of plan. For purposes of this A–18, the term plan has the same meaning provided in Q&A 9, except that the provision treating all account balance plans under which compensation is deferred as a single plan, all nonaccount balance plans under which compensation is deferred as a separate single plan, and all other nonqualified deferred compensation plans as a separate single plan, does not apply.

Q–19 Under what conditions may a plan adopted before December 31, 2005 be operated and amended without violating the requirements of § 409A(a)(2), (3) and (4)?

A–19 (a) In general. A plan adopted before December 31, 2005 will not be treated as violating § 409A(a)(2), (3) or (4) only if (i) the plan is operated in good faith compliance with the provisions of § 409A and this notice during the calendar year 2005, and (ii) the plan is amended on or before December 31, 2005 to conform to the provisions of § 409A with respect to amounts subject to § 409A.

(b) Good faith compliance. A plan will be treated as operated in good faith compliance during the calendar year 2005 if it is operated in accordance with the terms of this notice and, to the extent an issue is not addressed in this notice, a good faith, reasonable interpretation of § 409A, and, to the extent not inconsistent therewith, the plan's terms, provided that the plan sponsor does not exercise discretion under the terms of the plan, or that a participant does not exercise discretion with respect to that participant's benefits, in a manner that causes the plan to fail to meet the requirements of § 409A. For example, if an employer retains the discretion under the terms of the plan to delay or extend payments under the plan and exercises such discretion, the plan will not be considered to be operated in good faith compliance with § 409A with regard to any plan participant. However, an exercise of a right under the terms of the plan by a plan participant solely with respect to that participant's benefits under the plan, in a manner that causes the plan to fail to meet the requirements of § 409A, will not be considered to result in the plan failing to be operated in good faith compliance with respect to other participants. For example, the request for and receipt of an immediate payment permitted under the terms of the plan if the participant forfeits 10% of the participant's benefits (a "haircut") will be considered a failure of the plan to meet the requirements of § 409A with respect to that participant, but not with respect to all participants under the plan.

(c) Payment elections. With respect to amounts subject to § 409A, the plan may be amended to provide for new payment elections with respect to amounts deferred prior to the election and the election will not be treated as a change in the form and timing of a payment under § 409A(a)(4) or an acceleration of a payment under § 409A(a)(3), provided that the plan is so amended and the participant makes the election on or before December 31, 2005. Similarly, an outstanding stock option or stock appreciation right that provides for a deferral of compensation subject to § 409A may be amended to provide for fixed payment terms consistent with § 409A, or to permit holders of such rights to elect fixed payment terms consistent with § 409A, and such amendment or election will not be treated as a change in the form and timing of a payment under § 409A(a)(4) or an acceleration of a payment under § 409A(a)(3), provided that the option or right is so amended and any elections are made, on or before December 31, 2005.

(d) Severance plans. Provided that the plans are otherwise amended in compliance with paragraph (a), a plan that provides severance pay benefits, and that is either (i) a collectively bargained plan or (ii) covers no service providers who are key employees (as defined in § 416(i) and

the regulations thereunder), is not required to meet the requirements of § 409A during the calendar year 2005 with respect to such severance pay benefits. Benefits that are provided under a severance pay arrangement (within the meaning of § 3(2)(B)(i) of ERISA (29 U.S.C. § 1002(2)(B)(i)) that satisfies the conditions in 29 CFR § 2510.3–2(b)(1)(i) through (iii) are considered severance pay for purposes of this paragraph (d). Benefits provided under a severance pay arrangement (within the meaning of § 3(2)(B)(i) of ERISA) are in all cases severance pay within the meaning of this paragraph (d) if the benefits payable under the plan upon an employee's termination of employment are payable only if that termination is involuntary.

Q–20 Under what conditions may a plan adopted before December 31, 2005 provide a participant a right to terminate participation in the plan, or cancel an outstanding deferral election with regard to amounts subject to § 409A, and receive a payment of amounts subject to the termination or cancellation, without violating the requirements of § 409A(a)(2), (3) and (4)?

A–20 (a) Plan amendment. A plan adopted before December 31, 2005 may be amended to allow a participant during all or part of the calendar year 2005 to terminate participation in the plan or cancel a deferral election, without causing the plan to fail to conform to the provisions of § 409A(a)(2), (3) or (4), provided that (i) the amendment is enacted and effective on or before December 31, 2005, and (ii) the amounts subject to the termination or cancellation are includible in income of the participant in the calendar year 2005 or, if later, in the taxable year in which the amounts are earned and vested (as defined in Q&A 16). Solely for purposes of effecting the relief provided in this A–20, neither the availability of the election to the participant nor the making of the election by the participant will be treated as resulting in a violation of the requirements of § 409A(a)(2), (3) or (4) or causing amounts the participant continues to defer to be includible in income under § 451 or the doctrine of constructive receipt (although these provisions may still apply for other reasons). There is no requirement that the opportunity to terminate participation in a plan or to cancel a deferral election be granted, or that if granted, be granted to all plan participants. A termination or cancellation may be made with respect to elective or nonelective deferred compensation and may be undertaken by the service recipient or at the election of the participant. A termination or cancellation under this paragraph may apply in whole or in part to one or more plans in which a participant participates and to one or more outstanding deferral elections the participant has made with regard to amounts subject to § 409A.

(b) Payments. Provided that the plan amendment is adopted in accordance with paragraph (a), a provision permitting a payment to a participant during calendar year 2005 or, if later, the taxable year in which the amount is earned and vested (as defined in Q&A 16), upon a termination of participation in the plan or the cancellation of a deferral election with regard to amounts subject to § 409A, will not be treated as causing a plan to violate the provisions of § 409A(a)(2), (3) or (4), and a payment from a plan pursuant to such an amendment will not be treated as a violation of the provision of § 409A(a)(2), (3) or (4), provided that the full amount of the distribution is included in the participant's income in calendar year 2005 or, if later, the participant's taxable year in which the amount is earned and vested (as defined in Q&A 16).

(c) Partial terminations and cancellations. For purposes of this Q&A 20, the termination of participation in the plan or the cancellation of an outstanding deferral election with regard to amounts subject to § 409A includes a termination or cancellation that results in a lower amount of deferrals for the period, without a complete elimination of the deferrals.

(d) Definition of plan. For purposes of this A–20, the definition of plan under Q&A 9 applies, except that the rule requiring the aggregation of all account balance plans, all nonaccount balance plans, and all other plans does not apply.

Q–21 Under what conditions will deferral elections under a plan in existence on or before December 31, 2004, made with respect to deferrals relating all or in part to services performed on or before December 31, 2005, be exempt from the requirements of § 409A(a)(4)(B) relating to the timing of elections?

A–21 With respect to deferrals subject to § 409A that relate all or in part to services performed on or before December 31, 2005, the requirements of § 409A(a)(4)(B) relating to the timing of elections will not be applicable to any elections made on or before March 15, 2005, provided that (a) the amounts to which the deferral election relate have not been paid or become payable at the time of election, (b) the plan under which the deferral election is or was made was in existence on or before December 31, 2004, (c) the elections to defer compensation are made in accordance with the terms of the plan in effect on or before December 31, 2005 (other than a requirement to make a deferral election after March 15, 2005), (d) the plan is otherwise operated in accordance with § 409A with respect to deferrals subject to § 409A and (e) the plan is amended to comply with the requirements of § 409A in accordance with Q&A 19. For purposes of this A–21, a nonqualified deferred compensation plan will be treated as in existence before December 31, 2004 only if a written plan document (a) identifies a specific amount or type of compensation that is subject to the plan and not otherwise payable at the time of the deferral election, and (b) provides that a participant in the plan may elect to defer the compensation beyond the taxable year in which the amount otherwise would have been payable. Solely for purposes of effecting the relief provided in this A–21, neither the availability of the election to the participant nor the making of the election by the participant will be treated as causing amounts the participant defers to be includible in income under § 451 or the doctrine of constructive receipt.

Q–22 Until additional guidance is issued, under what conditions may deferral elections be made with respect to bonus compensation?

A–22 Section 409A(a)(4)(B)(iii) provides that in the case of any performance-based compensation based on services performed over a period of at least 12 months, an election to defer such compensation may be made no later than 6 months before the end of the period. The Treasury Department and the Service anticipate issuing guidance that sets forth the requirements for compensation to qualify as performance-based compensation. The Trea-

sury Department and the Service anticipate that those requirements will be more restrictive than the requirements outlined in this A–22. Until additional guidance is issued, a deferral election with respect to bonus compensation based on services performed over a period of at least 12 months will be treated as meeting the requirements of § 409A(a)(4) if the election is made at least 6 months before the end of the service period. For purposes of this transition relief, the term bonus compensation refers to compensation where (i) the payment of the compensation or the amount of the compensation is contingent on the satisfaction of organizational or individual performance criteria, and (ii) the performance criteria are not substantially certain to be met at the time a deferral election is permitted. Bonus compensation may include payments based upon subjective performance criteria, but (i) any subjective performance criteria must relate to the performance of the participant service provider, a group of service providers that includes the participant service provider, or a business unit for which the participant service provider provides services (which may include the entire organization); and (ii) the determination that any subjective performance criteria have been met must not be made by the participant service provider or a family member of the participant service provider (as defined in § 267(c)(4) applied as if the family of an individual includes the spouse of any member of the family). Bonus compensation may also include payments based on performance criteria that are not approved by a compensation committee of the board of directors (or similar entity in the case of a non-corporate service recipient) or by the stockholders or members of the service recipient. Notwithstanding the foregoing, bonus compensation does not include any amount or portion of any amount that will be paid either regardless of performance, or based upon a level of performance that is substantially certain to be met at the time the criteria is established, or that is based solely on the value of, or appreciation in value of, the service recipient or the stock of the service recipient.

Q–23 Under what circumstances will payments be permitted based upon elections under a qualified plan for periods ending on or before December 31, 2005.

A–23 For periods ending on or before December 31, 2005, an election as to the timing and form of a payment under a nonqualified deferred compensation plan that is controlled by a payment election made by the participant under a qualified plan will not violate § 409A, provided that the determination of the timing and form of the payment is made in accordance with the terms of the nonqualified deferred compensation plan as of October 3, 2004 that govern payments. For purposes of this paragraph, a qualified plan means a retirement plan qualified under § 401(a). For example, where a nonqualified deferred compensation plan provides as of October 3, 2004 that the time and form of payment to a participant will be the same time and form of payment elected by the participant under a related qualified plan, it will not be a violation of § 409A for the plan administrator to make or commence payments under the nonqualified deferred compensation plan on or after January 1, 2005 and on or before December 31, 2005 pursuant to the payment election under the related qualified plan. Notwithstanding the foregoing, other provisions of the Code and common law tax doctrines continue to apply to any election as to the timing and form of a payment under a nonqualified deferred compensation plan.

E. Information Reporting Requirements for Deferred Amounts

Q–24 What information reporting requirements are imposed by § 885(b) of the Act?

A–24 The Act adds §§ 6041(g)(1) and 6051(a)(13), which require that all deferrals for the year under a nonqualified deferred compensation plan be separately reported on a Form 1099 *(Miscellaneous Income)* or a Form W–2 *(Wage and Tax Statement)*, respectively. The Act requires annual reporting of all compensation deferred under the plan for the year regardless of whether such compensation is includible in gross income pursuant to § 409A(a)(1)(A). However, neither § 6041(g)(1) nor § 6051(a)(13) requires the reporting of deferrals under a nonqualified deferred compensation plan that benefit a person with respect to whom a Form 1099–MISC or a Form W–2 is not required to be filed.

Q–25 What constitutes deferrals for the year under a nonqualified deferred compensation plan for purposes of §§ 6041(g)(1) and 6051(a)(13)?

A–25 Deferrals for the year under a nonqualified deferred compensation plan for purposes of §§ 6041(g)(1) and 6051(a)(13) generally include all deferrals of compensation within the meaning of § 409A that occur during the year and that are made under a nonqualified deferred compensation plan within the meaning of § 409A(d). *See* Q&A 4 (definition of a deferral of compensation) and Q&A 3 (definition of a nonqualified deferred compensation plan). The Treasury Department and the Service anticipate issuing additional guidance that will provide a method for calculating the amount of deferrals for the year.

Q–26 Do the information reporting requirements imposed by §§ 6041(g)(1) and 6051(a)(13) apply with respect to amounts deferred under a nonqualified deferred compensation plan that is a nonaccount balance plan?

A–26 Yes. The information reporting requirements imposed by §§ 6041(g)(1) and 6051(a)(13) generally apply with respect to amounts deferred under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in § 31.3121(v)(2)–1(c)(2)). However, amounts deferred that are not reasonably ascertainable (as defined in § 31.3121(v)(2)–1(e)(4)) are not required to be reported until such deferrals become reasonably ascertainable (regardless of whether the service provider is an employee). The Treasury Department and the Service anticipate issuing additional guidance that will provide a method for calculating the amount of deferrals for the year under a nonqualified deferred compensation plan.

Q–27 Is there a minimum amount of aggregate deferrals for the year with respect to an individual employee below which the information reporting requirement imposed by § 6051(a)(13) does not apply?

A–27 Yes. The Act authorizes the Secretary of the Treasury, through regulations, to establish a minimum amount of deferrals below which the information reporting requirement imposed by § 6051(a)(13)

does not apply. The Treasury Department and the Service anticipate providing the authorized guidance in future regulations. Until such guidance is provided, however, employers may rely on this notice to exclude from the information reporting requirement imposed by § 6051(a)(13) all deferrals for the year with respect to an individual employee under one or more nonqualified deferred compensation plans if the aggregate amount of such deferrals does not exceed $600.

Q–28 What is the effective date for the information reporting requirements imposed by §§ 6041(g)(1) and 6051(a)(13)?

A–28 The information reporting requirements imposed by §§ 6041(g)(1) and 6051(a)(13) are effective for amounts actually deferred in calendar years beginning after December 31, 2004. Additionally, such information reporting requirements apply to income (whether actual or notional) attributable to amounts actually deferred in calendar years beginning after December 31, 2004. For purposes of §§ 6041(g)(1) and 6051(a)(13), amounts are considered actually deferred at the time the service provider has a legally binding right to the compensation as described in Q&A 4. Thus, the information reporting requirements are not effective for amounts actually deferred in calendar years beginning before January 1, 2005, (or for income attributable to such amounts) notwithstanding that § 885(d) of the Act may treat such amounts as having been deferred in a calendar year beginning on or after such date under the general effective date provisions.

Q–29 How should an employer report to an employee the total amount of deferrals for the year under a nonqualified deferred compensation plan as required by § 6051(a)(13)?

A–29 An employer should report to an employee the total amount of deferrals for the year under a nonqualified deferred compensation plan in box 12 of Form W–2 using code Y. The instructions for Form W–2 provide additional information relating to this reporting requirement. However, see Q&A 38 for interim guidance with respect to an employer's reporting requirements where the employer furnishes an expedited Form W–2 prior to the issuance of additional guidance that will provide a method for calculating the amount of deferrals for the year. Neither § 6051(a)(13) nor this notice affect the rules for reporting deferred compensation in Box 11 of Form W–2.

Q–30 How should a payer report to a nonemployee the total amount of deferrals for the year under a nonqualified deferred compensation plan as required by § 6041(g)(1)?

A–30 A payer should report to a nonemployee the total amount of deferrals for the year under a nonqualified deferred compensation plan in box 15a of Form 1099–MISC. The instructions for Form 1099–MISC provide additional information relating to this reporting requirement. However, the information reporting requirement imposed by § 6041(g)(1) does not apply to deferrals that are required to be reported under § 6051(a)(13) (without regard to any *de minimis* exception). Additionally, § 6041(g)(1) does not require the reporting of deferrals under a nonqualified deferred compensation plan that benefit a person with respect to whom a Form 1099–MISC is not required to be filed.

F. Wage Withholding for Employees

Q–31 What wage withholding requirements are imposed by § 885(b) of the Act?

A–31 The Act amends § 3401(a) (defining wages for income tax withholding purposes) to provide that the term "wages" includes any amount includible in gross income of an employee under § 409A. The amount is treated as a payment of wages in the taxable year in which the amount is includible in the employee's gross income. The Treasury Department and the Service anticipate issuing additional guidance that will provide a method for computing the amount includible in gross income of an employee under § 409A.

Q–32 When are amounts that are includible in gross income under § 409A treated as a payment of wages for income tax withholding purposes?

A–32 For the calendar year 2005, amounts includible in gross income under § 409A but neither actually nor constructively received by an employee may be treated as having been paid by an employer for income tax withholding purposes on any date on or before December 31, 2005. However, nothing in § 409A prevents the inclusion of amounts in gross income and in wages for income tax withholding purposes under any other provision or rule of law on a date earlier than December 31, 2005. Thus, amounts includible in gross income under § 409A and either actually or constructively received by an employee during the calendar year 2005 are considered a payment of wages when received by the employee for purposes of withholding, depositing, and reporting the income tax at source on wages.

Q–33 How should an employer report to an employee amounts includible in gross income under § 409A and in wages under § 3401(a) as required by § 6051(a)(3)?

A–33 An employer should report amounts includible in gross income under § 409A and in wages under § 3401(a) in box 1 of Form W–2 as part of the total wages, tips, and other compensation paid to the employee during the year. Additionally, an employer should report such amounts in box 12 of Form W–2 using code Z. The amount reported in box 12 using code Z should include all amounts deferred under the plan for the taxable year and all preceding taxable years that are currently includible in gross income under § 409A and in wages under § 3401(a). The instructions for Form W–2 provide additional information relating to this reporting requirement. However, see Q&A 38 for interim guidance with respect to an employer's reporting requirements relating to an employee or business that is terminated prior to the issuance of additional guidance that will provide a method for calculating the amounts includible in gross income under § 409A and in wages under § 3401(a).

G. Reporting Nonemployee Compensation

Q–34 What reporting requirements relating to nonemployee compensation are imposed by § 885(b) of the Act?

A–34 The Act adds § 6041(g)(2), which requires a payer to report to a nonemployee any amount includible in gross income under § 409A that is not treated as wages un-

der § 3401(a). However, § 6041(g)(2) does not require the reporting of amounts includible in gross income under § 409A that are treated as having been paid to a person with respect to whom a Form 1099–MISC is not required to be filed.

Q–35 How should a payer report to a nonemployee amounts includible in gross income under § 409A and not treated as wages under § 3401(a) as required by § 6041(g)(2)?

A–35 A payer should report the amounts includible in gross income under § 409A and not treated as wages under § 3401(a) in box 7 (nonemployee compensation) of Form 1099–MISC. Additionally, a payer should report such amounts in box 15b of Form 1099–MISC. The amount reported in box 15b should include only the amounts includible in gross income under § 409A and not included in wages under § 3401(a). The instructions for Form 1099–MISC provide additional information relating to this reporting requirement.

Q–36 What are the SECA tax consequences of a failure to satisfy the requirements of § 409A?

A–36 Gross income of a self-employed individual (for example, a nonemployee director, partner, or independent contractor) derived by the individual from any trade or business is generally subject to tax in accordance with the Self-Employment Contributions Act (SECA) when includible in gross income. *See* §§ 1401, 1402(a). Accordingly, an amount derived from an individual's trade or business that is includible in the self-employed individual's gross income under § 409A is generally subject to the application of SECA taxes at the time such amount is includible in gross income.

Q–37 Does § 885 of the Act affect the imposition of the employee tax and the employer tax under the Federal Insurance Contributions Act (FICA) with respect to wages paid and received for employment under a nonqualified deferred compensation plan within the meaning of § 409A(d)?

A–37 No. Section 885 of the Act does not affect the imposition of the employee tax and the employer tax under FICA with respect to wages paid and received for employment under a nonqualified deferred compensation plan within the meaning of § 409A(d). Thus, remuneration for employment constituting wages within the meaning of § 3121(a) is taken into account for FICA tax purposes in accordance with the rules for wage inclusion under §§ 3121(a) and 3121(v)(2).

H. Interim Reporting for Expedited Form W–2

Q–38 What are an employer's withholding and reporting obligations where an employee is terminated or a business files a final Form 941 prior to the issuance of further guidance providing methods for calculating the amount of deferrals for the year and the amounts includible in gross income under § 409A and in wages under § 3401(a)?

A–38 An employer is generally required to issue a Form W–2 reporting compensation paid during a calendar year no later than January 31 of the succeeding calendar year. However, if an employee's employment is terminated before the close of the calendar year, an employer must furnish an expedited Form W–2 if requested to do so by the employee. Additionally, an employer may, at its option, furnish a Form W–2 to such an employee at any time after the termination but no later than January 31 of the succeeding calendar year. *See* § 31.6051–1(d)(i). In addition, if an employer makes a final return on Form 941, the employer must furnish expedited Form W–2s to employees and file expedited Form W–2s with the Social Security Administration. *See* §§ 31.6051–1(d)(ii), 31.6071(a)–1. If an employer furnishes an expedited Form W–2 before the issuance of additional guidance providing methods for determining the amount of deferrals for the year or the amounts includible in gross income under § 409A and in wages under § 3401(a), the employer need not report an amount described in Q&A–25 (deferrals for the year) or in Q&A–31 (amounts includible in gross income and wages) on the Form W–2. However, if an employer furnishes an expedited Form W–2 prior to the issuance of additional guidance that requires the employer to report a deferral for the year or an amount includible in gross income and wages, then the employer must subsequently furnish a corrected Form W–2. See § 31.6051(c).

V. Drafting Information

The principal author of this notice is Stephen Tackney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) and, regarding the employment tax and information reporting requirements, Neil D. Shepherd of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the Service participated in its development. For further information regarding this notice, contact Stephen Tackney (202) 927–9639; or for further information regarding the employment tax and information reporting requirements, Neil D. Shepherd (202) 622–6040; or regarding the submission of comments, contact LaNita Van Dyke (202) 622–7180 (not toll-free calls).

Fuel Tax Guidance; Request for Public Comments

Notice 2005–4

Section 1. PURPOSE

This notice provides guidance on certain excise tax provisions in the Internal Revenue Code that were added or affected by the American Jobs Creation Act of 2004 (Pub. L. 108–357) (Act). These provisions relate to: alcohol and biodiesel fuels; the definition of off-highway vehicles; aviation-grade kerosene; claims related to diesel fuel used in certain buses; the display of registration on certain vessels; claims related to sales of gasoline to state and local governments and nonprofit educational organizations; two party exchanges of taxable fuel; and the classification of transmix and certain diesel fuel blendstocks as diesel fuel. Also, this notice requests comments from the public on these provisions as well as other excise tax provisions that were added or affected by the Act.

The provisions in this notice will be the subject of a notice of proposed rulemaking (NPRM) that Treasury and the Internal Revenue Service plan to issue in 2005. Also, excise tax provisions of the Act on which guidance is not provided by this no-

tice may be the subject of future guidance or addressed in the NPRM.

Unless otherwise specified, references to Code provisions in this notice are to the Code as in effect on January 1, 2005. Unless otherwise specified, references to regulations are to the Manufacturers and Retailers Excise Tax Regulations.

Section 2. ALCOHOL AND BIODIESEL FUELS

(a) *Overview*. Effective January 1, 2005, the Act generally eliminates the reduced rate of excise tax for most alcohol-blended fuels. In place of a reduced rate, the Act allows certain credits or payments related to alcohol and biodiesel fuels under §§ 40, 40A, 6426, and 6427(e). If the alcohol is ethanol with a proof of 190 or greater, the credit or payment amount is $0.51 per gallon. For agri-biodiesel, the credit or payment amount is $1.00 per gallon; for biodiesel other than agri-biodiesel, the credit or payment amount is $0.50 per gallon. Under the Code's coordination rules, a claim may be taken only once with respect to any particular gallon of alcohol or biodiesel.

(b) *Definitions*.

Alcohol has the meaning given to the term in § 48.4081–6(b)(1) except that, for purposes of the credit allowed by § 40, alcohol also includes alcohol with a proof of at least 150.

Alcohol fuel mixture and *biodiesel mixture* have the meaning given to the terms by § 6426(b)(3) and 6426(c)(3), respectively.

Biodiesel and *agri-biodiesel* have the meanings given to the terms by § 40A(d)(1) and 40A(d)(2), respectively.

(c) *Excise tax credit for alcohol fuel and biodiesel mixtures; § 6426*. Section 6426 allows a credit against the tax imposed by § 4081 on taxable fuel. The credit is equal to the sum of the alcohol fuel mixture credit and the biodiesel mixture credit. The credit is allowable to the person that produces the mixture for sale or use in the producer's trade or business. The credit is claimed on Form 720, *Quarterly Federal Excise Tax Return*, in accordance with the instructions for that form. For the requirement that the claimant obtain a certificate from a producer of biodiesel, see section 2(h) of this notice.

(d) *Income tax credits or payments for alcohol or biodiesel used to produce alcohol fuel and biodiesel mixtures; §§ 34 and 6427(e)*—(1) *In general*. To the extent that the sum of the alcohol fuel mixture credit and biodiesel mixture credit described in § 6426 exceeds a person's § 4081 liability for any particular quarter, an income tax credit or a payment under § 6427(e) is allowable to the producer of the mixture. This credit or payment is claimed on Form 720, Q*uarterly Federal Excise Tax Return*; Form 4136, *Credit for Federal Tax Paid on Fuels*; or Form 8849, *Claim for Refund of Excise Taxes*; in accordance with the instructions for those forms. For the requirement that the claimant obtain a certificate from a producer of biodiesel, see section 2(h) of this notice.

(2) *Coordination with excise tax credit*. If a person receives a payment under § 6427(e) for an amount claimed on Form 8849 with respect to a mixture for which the person is allowed a credit under § 6426, the amount of the payment constitutes an excessive amount for purposes of § 6206 and such amount, as well as the civil penalty under § 6675, may be assessed as if it were a tax imposed by § 4081. If an erroneous refund is repaid to the government, with interest from the date of the payment (§ 6602), on or before the due date of the Form 720, *Quarterly Federal Excise Tax Return*, on which the credit is allowed with respect to the mixture, the claim for the excessive amount will be treated as due to reasonable cause and the penalty under § 6675 will not be imposed with respect to the claim. If, in lieu of a payment under § 6427(e), a person claims an income tax credit on Form 4136 with respect to a mixture for which the person is allowed a credit under § 6426, the income tax rules related to assessing an underpayment of income tax liability apply. The § 6675 penalty for excessive claims with respect to fuels does not apply in the case of § 34 income tax credits.

(e) *Biodiesel used as a fuel; § 40A*. Section 40A allows a nonrefundable income tax credit, included in the general business credit, for biodiesel used as a fuel. (See § 38 for limit on the general business credit based on the amount of tax.) The credit is the sum of the biodiesel credit and the biodiesel mixture credit. In the case of biodiesel not in a mixture (100% biodiesel or B100), the credit is allowable to the person selling the biodiesel in a qualifying retail sale or, if the biodiesel has not been sold in a qualifying retail sale, to the person using the biodiesel as a fuel in a trade or business. A sale is a qualifying retail sale for this purpose if it is at retail and the biodiesel is placed in the fuel tank of the purchaser's vehicle at the time of the sale. In the case of biodiesel in a mixture, the credit is allowable to the producer of a mixture that is sold or used in the producer's trade or business. This credit is claimed on Form 8864, *Biodiesel Fuels Credit*, in accordance with the instructions for that form. For the requirement that the claimant obtain a certificate from a producer of biodiesel, see section 2(h) of this notice.

(f) *Registration*—(1) *Producers of alcohol and biodiesel; § 4101(a)(1)*—(i) *In general*. Under § 4101(a)(1) and this notice, every person producing or importing alcohol (other than alcohol with a proof of less than 190) or biodiesel must be registered by the Service by July 1, 2005. Application for registration is made on Form 637, *Application for Registration (For Certain Excise Tax Activities)*, in accordance with the instructions for that form. For penalties for failure to register as required, see § 6719 and § 48.4101–1(c)(3).

(ii) *Requirements*. The Service will register an applicant as an alcohol producer or biodiesel producer only if the Service—

(A) Determines that the applicant is engaged as a producer or importer of alcohol or biodiesel, or is likely to become so engaged within a reasonable time after being registered under § 4101; and

(B) Is satisfied with the filing, deposit, payment, reporting, and claim history for all federal taxes of the applicant and any related person (as defined in § 48.4101–1(b)(5)).

(2) *Blender registration*. Section 48.4101–1(c) requires any person that produces blended taxable fuel to be registered by the Service under § 4101. Application for this registration is made on Form 637, *Application for Registration (For Certain Excise Tax Activities)*, under Activity Letter "M" (Blender of taxable fuel outside the bulk transfer/terminal system) in accordance with the instructions for that form. A person that is registered under Activity Letter "T" (Buyer of gasoline for blending into gasohol outside the bulk transfer/terminal system) will be treated

as being registered under Activity Letter "M" for production occurring before July 1, 2005.

(g) *Conditions to allowance of credit or payment for biodiesel; form of claim*. A general description of the conditions to allowance and form of claim are included in sections 2(c), (d), and (e) of this notice.

(h) *Content of claim*—(1) *In general*. Section 6426(c)(4) provides that the biodiesel mixture credit of § 6426 is not allowed unless the producer of the mixture obtains a certificate, in such form and manner as may be prescribed by the Secretary, from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product. Section 40A(b)(4) provides a similar rule for the biodiesel mixture credit and biodiesel credit allowed by § 40A. Under this notice, this rule will also apply to the credit or payment allowed for biodiesel mixtures by § 6427(e). Accordingly, each claim for a credit or payment under §§ 6426, 6427, and 40A, with respect to a biodiesel mixture must contain a statement that the claimant has in its possession an unexpired certificate (in the form described in section 2(h)(2) of this notice) from the producer of the biodiesel in the mixture and has no reason to believe any information in that certificate is false.

(2) *Certificate*—(i) *In general*. The certificate to be obtained by the claimant claiming a credit or payment under §§ 6426(c), 6427(e), and 40A consists of a statement that is signed under penalties of perjury by a person with authority to bind the biodiesel producer, is substantially in the same form as the model certificate in paragraph (h)(2)(ii) of this section, and contains all the information necessary to complete such model certificate. The claimant must have the certificate at the time the credit or payment is claimed. The certificate may be included as part of the business records normally used to support a claim.

(ii) *Model certificate*.

CERTIFICATE FOR BIODIESEL

(To support a claim under §§ 6426(c), 6427(e), and 40A of the Internal Revenue Code)

_____

_____

_____

Name, address, and employer identification number of claimant.

The undersigned biodiesel producer ("Producer") hereby certifies the following under penalties of perjury:

Producer certifies that the biodiesel to which this certificate relates is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meets the requirements of the American Society of Testing and Materials D6751 and the registration requirements for fuels and fuel additives established by EPA under § 211 of the Clean Air Act (42 U.S.C. § 7545).

Producer certifies that the biodiesel to which this certificate relates is:

_____% Agri-biodiesel (derived solely from virgin oils, including esters derived from virgin vegetable oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, and mustard seeds and from animal fats).

_____% Biodiesel (other than agri-biodiesel)

This certificate applies to the following:

1. _____ Invoice or delivery ticket number

2. _____ Number of gallons

Producer understands that fraudulent use of this certificate may subject producer, claimant, and parties making such fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

_____

Printed or typed name of person signing

_____

Title of person signing

_____

Name of Producer

_____

Employer identification number

Address of Producer

Signature and date signed

(i) *Tax on alcohol and biodiesel fuels*.—(1) *Alcohol fuels*. Section 48.4081–1(c)(1)(i) generally defines *blended taxable fuel* as any taxable fuel that is produced outside the bulk transfer/terminal system by mixing taxable fuel on which tax has been imposed by § 4081 and any other liquid on which tax has not been imposed by § 4081. Section 48.4081–1(c)(1)(iii), however, excludes certain gasohol from the definition of blended taxable fuel. The regulations will be revised so that § 48.4081–1(c)(1)(iii) and the last sentence of § 48.4081–3(g)(1) (treating the alcohol in gasohol as previously taxed fuel) generally will not apply to the removal or sale of gasohol after December 31, 2004. As a result, gasohol produced outside the bulk transfer/terminal system after that date will be taxed as blended taxable fuel taxed under the revised rules of § 48.4081–3(g). However, in the case of gasoline removed or entered before January 1, 2005, if tax is imposed at a reduced rate for the production of gasohol and the gasoline is used to produce gasohol on or after such date, § 48.4081–1(c)(1)(iii) and the last sentence of § 48.4081–3(g)(1) will apply and the benefit allowed by §§ 40, 6426, and 6427(e) will be reduced by the amount of benefit received under former § 4081(c).

(2) *Biodiesel*. For rules relating to the taxation of biodiesel and blended taxable fuel containing biodiesel, see Rev. Rul. 2002–76, 2002–2 C.B. 840.

(j) *Information reporting for persons claiming certain tax benefits*. Section 4104 requires persons claiming tax benefits under §§ 34, 40, 40A, 4041(b)(2), 6426, and 6427(e) to file certain returns in such manner as may be prescribed by the Secretary. In the case of tax benefits claimed under §§ 34 and 40 for taxable years ending before January 1, 2005, this requirement is satisfied by filing the income tax return for the taxable year. The manner of reporting for other claims to which § 4104 applies is not prescribed in this notice. The reporting requirements for these claims will be prescribed in subsequent guidance.

Section 3. DEFINITION OF OFF-HIGHWAY VEHICLE

(a) *In general*. Section 7701(a)(48) provides that a vehicle with certain described features for off-highway transportation is not treated as a highway vehicle. This provision generally is effective on October 22, 2004; however, with respect to the taxes on special fuels imposed by § 4041 and on taxable fuels imposed by § 4081, the provision applies to taxable periods beginning after October 22, 2004.

(b) *Revision to regulations*. Section 48.4061(a)–1(d)(2)(ii) provides that, for purposes of §§ 4051 and 4481, a vehicle with certain described features for off-highway transportation is not a highway vehicle. Section 48.4041–8(b)(2)(ii) provides a similar exception for purposes of § 4041, § 4081, and the credits, refunds and payments related to § 4081. Sections 48.4041–8(b)(2)(ii) and 48.4061(a)–1(d)(2)(ii) will be revised so that they will not apply with respect to calendar quarters beginning after October 22, 2004.

Section 4. AVIATION-GRADE KEROSENE

(a) *Overview*. Effective January 1, 2005, the tax imposed by § 4091 on the sale of aviation fuel by the producer thereof is repealed. In its place, § 4081 provides reduced rates and special rules for aviation-grade kerosene, which is taxed as taxable fuel. Also, § 4082(d)(1), which allowed for the tax-free removal of undyed aviation-grade kerosene if the Secretary determined that such kerosene was destined for use as a fuel in an aircraft, is repealed effective January 1, 2005.

(b) *Definitions*.

Aviation-grade kerosene means kerosene-type jet fuel covered by ASTM specification D 1655 or military specification MIL-DTL–5624T (Grade JP–5) or MIL-DTL–83133E (Grade JP–8).

Commercial aviation has the meaning given to the term by § 4083(b).

Position holder includes a receiving person that is liable for tax under § 4105 (relating to two-party exchanges) and section 8 of this notice.

(c) *Imposition of tax; rate of tax; general rules*—(1) *In general*. Aviation-grade kerosene is taxable fuel and the provisions of §§ 48.4081–2 (relating to imposition of tax at the terminal rack) and 48.4081–3 (relating to other taxable events) apply unless the Code or this notice provides differently. The rate of tax on the removal, entry, or sale of aviation-grade kerosene is $0.219 per gallon unless a reduced rate of tax applies as described in this section.

(2) *Tax on each removal*. Taxpayers are reminded that, unless otherwise provided by § 4082, tax is imposed on each removal of aviation-grade kerosene from a terminal at the terminal rack even if that kerosene had previously been taxed on a removal from another terminal. For the conditions under which a refund (but not a credit) is allowable to the person that paid a second tax to the government, see § 48.4081–7.

(d) *Commercial aviation; liability for tax; rate of tax*—(1) *In general*. Under § 48.4081–2(c), the position holder is liable for tax with respect to the removal of taxable fuel from a terminal at a rack. However, the position holder is not liable for tax on the removal of aviation-grade kerosene from a terminal at the terminal rack if the kerosene is removed directly into the fuel tank of an aircraft for use in commercial aviation. In such a case, the operator of the aircraft in commercial aviation is liable for the tax on the removal at the rate of $0.044 per gallon. For purposes of determining whether a position holder is liable for tax under these rules, kerosene that is removed directly into the fuel tank of an aircraft will be treated as removed for use in commercial aviation if the position holder—

(i) Is a taxable fuel registrant,

(ii) Has an unexpired certificate (in the form described in section 4(g) of this notice) from the operator of the aircraft, and

(iii) Has no reason to believe that any information in the certificate is false.

(2) *Certain refueler trucks, etc*.—(i) *In general*. For purposes of the tax imposed on aviation-grade kerosene removed di-

rectly into the fuel tank of an aircraft for use in commercial aviation, the Act provides that certain refueler trucks, tankers, and tank wagons are treated as part of a terminal if the conditions described in § 4081(a)(3)(A) and (B) are met. One such condition is that, except in the case of exigent circumstances identified by the Secretary in regulations, no vehicle registered for highway use is loaded with aviation-grade kerosene at such terminal. This notice does not describe any such exigent circumstances. Also, § 4081(a)(3)(C) provides for reporting by terminal operators with respect to certain deliveries by refueler trucks, etc. This notice does not prescribe any such reporting. The reporting requirements under § 4081(a)(3)(C) will be prescribed in subsequent guidance. Until the issuance of this guidance, taxpayers are required to retain records containing the information described in § 4081(a)(3)(C) but are not required to report such information.

(ii) *Terminals within secured areas of airports*. Another condition for treating certain refueler trucks as part of a terminal is that the terminal must be located within a secured area of an airport. Section 4081(a)(3)(A)(i). The conference report to the Act, H.R. Conf. Rep. No. 755, 108th Cong., 2d Sess. 692 n.718 (2004), provides an initial list of qualifying terminals and the airports at which they are located. The conference report also provides that this list is subject to the Secretary's verification. This notice adopts the list in the conference report except for the following airport terminals, which the Commissioner has determined are not located within a secure area of the airport they serve: San Jose Municipal Airport, T–77–CA–4650; John Wayne Airport/Orange County, T–33–CA–4772; and Eppley Airfield, T–47–NE–3608. This list identifies airport fueling operations that are not susceptible to avoidance of the federal excise tax on taxable fuel, and has nothing to do with the general security of airports either included or not included on the list.

(e) *Exceptions*. Under the Act and this notice, in the case of aviation-grade kerosene that is exempt from the tax imposed by § 4041(c) (other than by reason of a prior imposition of tax) and that is removed from any refinery or terminal directly into the fuel tank of an aircraft, the rate of tax under § 4081 is zero. For purposes of determining the tax liability of the position holder under this rule, aviation-grade kerosene that is removed directly into the fuel tank of an aircraft will be treated as exempt from the tax imposed by § 4041(c) (other than by reason of a prior imposition of tax) if the position holder: (1) is a taxable fuel registrant; (2) has an unexpired certificate (described in section 4(g) of this notice) from the operator of the aircraft; and (3) has no reason to believe that any information in the certificate is false. Exemptions from the tax imposed by § 4041(c) include an exemption for aviation-grade kerosene sold for use or used as supplies for vessels or aircraft (within the meaning of § 4221(d)(3)), including fuel sold for use or used in aircraft actually engaged in foreign trade, and an exemption for aviation-grade kerosene sold for the exclusive use of a state or political subdivision of a state.

(f) *Registration*—(1) *Commercial aircraft operators; in general*. Under this notice, effective July 1, 2005, each commercial aircraft operator (other than an operator engaged exclusively in foreign trade) must be registered by the Service as a condition of providing the certificate that aviation-grade kerosene will be used in commercial aviation. Application for registration is made on Form 637, *Application for Registration (For Certain Excise Tax Activities)*, in accordance with the instructions for that form. A commercial aircraft operator that is registered under Activity Letter "Y" (Buyer of aviation fuel for its use in commercial aviation (other than foreign trade)) will be treated as being registered for this purpose and will not have to apply to be reregistered unless notified to do so by the Service.

(2) *Commercial aircraft operators; requirements*. The Service will register an applicant as a commercial aircraft operator only if the Service—

(i) Determines that the applicant is, in the course of its trade or business, regularly engaged as an operator of an aircraft in commercial aviation, or is likely to become so engaged within a reasonable time after being registered under § 4101; and

(ii) Is satisfied with the filing, deposit, payment, reporting, and claim history for all federal taxes of the applicant and any related person (as defined in § 48.4101–1(b)(5)).

(3) *Full rate buyers; in general*. Under this notice, effective July 1, 2005, each person that buys aviation-grade kerosene in connection with a removal from a terminal (other than a removal directly into the fuel tank of an aircraft) (full rate buyer) must be registered by the Service. Application for registration is made on Form 637, *Application for Registration (For Certain Excise Tax Activities)*, in accordance with the instructions for that form.

(4) *Full rate buyers; requirements*. The Service will register an applicant as a full rate buyer of aviation-grade kerosene only if the Service—

(i) Determines that the applicant buys aviation-grade kerosene in connection with the removal from a terminal (other than a removal directly into the fuel tank of an aircraft), or is likely to become such a buyer within a reasonable time after being registered under § 4101; and

(ii) Is satisfied with the filing, deposit, payment, reporting, and claim history for all federal taxes of the applicant and any related person (as defined in § 48.4101–1(b)(5)).

(g) *Certificate for commercial aviation and exempt use*—(1) *In general*. The certificate referred to in paragraphs (d)(1) and (e) of this section is a statement that is signed under penalties of perjury by a person with authority to bind the buyer, is in substantially the same form as the model certificate provided below, and contains all information necessary to complete the model certificate. A new certificate or notice that the current certificate is invalid must be given if any information in the current certificate changes. The certificate may be included as part of any business records normally used to document a sale. The Service may withdraw the right of a buyer of aviation-grade kerosene to provide a certificate under this section if the buyer uses the aviation-grade kerosene to which a certificate relates other than as stated in the certificate. The Service may notify any seller to whom the buyer has provided a certificate that the buyer's right to provide a certificate has been withdrawn. The certificate expires on the earliest of the following dates:

(i) The date one year after the effective date of the certificate (which may be no earlier than the date it is signed).

(ii) The date the buyer provides the seller a new certificate or notice that the current certificate is invalid.

(iii) The date the Service or the buyer notifies the seller that the buyer's right to provide a certificate has been withdrawn.

(2) *Model certificate.*

CERTIFICATE OF PERSON BUYING AVIATION-GRADE KEROSENE FOR COMMERCIAL AVIATION OR NONTAXABLE USE

(To support operator liability for tax on removals of aviation-grade kerosene directly into the fuel tank of an aircraft in commercial aviation pursuant to § 4081 of the Internal Revenue Code or to support a tax rate of zero pursuant to §§ 4041 and 4082.)

_____

_____

_____

Name, address, and employer identification number of the position holder

The undersigned aircraft operator ("Buyer") hereby certifies the following under the penalties of perjury:

The aviation-grade kerosene to which this certificate relates is purchased (check one):_____ for use on a farm for farming purposes; _____ for export; _____ for use in foreign trade (reciprocal benefits required for foreign registered airlines); _____ for use in certain helicopter and fixed-wing air ambulance uses; _____ for the exclusive use of a nonprofit educational organization; _____ for the exclusive use of a state; _____ for use in an aircraft owned by an aircraft museum; _____ for use in military aircraft; or _____ for use in commercial aviation (other than foreign trade).

With respect to aviation-grade kerosene purchased after June 30, 2005, for use in commercial aviation (other than foreign trade), Buyer's registration number is _____. Buyer's registration has not been suspended or revoked by the Internal Revenue Service.

This certificate applies to the following (complete as applicable):

_____ This is a single purchase certificate:

1. _____ Invoice or delivery ticket number
2. _____ Number of gallons

_____ This is a certificate covering all purchases under a specified account or order number:

1. Effective date _____
2. Expiration date _____ (period not to exceed 1 year after the effective date)
3. Buyer account number _____

Buyer agrees to provide the person liable for tax with a new certificate if any information in this certificate changes.

If the aviation-grade kerosene to which this certificate relates is being bought for use in commercial aviation (other than foreign trade), Buyer is liable for tax on its use of the fuel and will pay that tax to the government.

If Buyer sells or uses the aviation-grade kerosene to which this certificate relates for a use other than the use stated above, Buyer will be liable for tax.

Buyer understands that it must be prepared to establish by satisfactory evidence the purpose for which the fuel purchased under this certificate was used.

Buyer has not been notified by the Internal Revenue Service that its right to provide a certificate has been withdrawn. If Buyer violates the terms of this certificate, the Internal Revenue Service may withdraw Buyer's right to provide a certificate.

The fraudulent use of this certificate may subject Buyer and all parties making any fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

_____

Printed or typed name of person signing

_____

Title of person signing

Name of Buyer

Employer identification number

Address of Buyer

Signature and date signed

(h) *Claims by registered ultimate vendors (nontaxable uses)*—(1) *In general*. Section 6427(l)(4)(B) provides that if an ultimate purchaser of aviation-grade kerosene used for a nontaxable use waives its right to an income tax credit or payment, in the form and manner prescribed by the Secretary, and assigns such right to the registered ultimate vendor, then the ultimate vendor, and not the ultimate purchaser, may claim a payment or income tax credit. Neither the Code nor this notice requires any vendor to apply for registration or to file any claim.

(2) *Definitions*.

Nontaxable use means any use that is exempt from the tax imposed by § 4041(c) (other than by reason of a prior imposition of tax) and any use in commercial aviation within the meaning of § 4083(b).

Registered ultimate vendor is a person that sells aviation-grade kerosene to the ultimate purchaser for a nontaxable use and is registered as an ultimate vendor under § 4101.

(3) *Conditions to allowance of credit or payment*. A claim for an income tax credit or payment with respect to aviation-grade kerosene is allowable to an ultimate vendor by § 6427(l)(4)(B) only if—

(i) Tax was imposed on the aviation-grade kerosene under § 4081;

(ii) The claimant sold the aviation-grade kerosene to the ultimate purchaser for use in a nontaxable use;

(iii) The claimant is a registered ultimate vendor;

(iv) The ultimate purchaser has waived its right to a credit or payment as provided in paragraph (h)(6) of this section; and

(v) The claimant has filed a timely claim for a credit or payment and the claim contains all of the information required in paragraph (h)(5) of this section.

(4) *Form of claim*. A claim under § 6427(l)(4)(B) for a payment is made on Form 8849, *Claim for Refund of Excise Taxes*, and a claim under § 6427(l)(4)(B) for an income tax credit is made on Form 4136, *Credit for Federal Tax Paid on Fuels*.

(5) *Content of claim*. Each claim for a credit or payment under § 6427(l)(4)(B) must contain the following information with respect to the aviation-grade kerosene covered by the claim:

(i) The total number of gallons.

(ii) The claimant's registration number.

(iii) A statement that the claimant—

(A) Has not included the amount of the tax in its sales price of the aviation-grade kerosene and has not collected the amount of tax from its buyer;

(B) Has repaid the amount of the tax to the ultimate purchaser of the fuel; or

(C) Has obtained the written consent of its buyer to allowance of the claim.

(iv) A statement that the claimant has in its possession an unexpired waiver described in paragraph (h)(6) of this section and has no reason to believe any information in the waiver is false.

(6) *Waiver*—(i) *In general*. The ultimate purchaser waives its right to a credit or payment for purposes of § 6427(l)(4)(B) by providing a statement that is signed under penalties of perjury by a person with authority to bind the ultimate purchaser, is in substantially the same form as the model waiver in paragraph (h)(6)(ii) of this section, and contains all of the information necessary to complete such model waiver. A new waiver must be given if any information in the current waiver changes. The claimant must have the waiver at the time the credit or payment is claimed under § 6427(l)(4)(B). The waiver may be included as part of any business records normally used to document a sale. The waiver expires on the earlier of the following dates:

(A) The date one year after the effective date of the waiver, or

(B) The date a new waiver is provided.

(ii) *Model waiver*.

WAIVER FOR USE BY ULTIMATE PURCHASERS OF AVIATION-GRADE KEROSENE USED IN NONTAXABLE USES

(To support vendor's claim for a credit or payment under § 6427 of the Internal Revenue Code.)

Name, address, and employer identification number of ultimate vendor

The undersigned ultimate purchaser ("Buyer") hereby certifies the following under the penalties of perjury:

The aviation-grade kerosene to which this certificate relates is purchased (check one):_____ for use on a farm for farming purposes; _____ for export; _____ for use in foreign trade (reciprocal benefits required for foreign registered airlines); _____ for use in certain helicopter and fixed-wing air ambulance uses; _____ for the exclusive use of a nonprofit educational organization; _____ for the exclusive use of a state; _____ for use in an aircraft owned by an aircraft museum; _____ for use in military aircraft; or _____ for use in commercial aviation (other than foreign trade).

This waiver applies to the following (complete as applicable):

_____ This is a single purchase waiver:

1. _____ Invoice or delivery ticket number

2. _____ Number of gallons

_____ This is a waiver covering all purchases under a specified account or order number:

1. Effective date _____

2. Expiration date _____ (period not to exceed 1 year after the effective date)

3. Buyer account number _____

Buyer will provide a new waiver to the vendor if any information in this waiver changes.

If Buyer uses the aviation-grade kerosene to which this waiver relates for a use other than the use stated above, Buyer will be liable for tax.

Buyer understands that by signing this waiver, Buyer gives up its right to claim any credit or payment for the aviation-grade kerosene used in a nontaxable use.

Buyer acknowledges that it has not and will not claim any credit or payment for the aviation-grade kerosene to which this waiver relates.

Buyer understands that the fraudulent use of this waiver may subject Buyer and all parties making such fraudulent use of this waiver to a fine or imprisonment, or both, together with the costs of prosecution.

_____

Printed or typed name of person signing

_____

Title of person signing

_____

Name of Buyer

_____

Employer identification number

_____

Address of Buyer

_____

Signature and date signed

(7) *Registration*—(i) *In general*. Application for registration as a registered ultimate vendor of aviation-grade kerosene is made on Form 637, *Application for Registration (For Certain Excise Tax Activities)*, in accordance with the instructions for that form. A person that is registered under § 4101 under Activity Letter "UV" (Ultimate vendor that sells undyed diesel fuel or undyed kerosene to a state or local government for its exclusive use or for use by the buyer on a farm for farming purposes) is treated as registered for purposes of claims filed with respect to aviation-grade kerosene before July 1, 2005.

(ii) *Requirements*. The Service will register an applicant as an ultimate vendor of aviation-grade kerosene only if the Service—

(A) Determines that the applicant is, in the course of its trade or business, regularly engaged as a seller of aviation-grade kerosene to aircraft operators, or is likely to become so engaged within a reasonable time after being registered under § 4101; and

(B) Is satisfied with the filing, deposit, payment, reporting, and claim history for all federal taxes of the applicant and any related person (as defined in § 48.4101–1(b)(5)).

(i) *Extension of time to file Form 720 for the first quarter of 2005*. Under this notice, a return of tax on Form 720, *Quarterly Federal Excise Tax Return*, for the first quarter of 2005 is due May 31, 2005, if the return reports tax for either IRS No. 69, aviation-grade kerosene, or IRS No. 77, aviation-grade kerosene for use in commercial aviation (other than foreign trade).

A person must file only one return for a quarter. Thus, for example, a return of tax on Form 720 for the first quarter that reports tax for IRS No. 69 and IRS No. 26, transportation of persons by air, is due May 31, 2005. This rule does not extend the time for making deposits or paying any excise tax.

(j) *Deposits; application of the safe harbor deposit rule*. Section 40.6302(c)–1(b)(2)(ii)(D) of the Excise Tax Procedural Regulations provides that the safe harbor deposit rule for regular method taxes is applicable if, among other conditions, the person's liability does not include any regular method tax that was not imposed at all times during the look-back quarter. For the first and second quarters of 2005, the tax on aviation-grade kerosene under § 4081 will be treated under this notice as having been imposed during the look-back quarter if: (1) the person was a registered producer of aviation fuel (Activity Letter "H" (Importer or producer of aviation fuel) on Form 637, *Application For Registration (For Certain Excise Tax Activities)*) during the look-back quarter; or, (2) the deposit for each semimonthly period for the current quarter (determined under § 40.6302(c)–1(b)(2)) is increased by an amount equal to 95% of the person's net tax liability for aviation-grade kerosene under § 4081 incurred during the semimonthly period.

(k) *Floor stocks tax*—(1) *Imposition of tax*. A one-time floor stocks tax is imposed on aviation-grade kerosene if, on the first moment of January 1, 2005, the kerosene—

(i) Is outside of the bulk transfer/terminal system (as defined in § 48.4081–1(b) after taking paragraph (d)(2) of this section into account) and is not held in the fuel supply tank of an aircraft; and

(ii) Is held by a registered producer of aviation fuel (Activity Letter "H" (Importer or producer of aviation fuel) on Form 637, *Application for Registration (For Certain Excise Tax Activities)*) other than for use by the producer in a nontaxable use described in § 6427(l)(2)(B)(i).

(2) *Liability for tax*. The person holding the kerosene on the first moment of January 1, 2005, is liable for tax. Kerosene is considered held by a person if title thereto has passed to such person (whether or not delivery to the person has been made).

(3) *Rate of tax*. The rate of tax is $0.219 per gallon except that for aviation-grade kerosene held for the taxpayer's own use in commercial aviation, the rate of tax is $0.044 per gallon.

(4) *Persons holding not more than 2,000 gallons*—(i) A person is not liable for the floor stocks tax on aviation-grade kerosene if the amount of such aviation-grade kerosene held by the person on January 1, 2005, does not exceed 2,000 gallons. In determining whether this threshold is crossed, the amount of aviation-grade kerosene a person holds exclusively for an exempt use and the amount of aviation-grade kerosene a person holds in an aircraft fuel tank are not taken into account. If a person holds more than 2,000 gallons of aviation-grade kerosene, then the floor stocks tax is imposed on all aviation-grade kerosene that is held by the person and that is not otherwise exempt.

(ii) Members of controlled groups of corporations (as defined in § 1563(a)) must aggregate the aviation-grade kerosene held by all members in determining whether they hold no more than 2,000 gallons of kerosene. If holdings of all members in aggregate exceed 2,000 gallons, then the exception described in paragraph (k)(4)(i) of this section does not apply to any member of the group. The aggregation rule for controlled groups does not affect the requirement that each separate person liable for the floor stocks tax file a return.

(5) *Payment and return*. The floor stocks tax must be paid with a return on Form 720, *Quarterly Federal Excise Tax Return*. The return is due May 31, 2005. Persons that are required to report the floor stocks tax and are also required to report other excise taxes on Form 720 must report both the floor stocks tax and the other excise taxes for the first calendar quarter of 2005 on one Form 720 that is due May 31, 2005. This rule does not extend the time for making deposits or payments of the other excise taxes.

Section 5. DIESEL FUEL USED IN CERTAIN INTERCITY BUSES

(a) *Overview*. Before January 1, 2005, the penalty imposed by § 6715 on the misuse of dyed diesel fuel and dyed kerosene did not apply to dyed fuel used in buses while engaged in intercity bus transportation, as defined in paragraph (b) of this section. The operator of the bus was liable for a backup tax of $0.074 per gallon on dyed fuel used for this purpose. However, effective January 1, 2005, the § 6715 penalty applies to this use and the ability of these bus operators to use dyed diesel fuel and pay the $0.074-per-gallon backup tax is eliminated. As under prior law, an income tax credit or payment of $0.17 per gallon is allowable if undyed diesel fuel or undyed kerosene (which is taxed at $0.244 per gallon) is used for this purpose. In addition, § 6427(b)(4) provides that if the ultimate purchaser of undyed diesel fuel or undyed kerosene used in a bus for this purpose waives its right to an income tax credit or a payment, in the form and manner prescribed by the Secretary, and assigns such right to the registered ultimate vendor, then the ultimate vendor, and not the ultimate purchaser, may claim a payment or income tax credit. Neither the Code nor this notice requires any vendor to apply for registration or to file a claim.

(b) *Definitions*—(1) *Intercity bus transportation*—(i) *In general*. An automobile bus is engaged in *intercity bus transportation* if it is engaged in the furnishing (for compensation) of passenger land transportation available to the general public and the bus is engaged in-

(A) Scheduled transportation along regular routes; or

(B) Nonscheduled transportation if the seating capacity of the bus is at least 20 adults (not including the driver).

(ii) *Exceptions*. A bus is not engaged in intercity bus transportation if—

(A) The bus is engaged in transportation described in § 6427(b)(2)(B) (relating to the transportation of students and employees of schools); or

(B) The bus is engaged in transportation described in § 6427(b)(2)(C) (relating to intracity transportation in a qualified local bus).

(2) *Registered ultimate vendor*. A *registered ultimate vendor* is a person that sells diesel fuel to the ultimate purchaser for use in intercity bus transportation and is registered as an ultimate vendor under § 4101.

(c) *Conditions to allowance of credit or payment*. A claim for an income tax credit or payment with respect to diesel fuel or kerosene used for intercity bus transportation is allowable under § 6427(b)(4) only if—

(1) Tax was imposed on the diesel fuel or kerosene under § 4081;

(2) The claimant sold the diesel fuel or kerosene to the ultimate purchaser for use in intercity bus transportation;

(3) The claimant is a registered ultimate vendor;

(4) The ultimate purchaser has waived the right to payment as provided in paragraph (f) of this section; and

(5) The claimant has filed a timely claim for a credit or payment and the claim contains all of the information required in paragraph (e) of this section.

(d) *Form of claim.* A claim under § 6427(b)(4) for a payment is made on Form 8849, *Claim for Refund of Excise Taxes*, and a claim under § 6427(b)(4) for an income tax credit is made on Form 4136, *Credit for Federal Tax Paid on Fuels*.

(e) *Content of claim.* Each claim for a credit or payment under § 6427(b)(4) must contain the following information with respect to the diesel fuel or kerosene covered by the claim:

(1) The total number of gallons.

(2) The claimant's registration number.

(3) A statement that the claimant—

(i) Has not included the amount of the tax in its sales price of the diesel fuel or kerosene and has not collected the amount of tax from its buyer;

(ii) Has repaid the amount of the tax to the ultimate purchaser of the fuel; or

(iii) Has obtained the written consent of its buyer to allowance of the claim.

(4) A certification that the claimant has in its possession an unexpired waiver described in paragraph (f) of this section and has no reason to believe any information in the waiver is false.

(f) *Waiver*—(1) *In general.* The ultimate purchaser waives its right to credit or payment for purposes of § 6427(b)(4) by providing a statement that is signed under penalties of perjury by a person with authority to bind the ultimate purchaser, is in substantially the same form as the model waiver in paragraph (f)(2) of this section, and contains all of the information necessary to complete such model waiver. A new waiver must be given if any information in the current waiver changes. The claimant must have the waiver at the time the credit or payment is claimed under § 6427(b)(4). The waiver may be included as part of any business records normally used to document a sale. The waiver expires on the earlier of the following dates:

(i) The date one year after the effective date of the waiver.

(ii) The date a new waiver is provided.

(2) *Model waiver.*

WAIVER FOR USE BY ULTIMATE PURCHASERS OF DIESEL FUEL OR KEROSENE USED IN INTERCITY BUS TRANSPORTATION

(To support vendor's claim for a credit or payment under § 6427 of the Internal Revenue Code.)

_____

_____

_____

Name, address, and employer identification number of ultimate vendor

The undersigned ultimate purchaser ("Buyer") hereby certifies the following under the penalties of perjury:

The diesel fuel or kerosene to which this waiver relates is purchased for use in intercity bus transportation.

This waiver applies to the following (complete as applicable):

____ This is a single purchase waiver:

1. _____ Invoice or delivery ticket number

2. _____ Number of gallons

____ This is a waiver covering all purchases under a specified account or order number:

1. Effective date _____

2. Expiration date _____ (period not to exceed 1 year after the effective date)

3. Buyer account number _____

Buyer will provide a new waiver to the vendor if any information in this waiver changes.

If Buyer uses the diesel fuel or kerosene to which this waiver relates for a use other than in intercity bus transportation, Buyer will be liable for tax.

Buyer understands that by signing this waiver, Buyer gives up its right to claim any credit or payment for diesel fuel or kerosene used in intercity bus transportation during the period indicated.

Buyer acknowledges that it has not and will not claim any credit or payment for the diesel fuel or kerosene to which this waiver relates.

Buyer understands that the fraudulent use of this waiver may subject Buyer and all parties making such fraudulent use of this waiver to a fine or imprisonment, or both, together with the costs of prosecution.

Printed or typed name of person signing

Title of person signing

Name of Buyer

Employer identification number

Address of Buyer

Signature and date signed

(g) *Registration*—(1) *In general*. Application for registration as a registered ultimate vendor of diesel fuel or kerosene used in intercity bus transportation is made on Form 637, *Application for Registration (For Certain Excise Tax Activities)*, in accordance with the instructions for that form. A person that is registered under § 4101 under Activity Letter "UV" is treated as registered for purposes of claims with respect to diesel fuel or kerosene used in intercity bus transportation for claims filed before July 1, 2005.

(2) *Requirements*. The Service will register an applicant as an ultimate vendor of diesel fuel or kerosene used in intercity bus transportation only if the Service—

(i) Determines that the applicant is, in the course of its trade or business, regularly engaged as a seller of diesel fuel or kerosene for use in intercity bus transportation or is likely to become so engaged within a reasonable time after being registered under § 4101; and

(ii) Is satisfied with the filing, deposit, payment, reporting, and claim history for all federal taxes of the applicant and any related person (as defined in § 48.4101–1(b)(5)).

Section 6. DISPLAY OF REGISTRATION

Section 4101 provides that every operator of a vessel required to register must display proof of registration through an identification device prescribed by the Secretary on each vessel used by the operator to transport any taxable fuel. Section 6718 imposes a penalty on vessel operators who fail to display proof of registration. This notice does not prescribe the identification device that must be displayed. The identification device and the manner of its display will be prescribed in subsequent guidance. No penalty will be imposed on a registered operator under § 6718 with respect to any failure to display proof of registration occurring before the effective date of such guidance, and the effective date of the guidance will be after the date it is issued.

Section 7. GASOLINE; CLAIMS BY REGISTERED ULTIMATE VENDORS

(a) *Overview*—(1) *Claims by the person that paid the tax*—(i) *In general*. Section 6416(b)(2) generally provides that the tax paid on gasoline is deemed to be an overpayment if the gasoline was sold to a state for its exclusive use or to a nonprofit educational organization for its exclusive use. Section 6402(a) generally allows credits or refunds of overpayments to the person that made the overpayment (that is, the person that paid the tax to the government). Section 6416(a)(4) provides that the ultimate vendor of the gasoline is treated as the person (and the only person) that paid the tax, but only if such ultimate vendor is registered under § 4101. Thus, if the ultimate vendor is not registered as described in this section, then the person that actually paid the tax to the government may make the claim allowed by § 6416(b)(2). Guidance for claims by the person that actually paid the tax is set forth in §§ 48.6416(a)–3(b) and 48.6416(b)(2)–3. Guidance for claims by the person that is treated as having paid the tax (that is, the registered ultimate vendor) is set forth in this section. As noted in section 11 of this notice, Notice 89–29, 1989–1 C.B. 669, which provided guidance under former § 6416(a)(4), is obsolete.

(ii) *Sales on oil company credit cards*. Under the rules in effect prior to 2005, a sale charged on an oil company credit card issued to an exempt person is not considered a direct sale by the person actually selling the gasoline to the ultimate purchaser (*i.e.*, the person selling the gasoline is not the ultimate vendor) if the person actually selling the gasoline receives a reimbursement from the oil company based on a price that excludes the tax. Treasury and the Service are considering whether this rule has continuing applicability under new § 6416(a)(4) but, while considering the issue, will continue generally to apply the rule with respect to sales before March 1, 2005. Therefore, in the case of a sale of gasoline before March 1, 2005, on an oil company credit card issued to a state or nonprofit educational organization, the person that actually paid the tax is treated as the only person eligible to make the claim under §§ 6402 and 6416. As noted in paragraph (a)(1)(i) of this section, these claims must be in accordance with §§ 48.6416(a)–3(b) and 48.6416(b)(2)–3. If Treasury and the Service determine that the oil company credit card rule does not have continued application after February 28, 2005, commentators have suggested that persons paying the tax on gasoline (position holders) will find it difficult to determine whether they or the ultimate vendors of the gasoline are eligible for refunds. This, in turn, could re-

sult in multiple refund claims with respect to the same transaction. Congress may wish to address this issue prior to March 1, 2005, and Treasury and the Service will assist Congress in designing an administrable alternative.

(2) *Claims by the ultimate purchaser*. A claim for a credit or refund under § 6416 by the person that paid the tax (or that is treated as having paid the tax) is an alternative to a claim for an income tax credit or payment under § 6421(c) by the ultimate purchaser (that is, the state or nonprofit educational organization). For any particular transaction, a claim may not be made under § 6421(c) if the tax is credited or refunded under § 6416 to either the ultimate vendor or the person that actually paid the tax.

(b) *Definitions*.

Nonprofit educational organization has the meaning given to the term in § 4221(d)(5).

Registered ultimate vendor is a person that sells gasoline to a state for its exclusive use or to a nonprofit educational organization for its exclusive use and is registered as an ultimate vendor under § 4101.

State has the meaning given to the term by § 48.4081–1(b).

(c) *Conditions to allowance of a credit or refund*. A claim for credit or refund of an overpayment of tax is allowable under § 6416(b)(2)(C) or (D) and § 6416(a)(4) (relating to refunds of gasoline tax to registered ultimate vendors) if—

(1) The claimant sold the gasoline to a state for its exclusive use or to a nonprofit educational organization for its exclusive use;

(2) The claimant is a registered ultimate vendor; and

(3) The claim contains all of the information required in paragraph (e).

(d) *Form of claim*—(1) *In general*. A claim under § 6416(b)(2)(C) or (D) and § 6416(a)(4) is made—

(i) In the case of a claim for a refund, on Form 8849, *Claim for Refund of Excise Taxes*; and

(ii) In the case of a claimant reporting liability on Form 720, as a claim on Form 720 for an excise tax credit.

(2) *Electronic claim certification to the Secretary*. Section 6416(a)(4)(B) provides that electronic claims for refund under § 6416(a)(4) will be paid with interest if the claim is not paid within 20 days of the date it is filed and the claimant certifies that all ultimate purchasers are certified and entitled to a refund. This notice does not provide guidance on these certification procedures. These procedures and the procedures for filing an electronic claim will be prescribed in subsequent guidance.

(e) *Content of claim*. Each claim under § 6416(b)(2)(C) or (D) or § 6416(a)(4) for a credit or payment must contain the following information with respect to the gasoline covered by the claim:

(1) The total number of gallons.

(2) The claimant's registration number.

(3) A statement that the claimant—

(i) Has not included the amount of the tax in its sales price of the gasoline and has not collected the amount of tax from its buyer;

(ii) Has repaid the amount of the tax to the ultimate purchaser of the fuel; or

(iii) Has obtained the written consent of its buyer to allowance of the claim.

(4) A statement that the claimant has in its possession an unexpired certificate described in paragraph (f) of this section and has no reason to believe any information in the certificate is false.

(f) *Certificate*—(1) *In general*. The certificate to be provided to the ultimate vendor consists of a statement that is signed under penalties of perjury by a person with authority to bind the buyer, is in substantially the same form as the model certificate in paragraph (f)(2) of this section, and contains all of the information necessary to complete such model certificate. A new certificate must be given if any information in the current certificate changes. The certificate may be included as part of any business records normally used to document a sale. The certificate expires on the earlier of the following dates:

(i) The date one year after the effective date of the certificate.

(ii) The date a new certificate is provided.

(2) *Model certificate*.

CERTIFICATE FOR STATE USE OR NONPROFIT EDUCATIONAL ORGANIZATION USE

(To support ultimate vendor's claim for a credit or refund under § 6416(a)(4) of the Internal Revenue Code.)

_____

_____

_____

Name, address, and employer identification number of ultimate vendor

The undersigned ultimate purchaser ("Buyer") hereby certifies the following under the penalties of perjury:

Buyer will use the gasoline to which this certificate relates (check one):

_____ For the exclusive use of a state; or

_____ For the exclusive use of a nonprofit educational organization.

This certificate applies to the following (complete as applicable):

_____ This is a single purchase certificate:

1. _____ Invoice or delivery ticket number

2. _____ Number of gallons

_____ This is a certificate covering all purchases under a specified account or order number:

1. Effective date _____

2. Expiration date _____ (period not to exceed 1 year after the effective date)

3. Buyer account number _____

Buyer will provide a new certificate to the vendor if any information in this certificate changes.

Buyer understands that by signing this certificate, Buyer gives up its right to claim a credit or payment for the gasoline to which this certificate relates.

Buyer acknowledges that it has not and will not claim any credit or payment for the gasoline to which this certificate relates.

Buyer understands that the fraudulent use of this certificate may subject Buyer and all parties making such fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

_____

Printed or typed name of person signing

_____

Title of person signing

_____

Name of Buyer

_____

Employer identification number

_____

Address of Buyer

_____

Signature and date signed

(g) *Registration*—(1) *In general*. Application for registration as a registered ultimate vendor of gasoline is made on Form 637, *Application for Registration (For Certain Excise Tax Activities)*, in accordance with the instructions for that form. A person that is registered under § 4101 under Activity Letter "UV" or "UP" (Ultimate vendor that sells kerosene from a blocked pump) is treated as registered for purposes of claims under this section and will not have to be reregistered unless notified to do so by the Service.

(2) *Requirements*. The Service will register an applicant as an ultimate vendor of gasoline only if the Service—

(i) Determines that the applicant is, in the course of its trade or business, regularly engaged as a seller of gasoline to states or nonprofit educational organizations, or is likely to become so engaged within a reasonable time after being registered under § 4101; and

(ii) Is satisfied with the filing, deposit, payment, reporting, and claim history for all federal taxes of the applicant and any related person (as defined in § 48.4101–1(b)(5)).

Section 8. TWO-PARTY EXCHANGES

Section 4105(a) provides that in a two-party exchange, as defined in § 4105(b), the delivering person is not liable for the tax imposed on the removal of taxable fuel from the terminal at the terminal rack. Under this notice, in a two-party exchange the receiving person is liable for the tax imposed on the removal of taxable fuel from the terminal at the terminal rack. For purposes of § 48.4081–2(c)(2) (relating to the joint and several liability of a terminal operator), the "position holder" will include the receiving person in a two-party exchange. Also, a delivering person may treat a receiving person as a taxable fuel registrant for purposes of § 4105(b) if, at the time of the exchange, the delivering person has an unexpired notification certificate (described in § 48.4081–5) from the receiving person and has no reason to believe any information in the certificate is false.

Section 9. GASOLINE BLENDS, TRANSMIX, DIESEL FUEL BLENDSTOCKS

(a) *Gasoline blends*. Section 4083(a)(2) defines *gasoline* as including gasoline blends other than qualified methanol or ethanol fuel (as defined in § 4041(b)(2)(B)), partially exempt methanol or ethanol fuel (as defined in § 4041(m)(2)) or a denatured alcohol. Thus, for example, *gasoline* includes any gasoline/ethanol blend unless at least 85 percent of the blend consists of alcohol made from coal, at least 85 percent of the blend consists of alcohol made from nat-

ural gas, or the blend consists of alcohol with gasoline added solely as a denaturant.

(b) *Transmix*. Section 4083(a)(3)(A)(ii) defines *diesel fuel* as including any transmix as defined in § 4083(a)(3)(B). Effective January 1, 2005, § 48.4081–1(c)(3)(i) will be amended to remove *transmix containing gasoline* from the definition of a gasoline blendstock.

(c) *Diesel fuel blendstocks*. Section 4083(a)(3)(A)(iii) defines *diesel fuel* as including diesel fuel blendstocks identified by the Secretary. This notice does not identify any diesel fuel blendstocks.

Section 10. REQUEST FOR COMMENTS

Treasury and the Service invite comments from the public on any issue that should be addressed in regulations issued under the excise tax provisions identified in this notice and other excise tax provisions of the Act. Treasury and the Service are particularly interested in receiving comments on the following matters:

1. Concerning the credit or payment related to the taxes on fuel used in mobile machinery (§ 851 of the Act, § 6421 of the Code), the records and documentation required to substantiate that the vehicle was used on the public highways less than 7,500 miles during the taxpayer's taxable year.

2. Concerning whether a terminal is located within a secured area of an airport (§ 853 of the Act, § 4081 of the Code), the standards to be used in making such determination.

3. Concerning the requirement for display of registration on certain vessels (§ 861 of the Act, § 4101 of the Code), the type of identification device that should be used.

4. Concerning the definition of diesel fuel (§ 870 of the Act, § 4083 of the Code), the diesel fuel blendstocks that should be classified as diesel fuel.

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

Send submissions to: CC:PA:LPD:PR (REG–153838–04), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–153838–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically, via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–153838–04).

Comments should be submitted by February 14, 2005.

Section 11. EFFECT ON OTHER DOCUMENTS

The following notices are obsolete:
Notice 88–30, 1988–1 C.B. 497.
Notice 88–132, 1988–2 C.B. 552.
Notice 89–29, 1989–1 C.B. 669.
Notice 89–38, 1989–1 C.B. 679.

Section 12. EFFECTIVE DATE

This notice is effective January 1, 2005.

Section 13. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545–1915.

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

The collections of information in this notice are in the following sections.

Section 2(h)(2) describes the certificate that the producer of biodiesel must give to the claimant of a biodiesel mixture credit or biodiesel credit.

Section 4(d)(2) describes the recordkeeping requirements of certain terminal operators.

Section 4(g) describes the certificate that the buyer of aviation-grade kerosene must give to the seller in order to support removals of aviation-grade kerosene directly into the fuel tank of an aircraft in commercial aviation pursuant to § 4081 or to support a tax rate of zero pursuant to §§ 4041 and 4082.

Section 4(h)(6) describes the waiver that the ultimate purchaser of aviation-grade kerosene must give to the registered ultimate vendor in order to waive its right to an income tax credit or payment and assign such rights to the registered ultimate vendor.

Section 5(f) describes the waiver that the ultimate purchaser of diesel fuel or kerosene for use in an intercity bus must give to the registered ultimate vendor in order to waive its rights to an income tax credit or payment and assign such rights to the registered ultimate vendor.

Section 7(f) describes the certificate that the ultimate purchaser of gasoline for the exclusive use of the state or the exclusive use of a nonprofit educational organization must give to the registered ultimate vendor in order for the registered ultimate vendor to be treated as the taxpayer.

Section 8 describes the certificate that the delivering person may receive in order to treat the receiving person as a taxable fuel registrant.

The collections of information are required to obtain a tax benefit. This information will be used to substantiate claims for the tax benefits. The likely respondents are businesses, not-for-profit institutions, farmers, the federal government, and state, local or tribal governments.

The estimated total annual reporting and or recordkeeping burden is 34,390 hours.

The estimated average annual burden per respondent and/or recordkeeper is approximately .25 hours.

The estimated number of respondents and recordkeepers is 20,263.

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

Section 14. DRAFTING INFORMATION

The principal authors of this notice are Susan Athy and Deborah Karet of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, please contact Ms. Karet (concerning off-highway vehicles, aviation-grade kerosene, display of registration on certain vessels, and two-party exchanges) or Ms. Athy (concerning all other issues) at (202) 622–3130 (not a toll-free call).

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, §§ 162, 263, 446, 461, 481; 1.167(a)–3(b), 1.263(a)–4, 1.263(a)–5, 1.446–1, 1.461–4, 1.461–5, 1.481–1.)

Rev. Proc. 2005–9

SECTION 1. PURPOSE

This revenue procedure provides the exclusive administrative procedures under which a taxpayer described in section 4 of this revenue procedure may obtain automatic consent for the taxpayer's second taxable year ending on or after December 31, 2003, to change to a method of accounting provided in §§ 1.263(a)–4, 1.263(a)–5, and 1.167(a)–3(b) of the Income Tax Regulations (the "final regulations").

SECTION 2. BACKGROUND

.01 On January 5, 2004, the Internal Revenue Service and Treasury Department published final regulations in the Federal Register (T.D. 9107, 2004–7 I.R.B. 447 [69 FR 436]). Section 1.263(a)–4 prescribes the extent to which taxpayers must capitalize amounts paid or incurred to acquire or create (or to facilitate the acquisition or creation of) intangibles. Section 1.263(a)–5 prescribes the extent to which taxpayers must capitalize amounts paid or incurred to facilitate an acquisition of a trade or business, a change in the capital structure of a business entity, and certain other transactions. Section 1.167(a)–3(b) provides a safe harbor useful life for certain intangible assets. The final regulations under §§ 1.263(a)–4 and 1.263(a)–5 are effective for amounts paid or incurred on or after December 31, 2003. The final regulations under § 1.167(a)–3(b) are effective for intangible assets created on or after December 31, 2003.

.02 Sections 1.263(a)–4(p) and 1.263(a)–5(n) provide that a taxpayer seeking to change to a method of accounting provided in the final regulations must secure the consent of the Commissioner in accordance with the requirements of § 1.446–1(e). In addition, §§ 1.263(a)–4(p) and 1.263(a)–5(n) provide that, for the taxpayer's first taxable year ending on or after December 31, 2003, the taxpayer is granted the consent of the Commissioner to change to a method of accounting provided in the final regulations, provided the taxpayer follows the administrative procedures issued under § 1.446–1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002–9, 2002–1 C.B. 327, as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432). The final regulations further provide that any applicable § 481(a) adjustment for a change to a method of accounting provided in the final regulations for a taxpayer's first taxable year ending on or after December 31, 2003, is determined by taking into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. The preamble to the final regulations states that the Service may issue additional guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the regulations.

.03 Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting.

.04 Rev. Proc. 2002–9 provides procedures by which a taxpayer may obtain automatic consent to change to a method of accounting described in the Appendix of Rev. Proc. 2002–9.

.05 Rev. Rul. 90–38, 1990–1 C.B. 57, provides that, if a taxpayer uses an erroneous method of accounting for two or more consecutive taxable years, the taxpayer has adopted a method of accounting. The ruling further provides that a taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing an amended return.

.06 Rev. Proc. 2004–23, 2004–16 I.R.B. 785, provides the exclusive administrative procedures under which a taxpayer may obtain automatic consent for the taxpayer's first taxable year ending on or after December 31, 2003, to change to a method of accounting provided in the final regulations and, if desired, to change to a method of utilizing the 3½ month rule authorized by § 1.461–4(d)(6)(ii) or the recurring item exception authorized by § 1.461–5 in conjunction with a change to a method of accounting provided in the final regulations. Under Rev. Proc. 2004–23, a term and condition of the Commissioner's consent with respect to a change to a method of accounting provided in the final regulations is that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. In addition, Rev. Proc. 2004–23 states that for taxable years subsequent to the first taxable year ending on or after December 31, 2003, a similar term and condition will apply. (For further background, see Section 2 of Rev. Proc. 2004–23.)

.07 This revenue procedure applies only for a taxpayer's second taxable year ending on or after December 31, 2003. As in Rev. Proc. 2004–23, this revenue procedure grants taxpayers the Commissioner's consent to change to a method of utilizing the 3½ month rule or the recurring item exception only for the item for which the taxpayer is simultaneously changing to a method of accounting provided in the final regulations. In addition, a term and condition of obtaining the Commissioner's consent, whether or not automatic, is that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. The Service intends to issue future guidance for changes in methods of accounting made for subsequent taxable years, including automatic consent procedures for some or all methods of accounting provided in the final regulations. Such guidance will include as a term and condition of obtaining the Commissioner's consent, whether or not automatic, that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002.

.08 This revenue procedure constitutes the exclusive guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the final regulations for a taxpayer's second taxable year ending on or after December 31, 2003. For any change in method of accounting to which this revenue procedure applies, a taxpayer may not file an application for a change in method of accounting

under Rev. Proc. 97–27, 1997–1 C.B. 10 (as modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, as amplified and clarified by Rev. Proc. 2002–54, 2002–2 C.B. 432). See section 4.02(1) of Rev. Proc. 97–27.

SECTION 3. HOW THIS REVENUE PROCEDURE DIFFERS FROM REV. PROC. 2004–23

.01 Rev. Proc. 2004–23 applies to a taxpayer's first taxable year ending on or after December 31, 2003. This revenue procedure applies to a taxpayer's second taxable year ending on or after December 31, 2003.

.02 Rev. Proc. 2004–23 waives the scope limitations in section 4.02 of Rev. Proc. 2002–9. This revenue procedure does not waive those limitations.

.03 Rev. Proc. 2004–23 does not require taxpayers to complete many of the lines in Part II of Form 3115. Because this revenue procedure does not waive the scope limitations of Rev. Proc. 2002–9, this revenue procedure requires taxpayers to complete more of the lines in Part II of Form 3115. See section 5.02(2)(d) of this revenue procedure.

SECTION 4. SCOPE

.01 This revenue procedure applies to a taxpayer that seeks, for the taxpayer's second taxable year ending on or after December 31, 2003, to change to a method of accounting provided in the final regulations.

.02 This revenue procedure also applies to a taxpayer that, for the taxpayer's second taxable year ending on or after December 31, 2003, in addition to seeking a change to a method of accounting provided in the final regulations, also seeks to change its method of accounting to utilize the 3½ month rule authorized by § 1.461–4(d)(6)(ii) or to utilize the recurring item exception authorized by § 1.461–5.

SECTION 5. APPLICATION

.01 *In general.* A taxpayer within the scope of this revenue procedure is, in accordance with section 6.01 of Rev. Proc. 2002–9, granted the consent of the Commissioner to change to a method of accounting provided in the final regulations (and, if desired, to also utilize the 3½ month rule authorized by § 1.461–4(d)(6)(ii) or the recurring item exception authorized by § 1.461–5) provided that the taxpayer follows the automatic change in method of accounting provisions in Rev. Proc. 2002–9, with the following modifications:

(1) The taxpayer must prepare and file Form 3115, *Application for Change in Accounting Method*, in accordance with section 5.02 of this revenue procedure;

(2) The copy of Form 3115 must be sent to the following special address (note the special post office box number): Commissioner of Internal Revenue, Attention: CC:ITA (Automatic Rulings Branch, Rev. Proc. 2005–9 Filing) P.O. Box 7616, Benjamin Franklin Station, Washington, D.C. 20044 (or in the case of a private delivery service or hand delivery to the courier's desk: Commissioner of Internal Revenue, Attention: CC:ITA (Automatic Rulings Branch, Rev. Proc. 2005–9 Filing), 1111 Constitution Avenue, NW, Washington, D.C. 20224);

(3) The taxpayer must compute any applicable § 481(a) adjustment and take such adjustment into account in accordance with section 6 of this revenue procedure; and

(4) A taxpayer described in section 5.03(2) of this revenue procedure must file one or more amended federal income tax returns (amended returns) in accordance with section 5.03(3), (4), or (5), as applicable, of this revenue procedure.

.02 *Form 3115.* In preparing the Form 3115 referred to in section 5.01 of this revenue procedure, a taxpayer must comply with the following procedures:

(1) The taxpayer may use one Form 3115 for all changes in method of accounting made pursuant to the final regulations;

(2) The taxpayer is required to complete only the following information on Form 3115:

(a) The identification section of Page 1 (above Part I);

(b) The signature section at the bottom of Page 1;

(c) Part I, Line 1(a). The designated automatic accounting method change number for changes in method of accounting made pursuant to this revenue procedure is No. "78";

(d) Part II, all lines except lines 11, 13, 14, 15, and 17 (for purposes of completing line 12, see section 6.02(2) of this revenue procedure if the taxpayer is making more than one change in method of accounting);

(e) Part IV, in accordance with section 6 of this revenue procedure; and

(f) Schedule E, if applicable;

(3) In addition to the other information required on line 12 of Form 3115, the taxpayer must include the citation to the paragraph of the final regulations that provides for the proposed method of accounting for each item (*e.g.*, § 1.263(a)–4(d)(6) or § 1.263(a)–4(f)), and, if applicable, whether the taxpayer is also proposing to change to a method that uses the 3½ month rule authorized by § 1.461–4(d)(6)(ii) or the recurring item exception authorized by § 1.461–5 with respect to the item;

(4) In addition to the other information required on Schedule E of Form 3115 (if applicable), the taxpayer must include a statement as to whether the useful life is the safe harbor useful life prescribed by § 1.167(a)–3(b)(1) or § 1.167(a)–3(b)(1)(iv) and, if the useful life is the safe harbor useful life prescribed by § 1.167(a)–3(b)(1), a statement explaining why the intangible asset does not have a useful life the length of which can be estimated with reasonable accuracy; and

(5) A taxpayer that must file one or more amended returns as provided in section 5.03 of this revenue procedure to be eligible to use the automatic consent procedures of this revenue procedure must attach to the Form 3115 a written statement signed under penalties of perjury confirming that the taxpayer has filed the amended returns pursuant to section 5.03 of this revenue procedure.

.03 *Unauthorized change in a preceding year.*

(1) A taxpayer may change a method of accounting only with the consent of the Commissioner. § 1.446–1(e)(2). A taxpayer that changes a method of accounting without the consent of the Commissioner has made an unauthorized change in method of accounting. If a taxpayer makes an unauthorized change in method of accounting, the Service may adjust the taxpayer's taxable income during the examination of the taxpayer's income tax return for the taxable year the unauthorized change was made and for all affected subsequent years. In the notice of proposed rulemaking that preceded the publication of the final regulations (REG–125638–01,

2003–1 C.B. 373 [67 FR 77701]), the Service and Treasury Department advised taxpayers not to seek to change a method of accounting in reliance on rules contained in the notice of proposed rulemaking until the rules were published as final regulations. The Service and Treasury Department are aware that some taxpayers have made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations. The Service and Treasury Department have determined that it is not appropriate for taxpayers that have made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations to obtain automatic consent under this revenue procedure without correcting such unauthorized change. Therefore, a taxpayer that made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations is eligible to use the automatic consent procedures provided in this revenue procedure only if the taxpayer amends prior federal income tax returns to correct the unauthorized change in method of accounting. However, as a matter of administrative grace, the Service and Treasury Department have limited the application of this section 5.03 to certain taxpayers described in section 5.03(2) of this revenue procedure.

(2) This section 5.03 applies to a taxpayer that —

(a) in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is after January 24, 2002 —

(i) made any unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations; or

(ii) impermissibly changed the treatment of an item that is provided for in the final regulations in the taxpayer's first taxable year ending on or after December 31, 2003, but has only used such treatment on one federal income tax return; or

(b) made an unauthorized change in method of accounting to a method of accounting that is provided in the final regulations in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is on or before January 24, 2002, and for which the statute of limitations has not yet expired, if the taxpayer wishes to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting to which the taxpayer previously made the unauthorized change.

(3) A taxpayer described in section 5.03(2)(a)(i) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer changes back to the prior method of accounting (*i.e.*, the method of accounting used for an item prior to making the unauthorized change for the item) for each item referred to in section 5.03(2)(a) of this revenue procedure by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method (or methods) was used.

(4) A taxpayer described in section 5.03(2)(a)(ii) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer amends its federal income tax return for the preceding taxable year in which the unauthorized treatment was used to change the treatment of each item referred to in section 5.03(2)(a) of this revenue procedure to a treatment consistent with the taxpayer's historic method of accounting (*i.e.*, the method of accounting used for an item prior to changing the treatment of the item).

(5) A taxpayer described in section 5.03(2)(b) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting provided in the final regulations to which the taxpayer previously made the unauthorized change only if the taxpayer changes back to its prior method of accounting for the item (*i.e.*, the method of accounting used for the item prior to making the unauthorized change for the item) by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method was used.

(6) A taxpayer filing one or more amended returns pursuant to section 5.03(3), (4), or (5) of this revenue procedure must file the amended returns on or before the date the taxpayer files a Form 3115 under this revenue procedure (including the copy of Form 3115 filed with the national office under section 5.01(2) of this revenue procedure) for the taxpayer's second taxable year ending on or after December 31, 2003. For this purpose, a taxpayer under examination will be considered to have filed an amended return by providing the amended return to the examining agent.

(7) In accordance with § 1.446–1(e)(3)(ii) and Rev. Rul. 90–38, consent is hereby granted for a taxpayer described in section 4.01 of this revenue procedure that also is described in section 5.03(2)(a)(i) or (b) of this revenue procedure to file the amended returns referred to in section 5.03(3) or (5) of this revenue procedure to retroactively change its method of accounting. This consent is granted for the taxable year for which the taxpayer made the unauthorized change and for any subsequent taxable year affected by the unauthorized change.

.04 *Prior change*. For purposes of this revenue procedure, a change in method of accounting made pursuant to Rev. Proc. 2004–23 (including a change required to be made on an amended return as provided by section 4.03 of Rev. Proc. 2004–23) for an item is not treated as a prior change of the same method of accounting within the meaning of section 4.02(6) of Rev. Proc. 2002–9 with respect to a different item covered by this revenue procedure. Thus, for example, a taxpayer that obtained automatic consent under Rev. Proc. 2004–23 to change to a method of applying the 12-month rule to prepaid property insurance is not prohibited by section 4.02(6) of Rev. Proc. 2002–9 from obtaining consent under this revenue procedure to change to a method of applying the 12-month rule to the taxpayer's prepaid licenses and permits.

SECTION 6. COMPUTATION OF SECTION 481(a) ADJUSTMENT

.01 *In general*. A taxpayer changing a method of accounting under this revenue procedure is required to take into account any applicable § 481(a) adjust-

ment as provided in §§ 1.263(a)–4(p)(3) and 1.263(a)–5(n)(3). The § 481(a) adjustment is computed as of the first day of the taxpayer's second taxable year ending on or after December 31, 2003, and, as provided in the final regulations, takes into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. Thus, the § 481(a) adjustment is computed by taking into account only amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the first taxable year ending on or after December 31, 2003. The amount of the § 481(a) adjustment must include (i) as a reduction of taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the first taxable year ending on or after December 31, 2003, that were capitalized under the taxpayer's present method of accounting and are currently deductible under the taxpayer's proposed method of accounting, reduced by the amount of such capitalized costs recovered through amortization or depreciation under the taxpayer's present method of accounting, (ii) as an increase to taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the first taxable year ending on or after December 31, 2003, that were currently deducted under the taxpayer's present method of accounting and are capitalized under the taxpayer's proposed method of accounting, reduced by the amount of capitalized costs that would have been recovered through amortization or depreciation if the taxpayer's proposed method of accounting had been applied in taxable years ending on or after January 24, 2002, and (iii) as an increase or a reduction to taxable income, as appropriate, any other adjustments required as a result of the change in method of accounting. If under its present method of accounting a taxpayer capitalized costs incurred prior to the first taxable year that includes January 24, 2002, the taxpayer must continue to treat amortization or depreciation deductions attributable to those costs in accordance with the taxpayer's present method of accounting. Thus, for example, a taxpayer that files its federal income tax return on a calendar year basis continues to amortize or depreciate in 2004 an intangible created in 2001, even though the taxpayer has changed to a method of accounting provided in the final regulations under which the entire cost of the intangible would be currently deductible if incurred in 2004.

.02 *Reporting the section 481(a) adjustment on Form 3115.*

(1) *Netting*. For purposes of determining the adjustment period under section 2.05(2) of Rev. Proc. 2002–9, the § 481(a) adjustment is determined separately for each change in method of accounting being made under this revenue procedure. Thus, a positive adjustment attributable to a change in one method may not be netted against a negative adjustment attributable to a change in another method. However, in determining the adjustment attributable to a change in method, a taxpayer must net positive § 481(a) adjustments and negative § 481(a) adjustments resulting from that change in method (*e.g.*, if a taxpayer changes to a method of applying the 12-month rule to prepaid amounts, the taxpayer must net the resulting negative § 481(a) adjustment with the positive § 481(a) adjustment that results from including those amounts in inventory pursuant to the taxpayer's existing § 263A method of accounting for inventory).

(2) *Itemized listing on Form 3115*. The taxpayer must include on Form 3115, Part IV, line 25, the total § 481(a) adjustment for all changes in methods of accounting being made. If the taxpayer is making more than one change in method of accounting under the final regulations, the taxpayer must include on an attachment to Form 3115 —

(a) the information required by Part IV, line 25 for each change in method of accounting (including the amount of the § 481(a) adjustment for each change in method of accounting);

(b) the information required by Part II, line 12 of Form 3115 that is associated with each change; and

(c) the citation to the paragraph of the final regulations that provides for each proposed method of accounting (*e.g.*, § 1.263(a)–4(d)(6) or § 1.263(a)–4(f)).

.03 *Example*: Y, a calendar year taxpayer that uses an accrual method of accounting, is a service provider not required to maintain inventories. Y wishes to change to a method of accounting provided in the final regulations for taxable year 2004, which is Y's second taxable year ending on or after December 31, 2003. Y incurred and capitalized $100x in taxable year 2001, $200x in taxable year 2002, and $250x in taxable year 2003. In addition, Y incurred $300x in taxable year 2004. The $100x, $200x, and $250x capitalized and depreciated by Y in 2001, 2002, and 2003 all relate to the same method of accounting and would be currently deductible under the final regulations if the amounts had been incurred on or after December 31, 2003. Y claimed a depreciation deduction of $10x in each of the taxable years 2001, 2002, and 2003 with respect to the $100x incurred and capitalized in 2001, a depreciation deduction of $20x in each of the taxable years 2002 and 2003 with respect to the $200x incurred and capitalized in 2002, and a depreciation deduction of $25x in taxable year 2003 with respect to the $250x incurred and capitalized in 2003. For taxable year 2004, Y may apply for an automatic change in method of accounting with respect to the method under which the amounts had been capitalized. Y's section 481(a) adjustment is a decrease in income of $385x ($160x relating to amounts capitalized in 2002 ($200x - $40 ($20 for 2002 and $20 for 2003)) + $225x relating to amounts capitalized in 2003 ($250x - $25x)). Y must continue to use its present method of accounting for the amount capitalized in 2001. Y uses its new method of accounting for the amount incurred in 2004.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include these automatic changes in method of accounting in section 3 of the APPENDIX.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for a taxpayer's second taxable year ending on or after December 31, 2003.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Grace Matuszeski of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, call Ms. Matuszeski at (202) 622–7900 (not a toll-free call).

26 CFR 31.3121(b)(10): Services performed by certain students in the employ of a school, college, or university, or of a nonprofit organization auxiliary to a school, college, or university.

Rev. Proc. 2005–11

SECTION 1. PURPOSE

.01 This revenue procedure sets forth generally applicable standards for determining whether services in the employ of certain public or private nonprofit schools, colleges, or universities, or affiliated organizations described in § 509(a)(3) of the Internal Revenue Code (the Code) performed by a student qualify for the exception from Federal Insurance Contributions Act (FICA) tax provided under § 3121(b)(10) of the Code (Student FICA exception). These standards are intended to provide objective and administrable guidelines for determining employment tax liability.

.02 This revenue procedure modifies the safe harbor standards provided in Rev. Proc. 98–16, 1998–1 C.B. 403, in several respects in order to align them with the recently issued final regulations under § 31.3121(b)(10)–2 of the Employment Tax Regulations (T.D. 9167, 2005–2 I.R.B. 261 [69 F.R. 76404]).

SECTION 2. BACKGROUND INFORMATION AND OVERVIEW

.01 Proposed amendments to § 31.3121(b)(10)–2 of the Employment Tax Regulations were issued on February 25, 2004, and were proposed to be applicable with respect to services performed on or after that date (REG–156421–03, 2004–10 I.R.B. 571 [69 F.R. 8604]). Notice 2004–12, 2004–10 I.R.B. 556, issued in conjunction with the proposed amendments, proposed to replace Rev. Proc. 98–16 with a revenue procedure that is consistent with the proposed amendments. Notice 2004–12 provided interim reliance on the proposed revenue procedure as of February 25, 2004, and suspended Rev. Proc. 98–16 pending issuance of the final revenue procedure. Notice 2004–12 requested comments on the proposed revenue procedure. After consideration of the comments that were received, the proposed revenue procedure is adopted as revised by this revenue procedure, and Rev. Proc. 98–16 is modified and superseded effective April 1, 2005.

.02 This revenue procedure modifies the safe harbor standards of Rev. Proc. 98–16 in several respects in order to align them with the final regulations. First, in order for the safe harbor to be available, in addition to being an "institution of higher education" under the Department of Education's regulations, as required by Rev. Proc. 98–16, the employer must be a school, college, or university (SCU) as defined in § 31.3121(b)(10)–2(c) of the final regulations, or an affiliated § 509(a)(3) organization with respect to the SCU. The final regulations provide that an organization is not a SCU unless its primary function is to conduct educational activities. The primary function requirement may cause the student FICA exception to be unavailable to certain organizations, such as hospitals and museums, that have embedded within them divisions or functions that carry on educational activities. See section 5 of this revenue procedure.

.03 Second, a "full-time employee" as defined in § 31.3121(b)(10)–2(d)(3)(iii) of the final regulations is ineligible for the student FICA exception. This section provides that the services of a full-time employee are not incident to and for the purpose of pursuing a course of study. Whether an employee is a full-time employee is based on the employer's standards and practices, except that an employee whose normal work schedule is 40 hours or more per week is always considered a full-time employee. Accordingly, a full-time employee is ineligible for the safe harbor provided in this revenue procedure. See section 6 of this revenue procedure.

.04 Third, the safe harbor is unavailable with respect to the services of a "professional employee" as defined in § 31.3121(b)(10)–2(d)(3)(v)(B)(1) of the final regulations. This section provides that a professional employee is an employee whose work: (1) requires knowledge of an advanced type in a field of science or learning, (2) requires the consistent exercise of discretion and judgment, and (3) is predominantly intellectual and varied in character. Although the safe harbor is unavailable, a professional employee may qualify for the student FICA exception based on consideration of all the facts and circumstances. See section 6 of this revenue procedure.

.05 Fourth, and finally, this revenue procedure expands the list of employment benefits that cause an employee to be ineligible for the safe harbor. This change is consistent with § 31.3121(b)(10)–2(d)(3)(v)(C) of the final regulations, which provides that eligibility for employment benefits generally suggests that an employee is not a student. Rev. Proc. 98–16 provides that the services of a "career employee" are ineligible for the safe harbor. Under Rev. Proc. 98–16, a career employee is an employee who is eligible to participate in certain retirement plans, eligible for reduced tuition (with certain exceptions), or otherwise classified by the employer as a career employee. The final regulations adopt the same list of employment benefits, and add to the list eligibility for several other employment benefits that are identified. Although the safe harbor is unavailable if an employee receives employment benefits described in this revenue procedure, the employee may qualify for the student FICA exception based on consideration of all the facts and circumstances. See section 6 of this revenue procedure.

.06 Both the final regulations and this revenue procedure are applicable with respect to services performed on or after April 1, 2005. This revenue procedure provides that Rev. Proc. 98–16 is no longer suspended, and employers may rely on it with respect to services performed prior to April 1, 2005, including services performed on or after February 25, 2004, and prior to April 1, 2005. Rev. Proc. 98–16 is modified and superseded with respect to services performed on or after April 1, 2005. See section 10 of this revenue procedure.

SECTION 3. SCOPE

.01 Sections 6 and 7 of this revenue procedure contain generally applicable standards for determining whether services performed by employees of certain institutions of higher education are eligible for the student FICA exception.

.02 The standards contained in this revenue procedure do not apply to employees who are postdoctoral students, postdoctoral fellows, medical residents, or medical interns because the services performed by

these employees cannot be assumed to be incident to and for the purpose of pursuing a course of study. The employment activities of these individuals overlap with the activities arguably comprising a course of study, and thus it is not appropriate to apply the standards of this revenue procedure to these individuals.

.03 The standards contained in this revenue procedure may not constitute the exclusive method for determining whether the student FICA exception applies. If the standard for qualifying for the exclusion described in section 7 of this revenue procedure (providing generally that an employee enrolled at least half-time at an institution of higher education has the status of student) is not met, whether or not services in the employ of a SCU, or an affiliated § 509(a)(3) organization qualify for the student FICA exception will depend on consideration of all the facts and circumstances.

SECTION 4. BACKGROUND LAW

.01 Sections 3101 and 3111 of the Code impose social security and Medicare taxes (FICA taxes) on employees and employers, respectively, equal to a percentage of the wages received by an individual with respect to employment.

.02 Section 3121(a) of the Code defines "wages" for purposes of FICA taxes as all remuneration for employment, with certain exceptions. Section 3121(b) of the Code defines "employment" as services performed by an employee for an employer, with certain exceptions.

.03 Section 3121(b)(10) of the Code excepts from the definition of employment services performed in the employ of a SCU (whether or not that organization is exempt from income tax), or an affiliated § 509(a)(3) organization if the services are performed by a student who is enrolled and regularly attending classes at that SCU. Remuneration for services excluded from the definition of employment under § 3121(b)(10) of the Code is not subject to FICA taxes.

.04 Section 31.3121(b)(10)–2(b) of the final Employment Tax Regulations provides that the tests for determining eligibility for the student FICA exception are (1) whether the employer is a SCU within the meaning of § 31.3121(b)(10)–2(c) of the final regulations, and (2) whether the employee is a student within the meaning of § 31.3121(b)(10)–2(d) of the final regulations. If the employee has the status of a student, the amount of remuneration for services performed by the employee, the type of services performed by the employee, and the place where the services are performed are immaterial for purposes of the student FICA exception.

.05 Section 31.3121(b)(10)–2(c) of the final regulations provides that an organization is a SCU within the meaning of § 3121(b)(10) if its primary function is the presentation of formal instruction, it normally maintains a regular faculty and curriculum, and it normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on.

.06 Section 31.3121(b)(10)–2(d)(3)(i) of the final regulations provides that in order to have the status of a student, an employee's services for the SCU must be incident to and for the purpose of pursuing a course of study at the SCU. Whether an employee's services are incident to and for the purpose of pursuing a course of study is determined on the basis of the relationship of the employee with the organization for which such services are performed as an employee. The educational aspect of the relationship, as compared to the service aspect, must be predominant in order for the employee's services to be incident to and for the purpose of pursuing a course of study. Except in the case of a full-time employee described in § 31.3121(b)(10)–2(d)(3)(iii) of the final regulations, whether the educational aspect or service aspect of an employee's relationship with the employer is predominant is determined by considering all the relevant facts and circumstances. Whether an employee's services are incident to and for the purpose of pursuing a course of study is determined separately with respect to each academic term. Relevant factors in evaluating the educational and service aspects of an employee's relationship with the employer are described in §§ 31.3121(b)(10)–2(d)(3)(iv) and (v) of the final regulations respectively.

.07 Section 31.3121(b)(10)–2(d)(3)(iii) of the final regulations provides that the services of a full-time employee are not incident to and for the purpose of pursuing a course of study. The determination of whether an employee is a full-time employee is based on the employer's standards and practices, except regardless of the employer's classification of the employee, an employee whose normal work schedule is 40 hours or more per week is considered a full-time employee. The employee's work schedule during academic breaks is not considered in determining whether the employee's normal work schedule is 40 hours or more per week.

.08 Section 31.3121(b)(10)–2(d)(3)(iv) of the final regulations provides that the educational aspect of an employee's relationship with the employer is generally evaluated based on the employee's course workload. Whether an employee's course workload is sufficient in order for the employee's employment to be incident to and for the purpose of pursuing a course of study depends on the particular facts and circumstances. A relevant factor in evaluating an employee's course workload is the employee's course workload relative to a full-time course workload at the SCU at which the employee is enrolled and regularly attending classes.

.09 Section 31.3121(b)(10)–2(d)(3)(v) of the final regulations provides certain relevant factors in evaluating the service aspect of an employee's relationship with the employer. Under § 31.3121(b)(10)–2(d)(3)(v)(B)(1), if an employee has the status of a professional employee, then that suggests the service aspect of the employee's relationship with the employer is predominant. A professional employee is an employee—

(1) Whose primary duty consists of the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study, as distinguished from a general academic education, from an apprenticeship, and from training in the performance of routine mental, manual, or physical processes;

(2) Whose work requires the consistent exercise of discretion and judgment in its performance; and

(3) Whose work is predominantly intellectual and varied in character (as opposed to routine mental, manual, mechanical, or physical work) and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

.10 Section 31.3121(b)(10)–2(d)(3)(v)(C) of the final regulations provides that whether an employee is eligible to receive employment benefits is a relevant factor in evaluating the service aspect of an employee's relationship with the employer. However, eligibility for benefits mandated by law is given a lesser amount of weight in evaluating the relationship.

.11 Section 218 of the Social Security Act (the Act), 42 U.S.C. section 418, requires the Commissioner of Social Security, if requested by a State, to enter into an agreement with the State to provide Social Security coverage for services performed by individuals as employees of such State. The State may request that the coverage agreement exclude from coverage service performed by a student. If a State has exercised its option under § 218 of the Act to provide coverage for its employees, and has not chosen to exclude students from such coverage, § 3121(b)(10) of the Code provides that the services of students will not qualify for the student FICA exception; that is, the students' services will be covered and the wages will be subject to FICA taxation.

SECTION 5. SAFE HARBOR APPLIES TO CERTAIN INSTITUTIONS OF HIGHER EDUCATION

.01 The standards contained in this revenue procedure apply to an "institution of higher education" meeting the requirements of § 31.3121(b)(10)–2(c) of the final regulations. For purposes of this revenue procedure, the term "institution of higher education" means any public or private nonprofit SCU within the meaning of § 31.3121(b)(10)–2(c), or affiliated § 509(a)(3) organization with respect to the SCU, that meets the requirements set forth in Department of Education regulations at 34 C.F.R. § 600.4, as amended from time to time, and that is accredited or preaccredited by a nationally recognized accrediting agency as defined in the Department of Education regulations at 34 C.F.R. § 600.2.

.02 Services for other institutions may also be eligible for the student FICA exception. Thus, for example, services performed by a student for a secondary school may be eligible for the student FICA exception. Whether or not services for other institutions, such as secondary schools, qualify for the student FICA exception is determined based on the facts and circumstances of each case.

SECTION 6. SAFE HARBOR NOT AVAILABLE FOR CERTAIN EMPLOYEES

.01 Services performed by an employee with the status of a "full-time employee" within the meaning of § 31.3121(b)(10)–2(d)(3)(iii) of the final regulations are not eligible for the student FICA exception because such services are not incident to and for the purpose of pursuing a course of study. Accordingly, the services of a full-time employee are not eligible for the safe harbor provided under section 7 of this revenue procedure.

.02 Services performed by a "professional employee" within the meaning of § 31.3121(b)(10)–2(d)(3)(v)(B)(1) of the final regulations are not eligible for the safe harbor provided under section 7 of this revenue procedure, because such services cannot generally be considered to be incident to and for the purpose of pursuing a course of study. However, the services of a professional employee may be eligible for the student FICA exception based on consideration of all the facts and circumstances.

.03 Services performed by an employee who receives or is eligible to receive employment benefits as described in this paragraph 6.03 (except as provided in paragraph 6.04 of this revenue procedure) are not eligible for the safe harbor provided under section 7 of this revenue procedure, because such services cannot generally be considered to be incident to and for the purpose of pursuing a course of study. However, the services of an employee who receives or is eligible for employment benefits as described in this paragraph 6.03 may be eligible for the student FICA exception based on consideration of all the facts and circumstances. For purposes of this revenue procedure, an employee's services are not eligible for the safe harbor provided under section 7 of this revenue procedure if the individual —

(1) Is eligible for vacation, sick leave, or paid holiday benefits;

(2) Is eligible to participate in any retirement plan described in § 401(a) of the Code that is established or maintained by the institution, or would be eligible to participate if age and service requirements were met;

(3) Is eligible to receive an allocation of employer contributions other than contributions described in § 402(g) of the Code under an arrangement described in § 403(b) of the Code, or would be eligible to receive such allocations if age and service requirements were met, or if contributions described in § 402(g) of the Code were made by the employee;

(4) Is eligible to receive an annual deferral by nonelective employer contributions under an eligible deferred compensation plan described in § 457(b), or would be eligible for such annual deferrals if plan requirements were met, or if contributions by salary reduction were made by the employee to a plan described in § 457(b);

(5) Is eligible for reduced tuition (other than qualified tuition reduction under § 117(d)(5) of the Code provided to a teaching or research assistant who is a graduate student as described in section 8.03 of this revenue procedure) because of the individual's employment relationship with the institution; or

(6) Is eligible to receive one or more of the employment benefits described under sections 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), and 137 (adoption assistance) because of the individual's employment relationship with the institution.

.04 Receipt of or eligibility for an employment benefit as described in paragraph 6.03 of this revenue procedure that is mandated by state or local law will not cause an employee to be ineligible for the safe harbor provided under section 7 of this revenue procedure.

.05 If an individual described in section 6.01, 6.02, or 6.03 of this revenue procedure performs services in multiple job positions, then the individual will with respect to any of those positions be deemed to have the same employee status with respect to all of the positions.

SECTION 7. STANDARDS APPLICABLE TO UNDERGRADUATE AND GRADUATE STUDENTS

.01 An individual who is a half-time undergraduate student or a half-time graduate or professional student and who is not described in section 6.01, 6.02 or 6.03 of this

revenue procedure qualifies for the student FICA exception under this revenue procedure with respect to services performed for an institution of higher education described in section 5 of this revenue procedure at which the employee is enrolled or for an affiliated § 509(a)(3) organization with respect to the institution of higher education. Services performed by a student for any other employer are not covered by the standards of this revenue procedure.

.02 An individual is deemed to be a half-time undergraduate or half-time graduate or professional student if the individual is not described in section 6.01, 6.02, or 6.03 of this revenue procedure and is an undergraduate or graduate student who is in the last semester, trimester, or quarter of a course of study requiring at least two semesters, trimesters, or quarters to complete and is enrolled in the number of credit or unit hours needed to complete the requirements for obtaining a degree, certificate, or other recognized educational credential offered by that institution of higher education even if enrolled in less than half the number required of full-time students.

.03 The determination of student status should be made at the end of the drop-add period and may be adjusted thereafter at the institution of higher education's option. The determination of student status for payroll periods ending before the end of the drop-add period may be based on the number of semester, trimester, or quarter hours being taken at the end of the registration period for that semester, trimester, or quarter.

.04 If an individual is described in section 7.01 or 7.02 of this revenue procedure, then all services performed during all payroll periods of a month or less that fall wholly or partially within the academic term are excepted from employment under the student FICA exception.

.05 The student FICA exception does not apply to services performed by an individual who is not enrolled in classes during school breaks of more than five weeks (including summer breaks of more than five weeks), other than services described in section 7.04. See Rev. Rul. 72–142, 1972–1 C.B. 317, and Rev. Rul. 74–109, 1974–1 C.B. 288. However, the student FICA exception applies to employment which continues during normal school breaks of 5 weeks or less during which the individual is not eligible for the student FICA exception pursuant to section 7.01 of this revenue procedure provided that the individual qualifies for the student FICA exception pursuant to section 7.01 of this revenue procedure on the last day of classes or examinations preceding the break and is eligible to enroll in classes for the first academic period following the break.

.06 If the services performed by a student otherwise described in section 7.01 or 7.02 of this revenue procedure are covered under an agreement pursuant to section 218 of the Act, the student FICA exception does not apply.

.07 For provisions relating to domestic service performed by a student in a local college club, or local chapter of a college fraternity or sorority, see § 31.3121(b)(2)–1.

SECTION 8. DEFINITIONS

For purposes of the standard contained in section 7 of this revenue procedure, the following definitions must be used. For purposes of the following definitions, the term "institution of higher education" means an institution of higher education as defined in section 5 of this revenue procedure.

.01 Undergraduate student. The term "undergraduate student" has the meaning attributed to that term in the Department of Education regulations at 34 C.F.R. § 674.2.

.02 Half-time undergraduate student. The term "half-time undergraduate student" has the meaning attributed to that term in the Department of Education regulations at 34 C.F.R. § 674.2.

.03 Graduate or professional student. The term "graduate or professional student" means a student who—

(1) Is enrolled at an institution of higher education for the purpose of obtaining a degree, certificate, or other recognized educational credential above the baccalaureate level or is enrolled in a program leading to a professional degree;

(2) Has completed the equivalent of at least three years of full-time study at an institution of higher education, either prior to entrance into the program or as part of the program itself; and

(3) Is not a postdoctoral student, postdoctoral fellow, medical resident, or medical intern.

.04 Half-time graduate or professional student. The term "half-time graduate or professional student" means an enrolled graduate or professional student, as defined in section 8.03 of this revenue procedure, who is carrying at least a half-time academic workload at an institution of higher education as determined by that institution under its standards and practices.

SECTION 9. ANTI-ABUSE RULE

The standards in this revenue procedure must be applied in a reasonable manner, consistent with the purpose of excluding from employment only services that are performed as an incident to and for the purpose of pursuing a course of study at an institution of higher education as defined in section 5 of this revenue procedure. If the standards are inappropriately applied in a manner that conflicts with this underlying purpose so as to manipulate or mischaracterize the nature of the relationship between an employee and an institution of higher education, resulting in the improper avoidance of payment of FICA taxes, then whether the student FICA exception applies will be determined on the basis of all the facts and circumstances (except if the employee is a full-time employee under § 31.3121(b)(10)–2(d)(3)(iii) of the final regulations), rather than on the basis of the specific standards set forth in this revenue procedure. For example, the standards would be inappropriately applied through the manipulation of the relationship between employees and the institution of higher education if a university claimed that the student FICA exception applied to research laboratory workers, who had been full-time employees within the meaning of § 31.3121(b)(10)–2(d)(3)(iii) of the regulations, but were converted to non-full-time employees and required to enroll in a certificate program granting six credit hours per semester for work experience in the laboratory. As another example, if an individual who was not a student worked for a university for many years in a job generally performed by non-students (but nonetheless was not described in section 6.01, 6.02, or 6.03 of this revenue procedure), and then enrolled at the university for six credit hours of course work per semester while continuing to work in the same job, it may be

inappropriate to apply the standards of this revenue procedure to conclude that the individual's work has become incident to and for the purpose of pursuing a course of study solely because the individual enrolled for this course work. In both of these examples, whether the work is performed incident to and for the purpose of pursuing a course of study must be determined on the basis of all the relevant facts and circumstances.

SECTION 10. EFFECT ON OTHER PUBLISHED ITEMS

.01 Rev. Proc. 98–16, 1998–1 C.B. 403, is no longer suspended. Employers may rely on Rev. Proc. 98–16 with respect to services performed prior to April 1, 2005.

.02 Rev. Proc. 98–16 is modified and superseded effective April 1, 2005.

SECTION 11. EFFECTIVE DATE

This revenue procedure is applicable with respect to services performed on or after April 1, 2005 (the date on which T.D. 9167, 2005–2 I.R.B. 261 [69 F.R. 76404], amending § 31.3121(b)(10)–2 is applicable).

SECTION 12. DRAFTING INFORMATION

The principal author of this revenue procedure is Stephen Suetterlein of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue procedure, contact Mr. Suetterlein at (202) 622–6040 (not a toll-free call).

---

26 CFR 601.202: Closing agreements.
(Also Part I, §§ 446, 482, 7121; 1.446–1, 301.7121–1.)

Rev. Proc. 2005–12

TABLE OF CONTENTS

SECTION 1. PURPOSE

.01 This revenue procedure permits a taxpayer under the jurisdiction of the Large and Mid-Size Business Division to request that the Service examine specific issues relating to tax returns before those returns are filed. This revenue procedure supercedes Rev. Proc. 2001–22, 2001–1 C.B. 745. This revenue procedure provides the framework within which a taxpayer and the Service may work together in a cooperative environment to resolve, after examination, issues accepted into the program. If the taxpayer and the Service are able to resolve the examined issues before the returns that they affect are filed, this revenue procedure authorizes the taxpayer and the Service to memorialize their agreement by executing an LMSB Pre-Filing Agreement (PFA).

.02 This revenue procedure outlines the procedures for resolving issues through pre-filing examinations. Taxpayers and the Service often resolve issues more effectively and efficiently through a pre-filing examination than a post-filing examination, because the taxpayer and the Service have more timely access to the records and personnel that are relevant to the issues. A pre-filing examination also provides the taxpayer with certainty regarding the examined issue at an earlier point in time than a post-filing examination. These procedures benefit both taxpayers and the Service by improving the quality of tax compliance while reducing costs, burdens, and delays. Unlike letter rulings and other forms of written advice provided by the Offices of the Associates Chief Counsel (see Rev. Proc. 2004–1, 2004–1 I.R.B. 1), a PFA does not determine the tax treatment of prospective or future transactions or events, but only of completed transactions or events whose tax treatment has not yet been reported on a return.

SECTION 2. BACKGROUND

.01 In Rev. Proc. 2001–22, the Service provided procedures for LMSB taxpayers to request an examination and resolve specific issues relating to returns that were neither due (taking into account any extensions of time to file) nor filed. The objective of the PFA program is to resolve, before returns are filed, issues that are likely to be disputed in post-filing audits.

.02 Because Rev. Proc. 2001–22 limited the eligible years for the PFA program to current or prior taxable years for which returns were neither due nor filed, taxpayers and the Service could not resolve issues for multiple future taxable years or issues regarding appropriate methodologies for determining tax consequences that would affect future taxable years. The Service has determined that expanding the scope of the PFA program by allowing taxpayers and the Service to address certain issues over a limited number of future taxable years will significantly benefit both taxpayers and the Service.

.03 In addition, based on its experience with the PFA program, the Service has reconsidered the domestic and international issues that are eligible for the program.

SECTION 3. SCOPE

.01 *Eligible taxpayers*. This revenue procedure applies to taxpayers under the jurisdiction of LMSB that desire to resolve through a PFA issues that otherwise may be the subject of a post-filing examination.

.02 *Eligible taxable years*.

(1) *Current, past, and future taxable years*. An eligible taxpayer may request a PFA for the current taxable year, any prior taxable year for which the original return is not yet due (taking into account any extensions of time to file) and is not yet filed and, except in the case of a PFA provided under section 3.09(2), for a limited number of future taxable years.

(2) *Agreements for future taxable years*. Agreements for future taxable years are limited to four taxable years beyond the current taxable year.

.03 *Eligible issues generally*.

(1) *Factual issues and well-established law*. The Service will consider entering into a PFA on any issue that requires either a determination of facts or the application of well-established legal principles to known facts.

(2) *Issues that involve a methodology*. The Service also will, in general, consider entering into a PFA regarding a methodology used by a taxpayer to determine the appropriate amount of an item of income, allowance, deduction, or credit.

(3) *Issues under the jurisdiction of other Service divisions*. The Service will consider entering into a PFA on an issue under the jurisdiction of an operating division of the Service other than LMSB, but only with the concurrence of that operating division.

.04 *Relationship of eligible issues to eligible taxable years*. An issue also must relate to an eligible taxable year or years in order to be an eligible issue

.05 *Eligible domestic and eligible international issues require coordination and consultation with Associate Chief Counsel*.

There is no list of eligible domestic and international issues. Any domestic or international issue that requires either a determination of facts or application of well-established legal principles to known facts and that is not excluded under section 3.08 or section 3.09 of this revenue procedure is *likely* suitable for a PFA.

The Service may, in its sole discretion, refuse to address an issue in a PFA based on considerations of sound tax administration. Before any decision is made to proceed with the taxpayer's request for a PFA, the Service must coordinate and consult with the Associate Chief Counsel having subject matter jurisdiction over any issue proposed to be determined by a PFA. As part of this coordination and consultation, the Associate Chief Counsel may consider whether the issue is more appropriately resolved by a letter ruling or other form of written advice from the Offices of the Associates Chief Counsel, as described in Rev. Proc. 2004–1, 2004–1 I.R.B. 1, or its successors, and whether the issue is currently one with respect to which the Service will never, or will not ordinarily, issue a letter ruling. See Rev. Proc. 2004–3, 2004–1 I.R.B. 114, Rev. Proc. 2004–7, 2004–1 I.R.B. 237, and their successors.

.06 *Eligible international issues requiring Associate Chief Counsel (International) concurrence in execution*. This subsection lists specific international issues that are *likely* suitable for a PFA, but also require that the Associate Chief Counsel (International) concur with the acceptance of the issue into the PFA Program and execution of the PFA. Even though an issue in a particular case appears on this list, the Service may, in its sole discretion, refuse to address that issue based on considerations of sound tax administration. The eligible issues are:

(1) whether a unit of the taxpayer's trade or business is a qualified business unit within the meaning of section 989(a) and the regulations promulgated under that section;

(2) whether the taxpayer is engaged in a trade or business within the United States (excluding questions under section 864(b)(2));

(3) the amount of gross income that is effectively connected with the conduct by the taxpayer of a trade or business within the United States;

(4) factual determinations concerning the extent to which, under section 882(c), deductions are connected with income that is effectively connected with the taxpayer's conduct of a trade or business within the United States; and

(5) whether the taxpayer has a permanent establishment in the United States for purposes of a bilateral income tax convention to which the United States is a party and, if so, what profits are attributable to that permanent establishment.

.07 *Special provisions for requests on international issues*. The provisions of this section apply, in addition to the generally applicable provisions of this revenue procedure, to any request for a PFA on an issue having international implications.

(1) A PFA and any factual information contained in the background files is subject to exchange of information under income tax treaties or tax information exchange agreements in accordance with the terms of such treaties and agreements (including terms regarding relevancy, confidentiality, and the protection of trade secrets). In cases where the exchange of information would be discretionary, information may be exchanged to the extent consistent with sound tax administration and the practices of the relevant foreign competent authority.

(2) To minimize taxpayer and governmental uncertainty and administrative cost, taxpayers who seek a PFA on an international issue are encouraged to seek competent authority consideration under the mutual agreement procedure of any applicable United States income tax convention. This consideration will be given after the PFA is concluded, and the PFA may be modified to reflect the outcome of the mutual agreement procedure.

(3) A taxpayer may request a PFA for an international issue that is the subject of a previously submitted request for competent authority assistance. The consideration of this competent authority request will not be suspended during the PFA process. If the taxpayer requests a PFA and the previously submitted request for competent authority assistance is ongoing, if appropriate, the taxpayer also should make a request for the Accelerated Competent Authority Procedure of Rev. Proc. 2002–52, 2002–2 C.B. 242.

.08 *Excluded issues*. The Service will not enter into a PFA on the following types of issues:

(1) Transfer pricing issues. *See* Rev. Proc. 2004–40, 2004–29 I.R.B. 50 (Advance Pricing Agreement program);

(2) Except as provided in section 3.09(2) of this revenue procedure, issues involving a change in accounting method.

See Treas. Reg. § 1.446–1(e). This includes issues that are or have been the subject of a request by or with respect to the taxpayer for consent to change a method of accounting under procedures such as Rev. Proc. 97–27, 1997–1 C.B. 680 (as modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and as amplified and clarified by Rev. Proc. 2002–54, 2002–2 C.B. 432), or its predecessor or successor, or of an application filed under automatic consent procedures such as Rev. Proc. 2002–9, 2002–1 C.B. 327 (as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, as modified and amplified by Rev. Proc. 2002–19, and as amplified, clarified, and modified by Rev. Proc. 2002–54), or its predecessor or successor. This also includes issues for which a change in accounting method is necessary to resolve the issue. A taxpayer must obtain consent to make an accounting method change by using applicable administrative procedures. See generally Rev. Proc. 97–27 and Rev. Proc. 2002–9, or their successors;

(3) Issues involving the annual accounting period. See Treas. Reg. § 1.442–1. This includes issues that are or have been the subject of a request by or with respect to the taxpayer for permission to adopt, change, or retain an annual accounting period under procedures such as Rev. Proc. 2002–39, 2002–1 C.B. 1046, (as clarified and modified by Notice 2002–72, 2002–2 C.B. 843, and as modified by Rev. Proc. 2003–34, 2003–1 C.B. 856), or an application filed under automatic procedures such as Rev. Proc. 2002–37, 2002–1 C.B. 1030, and Rev. Proc. 2002–38, 2002–1 C.B. 1037, or their predecessors or successors. This also includes issues for which a ruling regarding an annual accounting period is necessary to resolve the issue;

(4) Issues of reasonable cause, due diligence, good faith, clear and convincing evidence, or any other similar standard under Subtitle F (Procedure and Administration) of the Internal Revenue Code;

(5) Issues involving the applicability of any penalty or criminal sanction;

(6) Issues that are, or will be, the subject of a pending or proposed request for a determination letter, technical advice memorandum, or letter ruling issued to or regarding the taxpayer;

(7) Issues for which the taxpayer proposes a resolution that is contrary to a private letter ruling, determination letter, technical advice memorandum, or closing agreement previously issued to or regarding the taxpayer;

(8) Issues for which the taxpayer proposes a resolution that is contrary to a position proposed by the Service in response to a request for a private letter ruling or determination letter that was withdrawn by the taxpayer;

(9) Issues that are the subject of pending litigation between the Service and the taxpayer for an earlier taxable year;

(10) Issues designated for litigation for an earlier taxable year of the taxpayer by the Office of Chief Counsel;

(11) Issues that involve a tax shelter described in section 6662(d)(2)(C)(ii);

(12) Issues that require the Service to determine whether the taxpayer, rather than another entity, is the common law employer; and

(13) Issues relating to transactions that have not yet occurred, regardless of whether the issue otherwise would qualify as one on which the Service will issue letter rulings or other forms of written guidance as described in Rev. Proc. 2004–1, 2004–1 I.R.B. 1, and successor revenue procedures.

.09 *Methods of accounting*.

(1) Except as provided in section 3.09(2) of this revenue procedure, the Service will not enter into a PFA for issues relating to a change in method of accounting. In applying the law to the facts, or establishing the facts, a change in the overall plan of accounting for gross income or deductions from the treatment of such items in prior taxable years, or a change in the treatment of any item that involves the proper time for the inclusion of an item or the taking of an item as a deduction from the treatment of such item in prior taxable years generally may be a change in method of accounting. A PFA may not be used to change a taxpayer's method of accounting.

(2) If the Service has issued a letter ruling granting consent to a change in method of accounting under Rev. Proc. 97–27, or its successor, a taxpayer may request and the Service may enter into a PFA with respect to the approved change in method of accounting. In such case, a PFA may include determinations described in section 11 of Rev. Proc. 97–27 or a similar provision of its successor. Thus, for example, a taxpayer may request and the Service may enter into a PFA with respect to the amount of the section 481(a) adjustment and the implementation of the change in method of accounting in accordance with the terms and conditions of the consent agreement and Rev. Proc. 97–27. A PFA under this provision may only apply to the taxable year of change and may not apply to any other taxable years, except that a determination of the amount of the section 481(a) adjustment under section 11.01(2) of Rev. Proc. 97–27, or a successor, shall apply to any other taxable year for which such amount is taken into account (*i.e.*, any spread period). A PFA under this provision may not be entered into with respect to a change in method of accounting requested pursuant to automatic consent procedures, such as Rev. Proc. 2002–9.

.10 *Definition of taxpayer*. For purposes of section 3 of this revenue procedure, any reference to the taxpayer also includes a related taxpayer and any predecessor of the taxpayer or a related taxpayer. A related taxpayer is one related within the meaning of section 267 or a member of an affiliated group within the meaning of section 1504 that includes the taxpayer. A predecessor is an entity for whose tax liability the taxpayer or a related taxpayer is or was primarily or secondarily liable.

SECTION 4. REQUESTING A PRE-FILING AGREEMENT

.01 *Required information*. A request for a PFA must contain the following information:

(1) Names, addresses, telephone numbers, and taxpayer identification numbers of all interested parties;

(2) The name, title, address and telephone number of a person to contact. If the person to contact is an authorized representative of the taxpayer, a properly executed Form 2848, *Power of Attorney and Declaration of Representative*, must accompany the request;

(3) The annual accounting period and the overall method of accounting (for example, cash receipts and disbursements or accrual) for maintaining the accounting books and filing the federal income tax returns of all interested parties;

(4) The location of the taxpayer's tax staff and records;

(5) A brief description of the taxpayer's business operations, including the principal business activity code used by the taxpayer on its last filed return;

(6) The taxable year(s) for which the PFA is sought, the last date on which the taxpayer may file (with extensions) a timely return for that year (or for the first of those taxable years), and, if earlier, the date on which the taxpayer intends to file that return; and

(7) The dollar amount of assets reflected on the most recently filed return.

.02 *Specific descriptions of issues*. A request for a PFA should also contain a separate written statement for each proposed issue that concisely:

(1) Describes the issue;

(2) Summarizes all the facts that are relevant and material to the issue and, in the case of agreements for future taxable years, any related factual assumptions that may be appropriate (see section 7.02(2), below);

(3) States whether the issue involves an item or transaction in which two or more persons may take contrary positions (a "whipsaw" issue);

(4) Summarizes all relevant legal authorities, including citations to specific sections of the Internal Revenue Code, Income Tax Regulations, case law, tax treaties, and other authorities, and discusses why the issue is an eligible issue, as defined in section 3 of this revenue procedure;

(5) Summarizes and discusses the implications of any known authorities that may be potentially contrary to the position advanced, such as legislation (or pending legislation), court decisions, regulations, revenue rulings, revenue procedures, notices (including notices of proposed rulemaking), or announcements;

(6) Discusses whether and how the PFA will affect taxable years before or after the taxable year for which the PFA is sought;

(7) Describes any proposed methodology to be used;

(8) Discusses whether the issue qualifies for mutual agreement procedure consideration under any United States income tax treaty, specifies the treaty, and states whether the taxpayer previously applied or will apply for competent authority assistance with respect to the issue for the year or years in question or any prior year;

(9) States whether the taxpayer has, for the current taxable year or any prior taxable year, requested a private letter ruling (including a request for consent to a change in method of accounting or a request to adopt, change, or retain an annual accounting period), determination letter, or technical advice on the issue;

(10) Discusses whether the issue can reasonably be resolved by the earliest date on which the taxpayer intends to file any relevant return; and

(11) Describes the availability, organization, and location of the records and other information that substantiate the taxpayer's proposed position on the issue.

.03 *Perjury statement*. A request for a PFA, and any supplemental submissions (including additional documents), must include a declaration, signed by a person currently authorized to sign the taxpayer's federal income tax return, in the following form:

> Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the request for the Pre-Filing Agreement are true, correct, and complete.

.04 *Agreement regarding examination or inspection of records*. The request for a PFA also must contain a statement by the taxpayer in the following form:

> The taxpayer agrees that the review of records and information under the PFA procedures does not constitute an inspection within the meaning of section 7605(b) and will not preclude or impede (under section 7605(b) or any administrative provisions adopted by the Service) the Service from later examining any return or inspecting any records. The taxpayer further agrees that procedural restrictions, such as providing notice under section 7605(b), do not apply to actions taken under the PFA procedures.

.05 *Signature*. The request for a PFA must be signed by the taxpayer or a representative properly authorized by the taxpayer in an accompanying Form 2848, *Power of Attorney and Declaration of Representative*.

.06 *Where to submit request*. A request for a PFA:

(1) In the case of a taxpayer whose return for any taxable year is currently under examination by LMSB, should be submitted to the LMSB Team Manager in charge of the examination; or

(2) In the case of a taxpayer who has no returns under examination for any taxable year, should be sent to the following address:

> Internal Revenue Service
> Attn: LMSB:PFT:PFS
> PFA Program Manager
> Mint Building
> 1111 Constitution Avenue, NW
> Washington, DC 20224

(3) In the case of a taxpayer who has no returns under examination for any taxable year, facsimile transmissions may be made to the attention of the PFA Program Manager at (202) 283–8406 (not a toll-free call).

SECTION 5. SELECTING TAXPAYERS FOR THE PFA PROGRAM

.01 *Jurisdiction of LMSB Industry Director and coordination and consultation with the Associate Chief Counsel*. The LMSB Industry Director having jurisdiction over the taxpayer, after coordination and consultation with the Associate Chief Counsel having subject matter jurisdiction over any issue proposed to be determined by a PFA, will decide whether to accept the taxpayer's request for a PFA. (For purposes of this revenue procedure, the term "LMSB Industry Director" includes a duly authorized designee of an LMSB Industry Director.) The decision regarding the acceptance of any PFA involving an international issue also will require the concurrence of the Director, International (LMSB). In general, the Associate Chief Counsel will respond within 10 business days to a request for coordination and consultation to proceed with the PFA.

.02 *Criteria for selection*. The criteria for selecting taxpayers to participate in the PFA program include, but are not limited to:

(1) Whether the specific issue presented by the taxpayer's facts is an eligible issue under section 3 of this revenue procedure and is otherwise suitable for the PFA program;

(2) The direct or indirect impact of a PFA upon other years, issues, taxpayers, or related cases;

(3) Whether Service resources are available;

(4) Whether the taxpayer is willing and able to dedicate sufficient resources to the PFA process;

(5) Whether the PFA is likely to result in two or more persons taking contrary positions on an item or transaction (a "whipsaw" issue);

(6) The time remaining until the due date and expected filing date, if earlier than the due date, of the earliest return to which the PFA relates; and

(7) The overall probability of completing the process and entering into a PFA by the proposed date for filing the earliest return to which the PFA relates.

Early submission of a request will facilitate completion of a PFA before any associated returns become due. As a result, early requests are more likely to be selected for the PFA program and the Service urges taxpayers to submit PFA requests as early as possible.

.03 *Notification*. A representative of LMSB will contact the taxpayer within 15 business days of actual receipt of the taxpayer's request for a PFA to acknowledge that the Service has received the request. After a PFA request is received, a representative of LMSB will inform the taxpayer in writing whether the request has been selected for the PFA program and the issues the Service will consider.

.04 *Requests not accepted*. A taxpayer may not appeal the Service's decision not to accept a request for a PFA. A taxpayer not selected for the PFA program remains eligible for other early issue resolution procedures, including the Accelerated Issue Resolution (AIR) program (see Rev. Proc. 94–67, 1994–2 C.B. 800).

SECTION 6. PROCESSING A REQUEST FOR A PFA

.01 *Planning*. If the Service accepts the taxpayer's request for a PFA, a representative of LMSB will contact the taxpayer and schedule an orientation meeting with the taxpayer and examination personnel to discuss the PFA process and explain the roles and responsibilities of each participant. Immediately after the orientation meeting, the taxpayer and the Service should meet to formulate a plan and timeline that will result in a thorough development of the facts and a successful resolution of the issues before any associated returns are due. During the planning phase and throughout the PFA process, the taxpayer must provide information requested by the Service and assist the Service in the timely and efficient resolution of the examined issues.

.02 *Drafting*. After the development of the facts and issues, the Team Manager will meet informally with the taxpayer to determine whether the parties agree on a PFA. If the parties reach agreement, the taxpayer will work with the Service to prepare the initial draft of the PFA. The PFA will be prepared by the taxpayer and the audit team with assistance, as necessary, from the PFA Program Manager, the Office of Chief Counsel, or other Service personnel. Except as provided in section 3.06, the Associate Chief Counsel having subject matter jurisdiction over the issue in the PFA need not execute or give final approval to the proposed PFA; however, upon execution of the PFA, a copy will be forwarded immediately to the office of that Associate Chief Counsel.

.03 *Return filing requirements*. The Service's acceptance of a taxpayer's request for a PFA does not suspend or waive the normal filing requirements for any tax returns that may be affected by the proposed PFA.

.04 *TEFRA taxpayers*. If the procedures set forth in sections 6221 through 6233 apply to the taxpayer requesting the PFA and the issue determined by the PFA is a partnership item as defined in section 6231, the PFA process will be terminated for that issue if no agreement is reached with all partners by the date that is 30 business days before the due date for the partnership return (taking into account any extensions of time to file that may be in effect).

.05 *Execution prior to filing*. If a PFA is executed before a return is filed, the taxpayer must report the issues determined by the PFA according to the terms and conditions of the PFA. A copy of the PFA must be attached to the return.

.06 *Execution after filing*. If the Service and the taxpayer do not reach agreement on an issue before the taxpayer files an associated return, the Service and the taxpayer may still attempt to resolve the issue and enter into a PFA. If the filed return is inconsistent with the terms and conditions of the contemplated PFA, the taxpayer must agree to file an amended return consistent with those terms and conditions. A post-filing PFA should state whether the taxpayer is required to file an amended return. It should further state that the Service may assess additional tax due, if any, if an amended return is not filed. The taxpayer must attach a copy of the PFA to any amended return.

SECTION 7. NATURE AND EFFECT OF A PFA

.01 *Criteria for issuance*. An authorized Service official may execute a PFA if that official determines that:

(1) Entering into the PFA is consistent with the goals of the PFA program;

(2) The resolution of issues in the PFA reflects well-settled legal principles and correctly applies those principles to the facts established by the examination team;

(3) The issues determined by the PFA are eligible issues under section 3 of this revenue procedure;

(4) Any methodology approved for use by a taxpayer to determine the appropriate amount of an item of income, allowance, deduction, or credit has a documented factual basis; and

(5) There is an advantage in having the issues permanently and conclusively resolved for the taxable years covered by the PFA, or the taxpayer shows good and sufficient reasons for desiring a PFA and the United States will suffer no disadvantage if the agreement is executed.

.02 *Form and content*.

(1) A PFA that makes determinations for the current taxable year (and any prior taxable year for which a return is not yet due) is a closing agreement under section 7121. The form and content of this type of PFA must comply with Rev. Proc. 68–16, 1968–1 C.B. 770.

(2) A PFA that makes a determination for one or more future taxable years as well as for the current taxable year (and any prior taxable year for which a return is not yet due) is a non-statutory agreement. Although not a closing agreement under section 7121, this type of PFA is a binding contract between the Service and a taxpayer. It is subject to any legislative enactment that is applicable to the taxable

years to which the PFA relates. There is no prescribed format for such an agreement. The parties to a non-statutory agreement may, by mutual consent (and, if applicable, the further mutual agreement between the United States and any treaty partner that has entered into a mutual agreement that is a basis for the PFA), modify or terminate the agreement. A taxpayer who wants to modify or terminate a non-statutory agreement should submit a request to the office that originally processed the taxpayer's request for a PFA. The parties to a non-statutory agreement also may condition its determinations on the continuing validity of certain stated assumptions. A "stated assumption" is any fact (whether or not within the control of the taxpayer) related to the taxpayer, a third party, an industry, or business and economic conditions whose continued existence is material to the determinations of the PFA. A stated assumption might include, for example, a particular mode of conducting business operations. If a stated assumption is no longer valid, a non-statutory agreement conditioned on such stated assumption will terminate as of the first day of the taxable year in which the stated assumption is no longer valid.

(3) A PFA concerning international issues will not be subject to the special limitation of section 7.05, *Effect of Agreements or Judicial Determinations on Competent Authority Proceedings*, of Rev. Proc. 2002–52, 2002–2 C.B. 242, which sets forth the effect of a closing agreement on the procedure for competent authority consideration under the mutual agreement procedure of United States income tax conventions.

.03 *Methods and periods of accounting*.

(1) A PFA does not constitute the consent of the Commissioner under section 446(e) to any change in method of accounting or the approval under section 442 of any adoption, change, or retention of an annual accounting period by the taxpayer.

(2) A PFA does not constitute a final determination regarding the adoption, change, or retention of an annual accounting period by the taxpayer,

(3) A PFA does not constitute a final determination regarding the methods of accounting of the taxpayer for any taxable year, except to the extent authorized by section 3.09(2).

(4) A PFA authorized under section 3.09(2) must include the following agreement:

> Nothing in this agreement precludes the taxpayer from requesting, or the Service from requiring, a change in the taxpayer's method of accounting for years after the year of change.

SECTION 8. WITHDRAWAL

.01 At any time prior to the execution of the PFA, either the taxpayer or the Service may withdraw from consideration all or part of the request for a PFA. The withdrawal must be in writing and signed by the party initiating the withdrawal, *i.e.*, the taxpayer or his authorized representative or the Industry Director, Director Field Operations, or the Director Field Specialists.

.02 Notwithstanding the withdrawal by either the taxpayer or the Service of any or all the issues that are the subject of the request for a PFA, the taxpayer's agreement under section 4.04 of this revenue procedure will remain in effect.

SECTION 9. NO PFA EXECUTED

.01 *Accelerated issue resolution.* If the Service and the taxpayer do not agree upon and execute a PFA that resolves an issue, either before or after the filing of the return to which the PFA relates, and the Service subsequently disagrees with the taxpayer's treatment of the issue on the return, the taxpayer and the Service may continue their efforts to reach an agreement using post-filing procedures, such as the Accelerated Issue Resolution (AIR) procedures under Rev. Proc. 94–67, 1994–2 C.B. 800. This continuation of the process does not require a new application.

.02 *Administrative appeals*. If the Service and the taxpayer are unable to resolve an issue by a PFA or an AIR agreement, the taxpayer may pursue an administrative appeal either by requesting an early referral to Appeals under the procedures set forth in Rev. Proc. 99–28, 1999–2 C.B. 109, or by protesting any proposed deficiency related to the issue.

SECTION 10. USER FEE

.01 *Taxpayers subject to fees*. Taxpayers are subject to a user fee only if they are selected to participate in the PFA program.

.02 *Amount of fee*. The user fees for taxpayers selected to participate in the PFA program are:

(1) $10,000 for taxpayers having $250,000,000 or more in assets;

(2) $5,000 for taxpayers having at least $50,000,000, but less than $250,000,000 in assets; and

(3) $1,000 for taxpayers having at least $10,000,000, but less than $50,000,000 in assets.

For purposes of determining the appropriate user fee, the amount of assets held by the taxpayer will be determined based on its most recently filed return. A fee will be assessed for each separate and distinct issue. If the subject entity of a PFA request is a member of an affiliated group filing a consolidated return, the fee will be assessed by reference to the amount of assets held by the consolidated group determined based on the group's most recently filed consolidated return. The orientation meeting or the first substantive meeting with the taxpayer to discuss the PFA issues will not take place until after the fee is received.

.03 *Time and method of payment*. Payment of the user fee must be made within 15 business days of notification that the issues have been selected for the PFA program. Payment must be made by check or money order payable to the Internal Revenue Service and submitted to the address indicated in section 4.06 of this revenue procedure.

.04 *Withdrawal*. Notwithstanding the withdrawal by either the taxpayer or the Service of any or all of the issues in the request for a PFA after acceptance of the request, the user fee paid by the taxpayer generally will not be refundable. A refund or waiver of the user fee will not be entertained unless a hardship has occurred (for example, a disaster loss) or if other circumstances beyond the control of the taxpayer exist. The Industry Director has discretion in granting a request for a refund of a user fee based on considerations of sound tax administration.

SECTION 11. DISCLOSURE

.01 PFAs are agreements described in section 6103(b)(2)(D). A PFA and the information generated or received by the Service during the PFA process constitute confidential return information. As required by the Conference Report to H.R. 4577, The Community Renewal Tax Relief Act of 2000 (Pub. L. 106–554), H.R. Conf. Rep. No. 1033, 106th Cong., 2d Sess. 1033 (2000), the Service will, consistent with the restrictions of section 6103, continue to publish annual reports summarizing the operation of the PFA program. PFAs are not written determinations under section 6110 and, accordingly, are exempt from disclosure to the public under the Freedom of Information Act.

SECTION 12. EFFECTIVE DATE AND DURATION OF PROCEDURE

This revenue procedure is effective on December 22, 2004. This revenue procedure will remain in effect until December 31, 2006, unless sooner revoked, modified, or superseded. A request for a PFA that has been accepted into the program under section 5 of this revenue procedure will remain subject to the provisions of this revenue procedure, notwithstanding the preceding sentence.

SECTION 13. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2001–22, 2001–1 C.B. 745, is superseded.

SECTION 14. RECORD-KEEPING REQUIREMENTS

.01 No aspect of the PFA process will affect the record-keeping requirements imposed by any section of the Internal Revenue Code.

.02 The taxpayer must maintain a copy of the PFA supporting documents and books of account and records to enable the Service to ensure the taxpayer's compliance with the PFA. These records may be specified in the PFA itself or in separate agreements.

SECTION 15. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under the control number 1545–1684.

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 OMB control number. The collections of information in this revenue procedure are in sections 4, 6, and 12. The information collected under section 4 is required to provide the Service with the information necessary to determine which taxpayers should be included in the PFA program. The information collected under section 6 will be used to resolve the taxpayer's issue and to support any PFA entered into between the taxpayer and the Service. The record-keeping requirements under section 12 will be used for tax administration. The collections of information under sections 4 and 6 are voluntary. Once a PFA is entered into, the record-keeping requirements under section 12 are mandatory. The likely respondents are businesses or other for-profit institutions.

The estimated total annual reporting and/or record-keeping burden is 49,215 hours.

The estimated annual burden per respondent varies from 5 hours to 1,092 hours, depending on whether a taxpayer applying to the PFA program is accepted into the program. The estimated annual burden per respondent for taxpayers who apply to the PFA program and are accepted is 1,092 hours. The estimated annual burden per respondent for taxpayers who apply to the PFA program and are not accepted is 5 hours. The estimated number of taxpayers who apply to the PFA program and are accepted is 45. The estimated number of taxpayers who apply to the PFA program and are not accepted is 15. The estimated total number of applicants and/or recordkeepers is 60.

The estimated annual frequency of responses is on occasion.

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

SECTION 16. DRAFTING INFORMATION

The principal author of this revenue procedure is Stuart Spielman of the Office of Associate Chief Counsel (Procedure & Administration). For further information about this revenue procedure, contact Melanie Perrin, Senior Program Analyst, LMSB Office of Pre-Filing and Technical Guidance, at (202) 283–8408 (voice) (not a toll-free call), (202) 283–8406 (fax) (not a toll-free call), or *pfa.info@irs.gov* (e-mail address).

Part IV. Items of General Interest

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

Announcement 2005-2

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

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

Consent Suspensions From Practice Before the Internal Revenue Service

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

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

Name	Address	Designation	Date of Suspension
Nadler, Herbert	New York, NY	Enrolled Actuary	November 1, 2004 to February 28, 2005

Correction to Rev. Proc. 2004–35

Announcement 2005–4

This announcement reflects the correction of an error in Rev. Proc. 2004–35, 2004–23 I.R.B. 1029, that provides automatic relief for certain taxpayers requesting relief for late shareholder consents for S corporation elections in community property states. In section 6, regarding the Paperwork Reduction Act, estimated total annual reporting burden is changed to 200 hours.

The principal author of this announcement is Jason T. Smyczek of the Office of Chief Counsel (Passthroughs & Special Industries). For further information regarding this announcement, contact Mr. Smyczek at (202) 622–3050 (not a toll-free call).

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 laws 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 a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement 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[1]

Bulletins 2005–1 through 2005–2

Announcements:

Notices:

Revenue Procedures:

Revenue Rulings:

Tax Conventions:

Treasury Decisions:

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2004–27 through 2004–52 is in Internal Revenue Bulletin 2004–52, dated December 27, 2004.

Findings List of Current Actions on Previously Published Items[1]

Bulletins 2005–1 through 2005–2

Notices:

88-30
Obsoleted by
Notice 2005-4, 2005-2 I.R.B. *289*

88-132
Obsoleted by
Notice 2005-4, 2005-2 I.R.B. *289*

89-29
Obsoleted by
Notice 2005-4, 2005-2 I.R.B. *289*

89-38
Obsoleted by
Notice 2005-4, 2005-2 I.R.B. *289*

Revenue Procedures:

98-16
Modified and superseded by
Rev. Proc. 2005-11, 2005-2 I.R.B. *307*

2001-22
Superseded by
Rev. Proc. 2005-12, 2005-2 I.R.B. *311*

2002-9
Modified and amplified by
Rev. Proc. 2005-9, 2005-2 I.R.B. *303*

2004-1
Superseded by
Rev. Proc. 2005-1, 2005-1 I.R.B. *1*

2004-2
Superseded by
Rev. Proc. 2005-2, 2005-1 I.R.B. *86*

2004-3
Superseded by
Rev. Proc. 2005-3, 2005-1 I.R.B. *118*

2004-4
Superseded by
Rev. Proc. 2005-4, 2005-1 I.R.B. *128*

2004-5
Superseded by
Rev. Proc. 2005-5, 2005-1 I.R.B. *170*

2004-6
Superseded by
Rev. Proc. 2005-6, 2005-1 I.R.B. *200*

2004-7
Superseded by
Rev. Proc. 2005-7, 2005-1 I.R.B. *240*

Revenue Procedures— Continued:

2004-8
Superseded by
Rev. Proc. 2005-8, 2005-1 I.R.B. *243*

2004-35
Corrected by
Ann. 2005-4, 2005-2 I.R.B. *319*

[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2004–27 through 2004–52 is in Internal Revenue Bulletin 2004–52, dated December 27, 2004.