

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

T.D. 9101, page 376.

REG-156232-03, page 399.

Temporary and proposed regulations under section 6043 of the Code provide information reporting rules regarding corporations which are acquired, or which experience a recapitalization or other substantial change in capital structure. The proposed regulations also withdraw REG-143321-02. A public hearing on the proposed regulations is scheduled for March 31, 2004.

T.D. 9102, page 366.

Final regulations under section 643 of the Code revise the definition of trust accounting income to take into account changes in the definition of trust accounting income under state laws, which allow certain amounts traditionally considered as principal to be treated as income. The regulations also clarify the situations in which capital gains will be included in a trust's distributable net income. Conforming amendments with regard to the revised definition of trust accounting income are made to regulations affecting various trusts, including pooled income funds, charitable remainder trusts, trusts qualifying for the marital deduction, and trusts exempt from the generation-skipping transfer tax.

EMPLOYEE PLANS

Notice 2004-3, page 391.

Weighted average interest rate update. The weighted average interest rate for January 2004 and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution are set forth.

ESTATE TAX

T.D. 9102, page 366.

Final regulations under section 643 of the Code revise the definition of trust accounting income to take into account changes in the definition of trust accounting income under state laws, which allow certain amounts traditionally considered as principal to be treated as income. The regulations also clarify the situations in which capital gains will be included in a trust's distributable net income. Conforming amendments with regard to the revised definition of trust accounting income are made to regulations affecting various trusts, including pooled income funds, charitable remainder trusts, trusts qualifying for the marital deduction, and trusts exempt from the generation-skipping transfer tax.

REG-139845-02, page 397.

Proposed regulations under section 2032 of the Code concern the election to value a decedent's gross estate on the alternate valuation date. The regulations reflect a change to the law made by the Deficit Reduction Act of 1984. The regulations, when finalized, will remove temporary regulation 301.9100-6T(b).

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Announcements of Disbarments and Suspensions begin on page 402.
Finding Lists begin on page ii.



GIFT TAX

T.D. 9102, page 366.

Final regulations under section 643 of the Code revise the definition of trust accounting income to take into account changes in the definition of trust accounting income under state laws, which allow certain amounts traditionally considered as principal to be treated as income. The regulations also clarify the situations in which capital gains will be included in a trust's distributable net income. Conforming amendments with regard to the revised definition of trust accounting income are made to regulations affecting various trusts, including pooled income funds, charitable remainder trusts, trusts qualifying for the marital deduction, and trusts exempt from the generation-skipping transfer tax.

ADMINISTRATIVE

T.D. 9106, page 384.

Final regulations under section 7430 of the Code provide guidance to taxpayers on how to make a qualified offer. The regulations explain the circumstances under which qualified offers may be made, the requirements to make a valid qualified offer, and to whom the qualified offer should be made. The regulations also provide examples to aid taxpayer in understanding how qualified offers operate.

REG-122379-02, page 392.

Proposed regulations under section 330 of title 31 of the Code set forth best practices for tax advisors providing advice to taxpayers relating to federal tax issues or submissions to the Internal Revenue Service and modify the standards for certain tax shelter opinions. Section 10.33 encourages all tax advisors to provide their clients with the highest quality representation. Section 10.35 prescribes specific requirements for "more likely than not" and "marketed" tax shelter opinions. Section 10.36 provides that the practitioner who has the principal authority and responsibility for overseeing a firm's practice of providing advice to clients regarding federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in place for purposes of complying with section 10.35. Section 10.37 authorizes the Director of the Office of Professional Responsibility to establish one or more advisory committees to review and make recommendations regarding professional standards or best practices for tax advisors, including whether a practitioner may have violated section 10.35 or 10.36. A public hearing is scheduled for February 18, 2004.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by

applying the tax law with integrity and fairness to all.

Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

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

The 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.*

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* **Beginning with Internal Revenue Bulletin 2003-43**, we are publishing the index at the end of the month, rather than at the beginning.

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

Section 643.—Definitions Applicable to Subparts A, B, C, and D

26 CFR 1.643(a)–3: Capital gains and losses.

T.D. 9102

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 20, 25, and 26

Definition of Income for Trust Purposes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations revising the definition of income under section 643(b) of the Internal Revenue Code. The regulations are necessary to reflect changes in the definition of trust accounting income under state laws. The final regulations also clarify the situations in which capital gains are included in distributable net income under section 643(a)(3). Conforming amendments are made to regulations affecting ordinary trusts, pooled income funds, charitable remainder trusts, trusts that qualify for the gift and estate tax marital deduction, and trusts that are exempt from generation-skipping transfer taxes. The regulations affect the grantors, beneficiaries, and fiduciaries of trusts.

DATES: *Effective Date:* These regulations are effective January 2, 2004.

Applicability Date: Generally, the final regulations are applicable to trusts and estates for taxable years ending after January 2, 2004. See revised §§1.642(c)–2, 1.642(c)–5, and 1.664–3 for special dates of applicability affecting those sections.

FOR FURTHER INFORMATION CONTACT: Bradford R. Poston at (202) 622–3060 (not a toll-free number).

Background

On February 15, 2001, proposed regulations (REG–106513–00, 2001–1 C.B. 1076 [66 FR 10396]) were published in the **Federal Register** containing proposed amendments to the Income Tax Regulations [26 CFR part 1], the Estate Tax Regulations [26 CFR part 20], the Gift Tax Regulations [26 CFR part 25], and the Generation-Skipping Transfer Tax Regulations [26 CFR part 26] relating to the definition of income for trust purposes. A public hearing was held on the proposed regulations on June 8, 2001. Written comments were received on the proposed regulations. The proposed regulations, with certain changes in response to the comments, are adopted as final regulations.

Summary of Comments and Explanation of Revisions

Definition of Income

The proposed regulations provide that, for purposes of determining what constitutes trust accounting income under section 643(b), trust provisions that depart fundamentally from the traditional concepts of income and principal generally will continue to be disregarded as they have been under the existing regulations. One commentator suggested that, instead of using traditional concepts of income and principal, the benchmark should be whether there is a departure from the duty to administer the trust or estate impartially based upon what is fair and reasonable to all the parties. One commentator suggested eliminating the distinction between trust accounting income and principal. Another suggested that the regulations clarify the consequences of a fundamental departure from traditional concepts of income and principal.

Income under section 643(b) is the amount of income determined under the terms of the governing instrument and applicable local law. This concept of income is used as the measure of the amount that must be distributed from a trust in order for the trust to qualify for certain treatment under various provisions of the Internal Revenue Code. Trusts classified

as simple trusts, pooled income funds, net income charitable remainder unitrusts, and qualified subchapter S trusts (QSSTs) are required to make distributions measured at least in part by the amount of trust accounting income. A similar concept applies to trusts that qualify for the gift and estate tax marital deductions. Because section 643(b) requires a determination of trust accounting income, it is not possible to ignore any distinctions between trust accounting income and principal as suggested by a commentator.

A trust instrument may provide for any amount to be distributed to beneficiaries currently. Trust provisions that measure the amount of the distribution by reference to income but define income differently from the state statutory definition of income generally will be recognized for state law purposes. However, Internal Revenue Code provisions that require the current distribution of income to qualify the trust for certain federal tax treatment are based on the assumption that the income beneficiary will receive what is traditionally considered to be income. In some situations, such as with QSSTs and marital deduction trusts for spouses who are U.S. citizens, the income beneficiary is permitted to also receive principal distributions as long as all the income is currently distributed. In other situations, as with pooled income funds and net income charitable remainder unitrusts, only the income may be distributed. In all these situations, the determination of income is critical. Thus, the definition of income under the terms of the governing instrument and applicable local law must not depart fundamentally from traditional concepts of income and principal, if the desired federal tax treatment is to be secured.

The IRS and the Treasury Department recognize that state statutes are in the process of changing traditional concepts of income and principal in response to investment strategies that seek total positive return on trust assets. These statutes are designed to ensure that, when a trust invests in assets that may generate little traditional income (including dividends, interest, and rents), the income and remainder beneficiaries are allocated rea-

sonable amounts of the total return of the trust (including both traditional income and capital appreciation of trust assets) so that both classes of beneficiaries are treated impartially. Some statutes permit the trustee to pay to the person entitled to the income a unitrust amount based on a fixed percentage of the fair market value of the trust assets. Other statutes permit the trustee the discretion to make adjustments between income and principal to treat the beneficiaries impartially. Under the proposed regulations, a trust's definition of income in conformance with applicable state statutes will be respected for federal tax purposes when the state statutes provide for a reasonable apportionment of the total return of the trust.

Some commentators suggested that, even in those states that have not enacted legislation specifically authorizing powers to adjust or a unitrust definition of income, trust instruments containing such provisions should be respected as defining income for purposes of section 643(b). Under a unitrust or power to adjust, items traditionally allocable to principal (such as gains from the sale or exchange of trust assets) may, under certain circumstances, be allocated to income, and items traditionally allocable to income (such as dividends, interest, and rents) may, under certain circumstances, be allocated to principal. The proposed regulations already recognize that gains from the sale or exchange of trust assets may, under certain circumstances, be allocated to income under the terms of the governing instrument. However, §1.643(b)-1 has always provided that the allocation to principal, under the terms of the governing instrument, of items that traditionally would be allocable to income will not be respected for purposes of section 643(b), and this position is maintained in the final regulations. Accordingly, the IRS and the Treasury Department believe that an allocation to principal of traditional income items should be respected for Federal tax purposes only if applicable state law has specifically authorized such an allocation in certain limited circumstances, such as when necessary to ensure impartiality regarding a trust investing for total return. Under the regulations, a state statute specifically authorizing certain unitrust payments in satisfaction of an income interest or certain powers to adjust would

satisfy that requirement. Further, the IRS and the Treasury Department acknowledge that other actions may constitute applicable state law, such as a decision by the highest court of the state announcing a general principle or rule of law that would apply to all trusts administered under the laws of that state. However, a court order applicable only to the trust before the court would not constitute applicable state law for this purpose.

Two commentators suggested that the permissible range of unitrust percentages should include any percentage permitted by state statutes. The IRS and the Treasury Department believe that when establishing a unitrust percentage that attempts to yield the equivalent of income over a long period of time that may encompass wide variations in economic conditions, a range of 3% to 5% will be considered a reasonable apportionment of a trust's total return. In response to one comment, the range of unitrust percentages has been adjusted in the final regulations to include, rather than exclude, unitrust percentages of 3% and 5%. Also in response to comments, the final regulations state that the periodic redetermination of the fair market value of the trust assets may be done as of a particular date each year or as an average determined on a multiple year basis.

The proposed regulations state that traditionally ordinary income is allocated to income and capital gains are allocated to principal. One commentator pointed out that ordinary income and capital gains are tax concepts and not concepts that have any meaning for purposes of trust accounting income. The final regulations have been revised to state that traditionally items such as dividends, interest, and rents are allocated to income and the proceeds from the sale or exchange of trust assets are allocated to principal.

The proposed regulations refer to a power to make equitable adjustments between income and principal and describe the circumstances under which these adjustments currently are permitted under state law and will be respected for Federal tax purposes. Specifically, state statutes permit adjustments when trust assets are invested under the state's prudent investor standard, the trust instrument refers to income in describing the amount that may or must be paid to a beneficiary, and the trustee, after applying the state statutory

rules regarding the allocation of receipts and disbursements between income and principal, is unable to administer the trust impartially. One commentator requested clarification of the requirements a trustee must satisfy to make an adjustment that will be respected for Federal tax purposes. Those requirements are a matter of local law and may differ from state to state; the trustee must meet whatever requirements are imposed by applicable local law on the exercise of this power. One commentator pointed out that state statutes do not include the term equitable in referring to this power and suggested deleting that term. One commentator suggested adding "generally" to the statement concerning the circumstances in which these adjustments are permitted because some states may permit these adjustments without enacting a prudent investor standard. These two suggestions are adopted in the final regulations.

One commentator suggested clarifying that the definition of income in the regulations also applies to spray and sprinkle trusts. The final regulations provide that allocations apportioning the total return of the trust pursuant to the state statute will be respected regardless of whether the trust has one or more income beneficiaries and irrespective of whether income must or may be paid out each year. The commentator also suggested that allocations pursuant to one apportionment method should be respected even if a different apportionment method was used in prior years. The final regulations provide that, as long as the trust complies with the requirements of state statutes for switching between methods authorized by the statute, then, when the trust switches between permitted methods: (i) the method used in any year will be respected for Federal tax purposes; (ii) the switch will not constitute a recognition event under section 1001; and (iii) neither the grantor nor any beneficiary will have any gift tax consequences. This provision does not apply to switches between methods not specifically authorized by state statute.

It has been questioned whether the changes to §1.643(b)-1 affect the amount of income required to be distributed by QSSTs. Section 1.1361-1(j) provides that QSSTs are required to distribute income as defined in §1.643(b)-1. Therefore, no amendment to the QSST regulations

is necessary for the new provisions of §1.643(b)-1 to be applicable to QSSTs.

The proposed regulations provide that an allocation of capital gains to income will be respected if made either (i) pursuant to the terms of the governing instrument and applicable local law, or (ii) pursuant to a reasonable and consistent exercise of a discretionary power granted to the fiduciary by local law, or by the governing instrument if not inconsistent with local law. One commentator suggested that in the phrase "pursuant to the terms of the governing instrument and applicable local law," the term "and" be replaced with "or." The phrase with the term "and" is consistent with the statutory language of section 643(b), and, therefore, no change has been made.

One commentator suggested that a discretionary power to allocate capital gains to income should not have to be exercised consistently. The exercise of the power generally affects the actual amount that may or must be distributed to the income beneficiaries and affects whether the trust or the beneficiary will be taxed on the capital gains. Thus, the IRS and the Treasury Department agree that the power does not have to be exercised consistently, as long as it is exercised reasonably and impartially. However, if the amount of income is determined by a unitrust amount, the exercise of this discretionary power has no effect on the amount of the distribution, but does affect whether the beneficiary or the trust is taxed on the capital gains. Under these circumstances, a discretionary power must be exercised consistently. One commentator suggested changing the phrase "if not inconsistent with local law" because powers to allocate capital gains to income will almost always be inconsistent with the default provisions of state law. Accordingly, the phrase has been changed to "if not prohibited by local law."

Pooled Income Funds

Several commentators were concerned about the provision in the proposed regulations that long-term capital gain does not qualify for the income tax charitable deduction available to pooled income funds (PIFs), if the amount of income payable to the noncharitable beneficiaries may be either a unitrust amount or an amount that could include unrealized appreciation in

the value of trust assets pursuant to the exercise of a trustee's power to adjust. One commentator suggested that, if income is defined as a unitrust amount or is subject to the trustee's power of adjustment, the provision in the proposed regulation invalidly limits the amount that can be paid to the noncharitable beneficiaries of the PIF.

This regulatory provision places no prohibition on paying to the noncharitable beneficiaries an amount of income determined under the governing instrument and applicable local law, even if that income is a unitrust amount or is determined pursuant to a power of adjustment that takes into account unrealized appreciation. Rather, this regulatory provision addresses whether long-term capital gains recognized during a year but not distributed during that year are permanently set aside for a charitable purpose as required by section 642(c)(3) to allow the PIF to claim a charitable deduction for these amounts. If income is defined as a unitrust amount, a future payment of income to the noncharitable beneficiaries may be attributable to long-term capital gains realized, but not distributed, in the current year. If income is determined pursuant to a power of adjustment that takes into account unrealized appreciation, a portion of the capital gain recognized during a year may be attributable to appreciation that was the basis for a distribution to the noncharitable beneficiaries in a prior year. In both situations, the long-term capital gains are not permanently set aside for charitable purposes and therefore do not qualify for the charitable deduction in computing the PIF's income tax liability.

Some commentators were concerned that PIFs need to be able to distribute more than the traditional amounts of income to remain useful vehicles for charitable giving. They suggest that PIFs should be able to define trust accounting income as traditional income plus any realized capital gains for the year but the total amount defined as income cannot exceed a specified percentage. Thus, the annual payout would be the lesser of a unitrust amount or trust accounting income defined to include gains from the appreciation of assets sold by the trust during the year.

Distinct statutory provisions govern PIFs and charitable remainder unitrusts (CRUTs). The provisions applicable to each type of trust are specifically designed

to achieve statutory objectives based on the nature of the charitable and noncharitable interests in each type of trust. The commentators' suggestion is, in effect, to permit PIFs to operate in the same manner as a net income CRUT, but without applying any of the other CRUT requirements to these funds. There is no authority for incorporating certain provisions applicable to CRUTs into the provisions applicable to PIFs.

Nevertheless, the power to adjust authorized by many state statutes currently applies to PIFs administered in those states. If permitted under the terms of the governing instrument and state statutes, a trustee may use the power to make adjustments by allocating to income a portion of the sales proceeds from trust assets in order to treat the income and remainder beneficiaries impartially. The proper exercise of a power to adjust may provide the income beneficiaries with amounts in excess of the amount of traditional income. The final regulations provide that, for a PIF, the amount of proceeds from the sale of assets that may be allocated to income pursuant to a power to adjust is limited to the amount by which those proceeds exceed the fair market value of those assets as of the date those assets were contributed to or purchased by the PIF. This provision ensures that amounts attributable to the fair market value of assets on the date contributed to the PIF cannot be reallocated to income under a power to adjust. In addition, long-term capital gains from the sale or exchange of trust assets do not qualify for the charitable deduction under section 642(c)(3) to the extent that any sales proceeds are distributed to the income beneficiaries.

One commentator suggested that the "or" in the phrase "under the terms of the governing instrument or applicable local law" should be changed to "and" to be consistent with the statutory definition of income under section 643(b). This change has been made.

Charitable Remainder Trusts

Several commentators were concerned about the requirement in the proposed regulations that net income CRUTs under sections 664(d)(2) and 664(d)(3) contain their own definition of income if applicable state law provides that income is a

unitrust amount. The purpose of this proposed requirement was to avert potential problems with qualification of a net income CRUT in a state that defines income as a unitrust amount. Some commentators pointed out that state statutes provide alternative definitions of income and all that should be necessary is that the trust use a definition of income, whether contained in the terms of the governing instrument or applicable local law, that is not a unitrust amount. Therefore, the requirement that the trust contain its own definition of income has been eliminated from the final regulations.

Several commentators were concerned about the provision in the proposed regulations that the allocation of post-contribution capital gain to income, if permitted under the terms of the governing instrument and applicable local law, may not be discretionary with the trustee. Some suggested eliminating the prohibition on discretionary powers held by the trustee. Some suggested that a discretionary power should be permitted if held by an independent trustee. Some requested clarification that this prohibition does not apply to a trustee's power to allocate receipts to income or principal pursuant to state law.

The provision in the proposed regulations has no effect on the determination of trust accounting income under applicable state law that grants the trustee a power to reasonably apportion the total return of the trust. The provision is directed at discretion given the trustee under the terms of the governing instrument to allocate capital gains to income in some years and not others. Allowing the trustee this type of discretion is inconsistent with the requirements for net income CRUTs as explained in the legislative history. The settlor has the option of providing in the trust that the trustee is to distribute the lesser of the stated percentage payout or trust income. However, this option must be adopted in the trust instrument and not left to the discretion of the trustee. See H.R. Conf. Rep. No. 91-782, at 296 (1969), reprinted in 1969-3 C.B. 644, 655. A power to allocate capital gains to income in some years and not others in the trustee's sole discretion is similar to having the discretionary ability to pay out either the trust income or the stated percentage payout each year, regardless of their relative values. Thus, the final regulations continue to provide

that, for CRUTs, post-contribution capital gains may be included in the definition of income under the terms of the governing instrument or applicable local law, but not pursuant to a trustee's discretionary power granted by the trust instrument, rather than by state statute, to allocate capital gains to income.

Capital Gains and Distributable Net Income

Section 643(a)(3) provides that gains from the sale or exchange of capital assets generally are excluded from distributable net income (DNI) to the extent that these gains are allocated to corpus. However, capital gains allocated to corpus are included in DNI if they are either paid, credited, or required to be distributed, to a beneficiary during the year, or paid, permanently set aside, or to be used for a charitable purpose. In certain situations it is easily ascertained whether capital gains are paid to a beneficiary. For example, if the trust instrument provides that the proceeds from the sale of a certain asset are to be paid to a beneficiary upon sale, then any capital gain recognized upon the sale of that asset is paid to the beneficiary and is includible in DNI. However, the circumstances in which recognized capital gain determines the amount to be distributed to a beneficiary during the year are relatively rare.

More frequently, the trustee is authorized by the trust instrument to make discretionary distributions of principal or, by the recently-enacted state statutes, to pay the income beneficiary a unitrust amount. In these circumstances, the amount of realized capital gain during the year does not affect the amount distributed to a beneficiary, and because money is fungible, it is difficult to ascertain whether capital gains are actually paid to the beneficiary. With respect to these situations, the proposed regulations attempt to clarify the circumstances in which capital gains are treated as distributed to a beneficiary and therefore are includable in DNI. The proposed regulations provide that capital gains will be treated as part of a distribution to a beneficiary, if the trustee allocates capital gains to the distribution pursuant to a discretionary power granted by local law or by the governing instrument (if not inconsistent with local law) to treat capital

gains in this manner, provided the allocation power is exercised in a reasonable and consistent manner, and is evidenced on the trust's books, records, and tax returns.

Commentators requested guidance on several issues concerning the treatment of capital gains as part of a distribution to a beneficiary. These issues include clarification that one trustee may exercise the discretion differently for different trusts and that the treatment of capital gains from the sale of different types of assets may be different. Examples have been added to the final regulations to address these situations. In addition, some commentators were concerned about how a trustee may show consistency in the first year, whether the treatment in future years may be changed based on something other than a change in the definition of income, and whether existing trusts may establish a different treatment based on the rules in the final regulations.

In some respects, the proposed regulations merely clarify how a trustee may demonstrate that capital gain has been paid to a beneficiary and therefore is includible in DNI under section 643(a)(3). This determination is relevant when distributions are made to beneficiaries that exceed the amount of DNI determined without regard to the capital gains. In the past, this situation arose when mandatory or discretionary payments of principal were made. Because of the changes to the definition of income under state statutes, the number and variety of situations in which this determination is relevant are increasing. In implementing a different method for determining income under a state statute, the trustee may establish a pattern for including or not including capital gains in DNI to the extent that the amount of income so determined is greater than the amount of DNI determined without regard to the capital gains. This choice may be made irrespective of the trustee's practice under a prior legal definition of income regarding the treatment of capital gains as part of DNI when discretionary or mandatory distributions of principal were made from the trust.

Two commentators requested examples of the inclusion of capital gains in DNI when the trustee exercises a power to adjust between income and principal under applicable local law. The circumstances in which a power to adjust is exercisable

may vary among states and may be determined by the powers of the trustee to make distributions of income and principal under the terms of the governing instrument. For example, if a trust instrument does not permit the trustee to distribute any corpus and the power to adjust under local law may be exercised only with respect to receipts from the sale of trust assets, the amount allocated to income under the power to adjust may have to be from the realized appreciation in the value of the assets that were sold. On the other hand, if the trust instrument permits discretionary distributions of principal and the power to adjust under local law may be exercised only with respect to appreciation in the value of trust assets, the power to adjust may be similar to a unitrust amount that is payable irrespective of whether appreciated assets are sold during the year. Because of the potential variations in the circumstances and ramifications of exercising a power to adjust under applicable state statutes, additional examples would be unlikely to provide meaningful or complete guidance; thus, the final regulations contain no additional examples concerning inclusion of capital gains in DNI when the trustee exercises a power to adjust.

It has been pointed out that *Examples 6 through 8* in §1.643(a)-3(e) of the proposed regulations, which are essentially identical to examples in the existing regulations, may no longer be consistent with the rules in the proposed regulations. In the final regulations, the corresponding examples, now *Examples 7 through 10*, have been updated to take into account the new rules. One commentator requested examples of the effect on DNI of capital gains from a passthrough entity and income from a passthrough entity that is more or less than the trust accounting income from that entity. These issues are beyond the scope of this project.

Trusts Qualifying for Gift and Estate Tax Marital Deductions

The proposed regulations provide that a spouse will be treated as entitled to receive all net income from a trust, as required for the trust to qualify for the gift and estate tax marital deductions under §20.2056(b)-5(a)(1) of the Estate Tax Regulations and §25.2523(e)-1(f)(1) of the Gift Tax Regulations, if the trust is

administered under applicable state law that provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and that meets the requirements of §1.643(b)-1. Thus, a spouse who, as the income beneficiary, is entitled in accordance with the state statute and the governing instrument to a unitrust amount of no less than 3% and no more than 5% would be entitled to all the income from the trust for purposes of qualifying the trust for the marital deduction.

Several commentators suggested that a trust that provides for a unitrust payment to the spouse should satisfy the income standard even in states that have not enacted legislation defining income as a unitrust amount or providing that a right to income may be satisfied by such a payment. The income distribution requirement that must be satisfied for a trust to qualify for the gift and estate tax marital deductions ensures that the spouse receives what is traditionally considered to be income from the assets held in trust. As previously discussed, the IRS and the Treasury Department believe that only if applicable state law has authorized a departure from traditional concepts of income and principal should such a departure be respected for Federal tax purposes. A state statute specifically authorizing certain unitrust amounts in satisfaction of an income interest or certain powers to adjust in conformance with the provisions of §1.643(b)-1 would meet this standard. However, in the absence of a state statute, or, for example, a decision of the highest court of the state applicable to all trusts administered under that state's law, the applicable state law requirement will not be satisfied.

It has also been suggested that, in some circumstances, the proposed regulations would allow the spouse to receive less than all the traditional trust income, and therefore would conflict with the section 2056 statutory requirement that the spouse receive all trust income. For example, a spouse who, in accordance with the state statute, receives a 4% unitrust amount would receive less than all the traditional income generated by the trust, if the trust's total dividends, interest, rents, etc., for the year exceed 4%. However, that spouse would receive more than the amount of traditional income earned by the trust in

any year that the trust's total dividends, interest, rents, etc., do not exceed 4%. The regulations are intended to strike a reasonable balance between the marital deduction statutory requirements and the many state statutes intended to facilitate the investment of trust assets while ensuring equitable treatment for the income and remainder beneficiaries. Indeed, Congress contemplated that, in appropriate circumstances, an annuity could be treated as satisfying the statutory income distribution requirement. The flush language following section 2056(b)(7)(B)(ii) specifically authorizes regulations that treat an annuity "in a manner similar to an income interest in property." The IRS and Treasury Department believe that these regulations implement this statutory authorization in a reasonable manner by recognizing allocations under state statutes that provide for a reasonable apportionment of the total return of the trust.

Trusts Exempt From Generation-Skipping Transfer Tax

The proposed regulations expand the rules concerning changes that may be made to trusts that are exempt from the generation-skipping transfer tax because they were irrevocable on September 25, 1985, without causing the loss of the trusts' exempt status. If such an exempt trust is administered in conformance with applicable state law that permits a unitrust amount to be paid to the income beneficiary or permits adjustments between income and principal to ensure impartiality, and that meets the requirements of §1.643(b)-1, its exempt status will not be affected.

One commentator requested that the final regulations also provide that administration of an exempt trust as described in these regulations will not cause any trust beneficiary to be treated as making a gift and will not result in any taxable exchange by the trust or any of its beneficiaries. Another commentator requested that the final regulations clarify that changing the situs of a trust from a state with only a traditional definition of income to a state that permits unitrusts or powers to adjust will not affect the exempt status of the trust. *Examples 11 and 12* have been revised to address these and similar concerns. The same conclusions apply to a change of si-

tus in the opposite direction, from a state that permits unitrusts or the power to adjust to a state that has only the traditional definition of income.

Effective Dates

The proposed regulations provide that the final regulations apply for taxable years that begin on or after January 2, 2004. Commentators suggested that, as a number of states have already enacted statutes permitting the trustee to pay to the person entitled to the income a unitrust amount based on a fixed percentage of the fair market value of the trust assets or providing the trustee the discretion to make adjustments between income and principal to treat the beneficiaries impartially, the effective date provision should be changed to allow trustees to take advantage of these statutes for periods beginning before the date of the publication of the final regulations. As an alternative, one commentator suggested that the IRS issue guidance allowing trustees to rely on the proposed regulations prior to the publication of the final regulations.

The final regulations, in general, will become effective for taxable years of trusts and estates ending after January 2, 2004. In addition, taxpayers may rely on the provisions of the final regulations for any taxable years in which a trust or estate is governed by a state statute authorizing a unitrust payment in satisfaction of the income interest of the income beneficiaries or granting the trustee a power to adjust between income and principal, in each case as described in the final regulations.

With respect to CRUTs, the prohibition of a trustee's discretionary power, granted solely by the governing instrument and not by applicable state statute, to allocate to income sales proceeds attributable to appreciation in the value of the asset after the date it was contributed to the trust or purchased by the trust is applicable to trusts created after January 2, 2004.

With respect to PIFs, the provision concerning the failure of net long-term capital gain to qualify for the charitable deduction if the income beneficiaries, under the terms of the governing instrument and the state statute, may receive a unitrust amount or an amount based on unrealized appreciation in the value of the fund's assets is applicable to taxable years of PIFs begin-

ning after January 2, 2004. However, provided income has not already been determined in such a manner, the fund's governing instrument may be amended or reformed to eliminate this possibility. A judicial proceeding to reform the fund's governing instrument must be commenced, or a nonjudicial reformation that is valid under state law must be completed, by the date that is nine months after the later of January 2, 2004, or the effective date of the state statute authorizing determination of income in such a manner.

Special Analyses

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

Drafting Information

The principal authors of these regulations are Bradford R. Poston and Mary Berman of the Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20, 25, and 26 are amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.642(c)-2 is amended as follows:

1. Paragraph (c) is amended by adding two sentences after the first sentence.

2. Paragraph (e) is added immediately following paragraph (d).

The additions read as follows

§1.642(c)-2 Unlimited deduction for amounts permanently set aside for a charitable purpose.

* * * * *

(c) * * * No amount of net long-term capital gain shall be considered permanently set aside for charitable purposes if, under the terms of the fund's governing instrument and applicable local law, the trustee has the power, whether or not exercised, to satisfy the income beneficiaries' right to income by the payment of either: an amount equal to a fixed percentage of the fair market value of the fund's assets (whether determined annually or averaged on a multiple year basis); or any amount that takes into account unrealized appreciation in the value of the fund's assets. In addition, no amount of net long-term capital gain shall be considered permanently set aside for charitable purposes to the extent the trustee distributes proceeds from the sale or exchange of the fund's assets as income within the meaning of §1.642(c)-5(a)(5)(i). * * *

* * * * *

(e) *Effective dates.* Generally, the second sentence of paragraph (c) of this section, concerning the loss of any charitable deduction for long-term capital gains if the fund's income may be determined by a fixed percentage of the fair market value of the fund's assets or by any amount that takes into account unrealized appreciation in the value of the fund's assets, applies for taxable years beginning after January 2, 2004. In a state whose statute permits income to be determined by reference to a fixed percentage of, or the unrealized appreciation in, the value of the fund's assets, net long-term capital gain of a pooled income fund may be considered to be permanently set aside for charitable purposes if the fund's governing instrument is amended or reformed to eliminate the possibility of determining income in such a manner and if income has not been determined in this manner. For this purpose, a judicial proceeding to reform the fund's governing instrument must be commenced, or a nonjudicial reformation

that is valid under state law must be completed, by the date that is nine months after the later of January 2, 2004, or the effective date of the state statute authorizing determination of income in such a manner.

* * * * *

Par. 3. In §1.642(c)-5, paragraph (a)(5)(i) is revised to read as follows:

§1.642(c)-5 Definition of pooled income fund.

(a) * * *
(5) * * *

(i) The term *income* has the same meaning as it does under section 643(b) and the regulations thereunder, except that income generally may not include any long-term capital gains. However, in conformance with the applicable state statute, income may be defined as or satisfied by a unitrust amount, or pursuant to a trustee's power to adjust between income and principal to fulfill the trustee's duty of impartiality, if the state statute both provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of §1.643(b)-1. In exercising a power to adjust, the trustee must allocate to principal, not to income, the proceeds from the sale or exchange of any assets contributed to the fund by any donor or purchased by the fund at least to the extent of the fair market value of those assets on the date of their contribution to the fund or of the purchase price of those assets purchased by the fund. This definition of income applies for taxable years beginning after January 2, 2004.

* * * * *

Par. 4. Section 1.643(a)-3 is revised to read as follows:

§1.643(a)-3 Capital gains and losses.

(a) *In general.* Except as provided in §1.643(a)-6 and paragraph (b) of this section, gains from the sale or exchange of capital assets are ordinarily excluded from distributable net income and are not ordinarily considered as paid, credited, or required to be distributed to any beneficiary.

(b) *Capital gains included in distributable net income.* Gains from the sale or exchange of capital assets are included in distributable net income to the extent they are, pursuant to the terms of the

governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of discretion by the fiduciary (in accordance with a power granted to the fiduciary by applicable local law or by the governing instrument if not prohibited by applicable local law) —

(1) Allocated to income (but if income under the state statute is defined as, or consists of, a unitrust amount, a discretionary power to allocate gains to income must also be exercised consistently and the amount so allocated may not be greater than the excess of the unitrust amount over the amount of distributable net income determined without regard to this subparagraph §1.643(a)-3(b));

(2) Allocated to corpus but treated consistently by the fiduciary on the trust's books, records, and tax returns as part of a distribution to a beneficiary; or

(3) Allocated to corpus but actually distributed to the beneficiary or utilized by the fiduciary in determining the amount that is distributed or required to be distributed to a beneficiary.

(c) *Charitable contributions included in distributable net income.* If capital gains are paid, permanently set aside, or to be used for the purposes specified in section 642(c), so that a charitable deduction is allowed under that section in respect of the gains, they must be included in the computation of distributable net income.

(d) *Capital losses.* Losses from the sale or exchange of capital assets shall first be netted at the trust level against any gains from the sale or exchange of capital assets, except for a capital gain that is utilized under paragraph (b)(3) of this section in determining the amount that is distributed or required to be distributed to a particular beneficiary. See §1.642(h)-1 with respect to capital loss carryovers in the year of final termination of an estate or trust.

(e) *Examples.* The following examples illustrate the rules of this section:

Example 1. Under the terms of Trust's governing instrument, all income is to be paid to A for life. Trustee is given discretionary powers to invade principal for A's benefit and to deem discretionary distributions to be made from capital gains realized during the year. During Trust's first taxable year, Trust has \$5,000 of dividend income and \$10,000 of capital gain from the sale of securities. Pursuant to the terms of the governing instrument and applicable local law, Trustee allocates the \$10,000 capital gain to principal. During the year, Trustee distributes to A \$5,000, representing A's right to trust income. In addition, Trustee distributes to A \$12,000, pursuant

to the discretionary power to distribute principal. Trustee does not exercise the discretionary power to deem the discretionary distributions of principal as being paid from capital gains realized during the year. Therefore, the capital gains realized during the year are not included in distributable net income and the \$10,000 of capital gain is taxed to the trust. In future years, Trustee must treat all discretionary distributions as not being made from any realized capital gains.

Example 2. The facts are the same as in *Example 1*, except that Trustee intends to follow a regular practice of treating discretionary distributions of principal as being paid first from any net capital gains realized by Trust during the year. Trustee evidences this treatment by including the \$10,000 capital gain in distributable net income on Trust's federal income tax return so that it is taxed to A. This treatment of the capital gains is a reasonable exercise of Trustee's discretion. In future years, Trustee must treat all discretionary distributions as being made first from any realized capital gains.

Example 3. The facts are the same as in *Example 1*, except that Trustee intends to follow a regular practice of treating discretionary distributions of principal as being paid from any net capital gains realized by Trust during the year from the sale of certain specified assets or a particular class of investments. This treatment of capital gains is a reasonable exercise of Trustee's discretion.

Example 4. The facts are the same as in *Example 1*, except that pursuant to the terms of the governing instrument (in a provision not prohibited by applicable local law), capital gains realized by Trust are allocated to income. Because the capital gains are allocated to income pursuant to the terms of the governing instrument, the \$10,000 capital gain is included in Trust's distributable net income for the taxable year.

Example 5. The facts are the same as in *Example 1*, except that Trustee decides that discretionary distributions will be made only to the extent Trust has realized capital gains during the year and thus the discretionary distribution to A is \$10,000, rather than \$12,000. Because Trustee will use the amount of any realized capital gain to determine the amount of the discretionary distribution to the beneficiary, the \$10,000 capital gain is included in Trust's distributable net income for the taxable year.

Example 6. Trust's assets consist of Blackacre and other property. Under the terms of Trust's governing instrument, Trustee is directed to hold Blackacre for ten years and then sell it and distribute all the sales proceeds to A. Because Trustee uses the amount of the sales proceeds that includes any realized capital gain to determine the amount required to be distributed to A, any capital gain realized from the sale of Blackacre is included in Trust's distributable net income for the taxable year.

Example 7. Under the terms of Trust's governing instrument, all income is to be paid to A during the Trust's term. When A reaches 35, Trust is to terminate and all the principal is to be distributed to A. Because all the assets of the trust, including all capital gains, will be actually distributed to the beneficiary at the termination of Trust, all capital gains realized in the year of termination are included in distributable net income. See §1.641(b)-3 for the determination of the year of final termination and the taxability of

capital gains realized after the terminating event and before final distribution.

Example 8. The facts are the same as *Example 7*, except Trustee is directed to pay B \$10,000 before distributing the remainder of Trust assets to A. Because the distribution to B is a gift of a specific sum of money within the meaning of section 663(a)(1), none of Trust's distributable net income that includes all of the capital gains realized during the year of termination is allocated to B's distribution.

Example 9. The facts are the same as *Example 7*, except Trustee is directed to distribute one-half of the principal to A when A reaches 35 and the balance to A when A reaches 45. Trust assets consist entirely of stock in corporation M with a fair market value of \$1,000,000 and an adjusted basis of \$300,000. When A reaches 35, Trustee sells one-half of the stock and distributes the sales proceeds to A. All the sales proceeds, including all the capital gain attributable to that sale, are actually distributed to A and therefore all the capital gain is included in distributable net income.

Example 10. The facts are the same as *Example 9*, except when A reaches 35, Trustee sells all the stock and distributes one-half of the sales proceeds to A. If authorized by the governing instrument and applicable state statute, Trustee may determine to what extent the capital gain is distributed to A. The \$500,000 distribution to A may be treated as including a minimum of \$200,000 of capital gain (and all of the principal amount of \$300,000) and a maximum of \$500,000 of the capital gain (with no principal). Trustee evidences the treatment by including the appropriate amount of capital gain in distributable net income on Trust's federal income tax return. If Trustee is not authorized by the governing instrument and applicable state statutes to determine to what extent the capital gain is distributed to A, one-half of the capital gain attributable to the sale is included in distributable net income.

Example 11. The applicable state statute provides that a trustee may make an election to pay an income beneficiary an amount equal to four percent of the fair market value of the trust assets, as determined at the beginning of each taxable year, in full satisfaction of that beneficiary's right to income. State statute also provides that this unitrust amount shall be considered paid first from ordinary and tax-exempt income, then from net short-term capital gain, then from net long-term capital gain, and finally from return of principal. Trust's governing instrument provides that A is to receive each year income as defined under state statute. Trustee makes the unitrust election under state statute. At the beginning of the taxable year, Trust assets are valued at \$500,000. During the year, Trust receives \$5,000 of dividend income and realizes \$80,000 of net long-term gain from the sale of capital assets. Trustee distributes to A \$20,000 (4% of \$500,000) in satisfaction of A's right to income. Net long-term capital gain in the amount of \$15,000 is allocated to income pursuant to the ordering rule of the state statute and is included in distributable net income for the taxable year.

Example 12. The facts are the same as in *Example 11*, except that neither state statute nor Trust's governing instrument has an ordering rule for the character of the unitrust amount, but leaves such a decision to the discretion of Trustee. Trustee intends to follow a regular practice of treating principal, other than capital gain, as distributed to the beneficiary to the extent

that the unitrust amount exceeds Trust's ordinary and tax-exempt income. Trustee evidences this treatment by not including any capital gains in distributable net income on Trust's Federal income tax return so that the entire \$80,000 capital gain is taxed to Trust. This treatment of the capital gains is a reasonable exercise of Trustee's discretion. In future years, Trustee must consistently follow this treatment of not allocating realized capital gains to income.

Example 13. The facts are the same as in *Example 11*, except that neither state statutes nor Trust's governing instrument has an ordering rule for the character of the unitrust amount, but leaves such a decision to the discretion of Trustee. Trustee intends to follow a regular practice of treating net capital gains as distributed to the beneficiary to the extent the unitrust amount exceeds Trust's ordinary and tax-exempt income. Trustee evidences this treatment by including \$15,000 of the capital gain in distributable net income on Trust's Federal income tax return. This treatment of the capital gains is a reasonable exercise of Trustee's discretion. In future years, Trustee must consistently treat realized capital gain, if any, as distributed to the beneficiary to the extent that the unitrust amount exceeds ordinary and tax-exempt income.

Example 14. Trustee is a corporate fiduciary that administers numerous trusts. State statutes provide that a trustee may make an election to distribute to an income beneficiary an amount equal to four percent of the annual fair market value of the trust assets in full satisfaction of that beneficiary's right to income. Neither state statutes nor the governing instruments of any of the trusts administered by Trustee has an ordering rule for the character of the unitrust amount, but leaves such a decision to the discretion of Trustee. With respect to some trusts, Trustee intends to follow a regular practice of treating principal, other than capital gain, as distributed to the beneficiary to the extent that the unitrust amount exceeds the trust's ordinary and tax-exempt income. Trustee will evidence this treatment by not including any capital gains in distributable net income on the Federal income tax returns for those trusts. With respect to other trusts, Trustee intends to follow a regular practice of treating any net capital gains as distributed to the beneficiary to the extent the unitrust amount exceeds the trust's ordinary and tax-exempt income. Trustee will evidence this treatment by including net capital gains in distributable net income on the Federal income tax returns filed for these trusts. Trustee's decision with respect to each trust is a reasonable exercise of Trustee's discretion and, in future years, Trustee must treat the capital gains realized by each trust consistently with the treatment by that trust in prior years.

(f) *Effective date.* This section applies for taxable years of trusts and estates ending after January 2, 2004.

Par. 5. Section 1.643(b)-1 is revised to read as follows:

§1.643(b)-1 Definition of income.

For purposes of subparts A through D, part I, subchapter J, chapter 1 of the Internal Revenue Code, "income," when not preceded by the words "taxable,"

"distributable net," "undistributed net," or "gross," means the amount of income of an estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Trust provisions that depart fundamentally from traditional principles of income and principal will generally not be recognized. For example, if a trust instrument directs that all the trust income shall be paid to the income beneficiary but defines ordinary dividends and interest as principal, the trust will not be considered one that under its governing instrument is required to distribute all its income currently for purposes of section 642(b) (relating to the personal exemption) and section 651 (relating to simple trusts). Thus, items such as dividends, interest, and rents are generally allocated to income and proceeds from the sale or exchange of trust assets are generally allocated to principal. However, an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation. For example, a state statute providing that income is a unitrust amount of no less than 3% and no more than 5% of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis, is a reasonable apportionment of the total return of the trust. Similarly, a state statute that permits the trustee to make adjustments between income and principal to fulfill the trustee's duty of impartiality between the income and remainder beneficiaries is generally a reasonable apportionment of the total return of the trust. Generally, these adjustments are permitted by state statutes when the trustee invests and manages the trust assets under the state's prudent investor standard, the trust describes the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee after applying the state statutory rules regarding the allocation of receipts and disbursements to income and principal, is unable to administer the trust impartially. Allocations pursuant to methods prescribed by such state statutes for apportioning the total return of a trust between income and principal will be re-

spected regardless of whether the trust provides that the income must be distributed to one or more beneficiaries or may be accumulated in whole or in part, and regardless of which alternate permitted method is actually used, provided the trust complies with all requirements of the state statute for switching methods. A switch between methods of determining trust income authorized by state statute will not constitute a recognition event for purposes of section 1001 and will not result in a taxable gift from the trust's grantor or any of the trust's beneficiaries. A switch to a method not specifically authorized by state statute, but valid under state law (including a switch via judicial decision or a binding non-judicial settlement) may constitute a recognition event to the trust or its beneficiaries for purposes of section 1001 and may result in taxable gifts from the trust's grantor and beneficiaries, based on the relevant facts and circumstances. In addition, an allocation to income of all or a part of the gains from the sale or exchange of trust assets will generally be respected if the allocation is made either pursuant to the terms of the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of a discretionary power granted to the fiduciary by applicable local law or by the governing instrument, if not prohibited by applicable local law. This section is effective for taxable years of trusts and estates ending after January 2, 2004.

Par. 6. In §1.651(a)-2, paragraph (d) is added to read as follows:

§1.651(a)-2 Income required to be distributed currently.

* * * * *

(d) If a trust distributes property in kind as part of its requirement to distribute currently all the income as defined under section 643(b) and the applicable regulations, the trust shall be treated as having sold the property for its fair market value on the date of distribution. If no amount in excess of the amount of income as defined under section 643(b) and the applicable regulations is distributed by the trust during the year, the trust will qualify for treatment under section 651 even though property in kind was distributed as part of a distribution of all such income. This paragraph (d)

applies for taxable years of trusts ending after January 2, 2004.

Par. 7. In §1.661(a)-2, paragraph (f) is revised to read as follows:

§1.661(a)-2 Deduction for distributions to beneficiaries.

* * * * *

(f) Gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as defined under section 643(b) and the applicable regulations, if income is required to be distributed currently. In addition, gain or loss is realized if the trustee or executor makes the election to recognize gain or loss under section 643(e). This paragraph applies for taxable years of trusts and estates ending January 2, 2004.

Par. 8. Section 1.664-3 is amended as follows:

1. Paragraphs (a)(1)(i)(b)(3) and (4) are revised.

2. Paragraph (a)(1)(i)(b)(5) is removed.

The revisions read as follows:

§1.664-3 Charitable remainder unitrust.

(a) * * *

(1) * * *(i) * * *

(b) * * *

(3) For purposes of this paragraph (a)(1)(i)(b), trust income generally means income as defined under section 643(b) and the applicable regulations. However, trust income may not be determined by reference to a fixed percentage of the annual fair market value of the trust property, notwithstanding any contrary provision in applicable state law. Proceeds from the sale or exchange of any assets contributed to the trust by the donor must be allocated to principal and not to trust income at least to the extent of the fair market value of those assets on the date of their contribution to the trust. Proceeds from the sale or exchange of any assets purchased by the trust must be allocated to principal and not to trust income at least to the extent of the trust's purchase price of those assets. Except as provided in the two preceding sentences, proceeds from the sale or exchange of any assets contributed to the trust by the donor or purchased by the

trust may be allocated to income, pursuant to the terms of the governing instrument, if not prohibited by applicable local law. A discretionary power to make this allocation may be granted to the trustee under the terms of the governing instrument but only to the extent that the state statute permits the trustee to make adjustments between income and principal to treat beneficiaries impartially.

(4) The rules in paragraph (a)(1)(i)(b)(1) and (2) of this section are applicable for taxable years ending after April 18, 1997. The rule in the first sentence of paragraph (a)(1)(i)(b)(3) is applicable for taxable years ending after April 18, 1997. The rules in the second, fourth, and fifth sentences of paragraph (a)(1)(i)(b)(3) are applicable for taxable years ending after January 2, 2004. The rule in the third sentence of paragraph (a)(1)(i)(b)(3) is applicable for sales or exchanges that occur after April 18, 1997. The rule in the sixth sentence of paragraph (a)(1)(i)(b)(3) is applicable for trusts created after January 2, 2004.

* * * * *

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 9. The authority citation for part 20 continues to read in part as follows:

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

Par. 10. Section 20.2056(b)-5 is amended by adding a new sentence to the end of paragraph (f)(1) to read as follows:

§20.2056(b)-5 Marital deduction; life estate with power of appointment in surviving spouse.

* * * * *

(f) * * * (1) * * * In addition, the surviving spouse's interest shall meet the condition set forth in paragraph (a)(1) of this section if the spouse is entitled to income as determined by applicable local law that provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and that meets the requirements of §1.643(b)-1 of this chapter.

* * * * *

Par. 11. Section 20.2056(b)-7 is amended by adding a new sentence to the end of paragraph (d)(1) to read as follows:

§20.2056(b)-7 Election with respect to life estate for surviving spouse.

(d) *** (1) *** A power under applicable local law that permits the trustee to adjust between income and principal to fulfill the trustee's duty of impartiality between the income and remainder beneficiaries that meets the requirements of §1.643(b)-1 of this chapter will not be considered a power to appoint trust property to a person other than the surviving spouse.

Par. 12. Section 20.2056(b)-10 is amended by adding a new sentence at the end of the section to read as follows:

§20.2056(b)-10 Effective dates.

*** In addition, the rule in the last sentence of §20.2056(b)-5(f)(1) and the rule in the last sentence of §20.2056(b)-7(d)(1) regarding the effect on the spouse's right to income if applicable local law provides for the reasonable apportionment between the income and remainder beneficiaries of the total return of the trust are applicable with respect to trusts for taxable years ending after January 2, 2004.

Par. 13. Section 20.2056A-5 is amended by adding a new sentence in paragraph (c)(2) after the third sentence to read as follows:

§20.2056A-5 Imposition of section 2056A estate tax.

(c) ***

(2)*** However, distributions made to the surviving spouse as the income beneficiary in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount), or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries, will be considered distributions of trust income if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of §1.643(b)-1 of this chapter. ***

Par. 14. Section 20.2056A-13 is revised to read as follows:

§20.2056A-13 Effective dates.

Except as provided in this section, the provisions of §§20.2056A-1 through 20.2056A-12 are applicable with respect to estates of decedents dying after August 22, 1995. The rule in the fourth sentence of §20.2056A-5(c)(2) regarding unitrusts and distributions of income to the surviving spouse in conformance with applicable local law is applicable to trusts for taxable years ending after January 2, 2004.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 15. The authority citation for part 25 continues to read in part as follows:

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

Par. 16. Section 25.2523(e)-1 is amended by adding a new sentence to the end of paragraph (f)(1) to read as follows:

§25.2523(e)-1 Marital deduction; life estate with power of appointment in donee spouse.

(f) *** (1) *** In addition, the spouse's interest shall meet the condition set forth in paragraph (a)(1) of this section if the spouse is entitled to income as defined or determined by applicable local law that provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and that meets the requirements of §1.643(b)-1 of this chapter.

Par. 17. Section 25.2523(h)-2 is amended by adding a new sentence to the end of the section to read as follows:

§25.2523(h)-2 Effective dates.

*** In addition, the rule in the last sentence of §25.2523(e)-1(f)(1) regarding the determination of income under applicable local law applies to trusts for taxable years ending after January 2, 2004.

PART 26—GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986

Par. 18. The authority citation for part 26 continues to read in part as follows:

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

Par. 19. Section 26.2601-1 is amended as follows:

1. The second and third sentences of paragraph (b)(4)(i) are revised to read as follows.

2. Paragraph (b)(4)(i)(D)(2) is amended by adding a new sentence to the end of the paragraph.

3. Paragraph (b)(4)(i)(E) is amended by adding *Examples 11 and 12*.

4. Paragraph (b)(4)(ii) is revised to read as follows.

The additions and revisions read as follows:

§26.2601-1 Effective dates.

(b) ***

(4) *** (i) *** In general, unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Thus (unless specifically noted), the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain for purposes of section 1001.

(D) ***

(2) *** In addition, administration of a trust in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust, if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of §1.643(b)-1 of this chapter.

(E) * * *

Example 11. Conversion of income interest to unitrust interest under state statute. In 1980, Grantor, a resident of State X, established an irrevocable trust for the benefit of Grantor's child, A, and A's issue. The trust provides that trust income is payable to A for life and upon A's death the remainder is to pass to A's issue, per stirpes. In 2002, State X amends its income and principal statute to define income as a unitrust amount of 4% of the fair market value of the trust assets valued annually. For a trust established prior to 2002, the statute provides that the new definition of income will apply only if all the beneficiaries who have an interest in the trust consent to the change within two years after the effective date of the statute. The statute provides specific procedures to establish the consent of the beneficiaries. A and A's issue consent to the change in the definition of income within the time period, and in accordance with the procedures, prescribed by the state statute. The administration of the trust, in accordance with the state statute defining income to be a 4% unitrust amount, will not be considered to shift any beneficial interest in the trust. Therefore, the trust will not be subject to the provisions of chapter 13 of the Internal Revenue Code. Further, under these facts, no trust beneficiary will be treated as having made a gift for federal gift tax purposes, and neither the trust nor any trust beneficiary will be treated as having made a taxable exchange for federal income tax purposes. Similarly, the conclusions in this example would be the same if the beneficiaries' consent was not required, or, if the change in administration of the trust occurred because the situs of the trust was changed to State X from a state whose statute does not define income as a unitrust amount or if the situs was changed to such a state from State X.

Example 12. Equitable adjustments under state statute. The facts are the same as in *Example 11*, except that in 2002, State X amends its income and principal statute to permit the trustee to make adjustments between income and principal when the trustee invests and manages the trust assets under the state's prudent investor standard, the trust describes the amount that shall or must be distributed to a beneficiary by referring to the trust's income, and the trustee after applying the state statutory rules regarding allocation of receipts between income and principal is unable to administer the trust impartially. The provision permitting the trustees to make these adjustments is effective in 2002 for trusts created at any time. The trustee invests and manages the trust assets under the state's prudent investor standard, and pursuant to authorization in the state statute, the trustee allocates receipts between the income and principal accounts in a manner to ensure the impartial administration of the trust. The administration of the trust in accordance with the state statute will not be considered to shift any beneficial interest in the trust. Therefore, the trust will not be subject to the provisions of chapter 13 of the Internal Revenue Code. Further, under these facts, no trust beneficiary will be treated as having made a gift for federal gift tax purposes, and neither the trust nor any trust beneficiary will be treated as having made a taxable exchange for federal income tax purposes. Similarly, the conclusions in this example would be the same if the change in administration of the trust occurred because the situs of the trust was changed to State X from a state whose

statute does not authorize the trustee to make adjustments between income and principal or if the situs was changed to such a state from State X.

(ii) *Effective dates.* The rules in this paragraph (b)(4) are generally applicable on and after December 20, 2000. However, the rule in the last sentence of paragraph (b)(4)(i)(D)(2) of this section and *Example 11* and *Example 12* in paragraph (b)(4)(i)(E) of this section regarding the administration of a trust and the determination of income in conformance with applicable state law applies to trusts for taxable years ending after January 2, 2004.

* * * * *

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

Approved December 16, 2003.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 30, 2003, 8:45 a.m., and published in the issue of the Federal Register for January 2, 2004, 69 F.R. 12)

Section 6043.—Liquidating, etc., Transactions

26 CFR 1.6043-4T: Information returns relating to certain acquisitions of control and changes in capital structure (temporary).

T.D. 9101

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

Information Reporting Relating to Taxable Stock Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations requiring information reporting by a corporation if control of the corporation is acquired or if the corporation has a recapitalization or other substantial change in capital structure. This document also contains temporary regulations

concerning information reporting requirements for brokers with respect to transactions described in section 6043(c). The text of these temporary regulations also serves as the text of proposed regulations (REG-156232-03) set forth in this issue of the Bulletin.

DATES: Effective Date: These regulations are effective December 30, 2003.

Applicability Dates: For dates of applicability, see §§1.6043-4T(i) and 1.6045-3T(g).

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

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The forms referenced in these regulations have been, or will be, reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

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.

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

Background

Section 6043(c) provides that if any person acquires control of a corporation, or if there is a recapitalization or other substantial change in capital structure of a corporation, the corporation, when required by the Secretary, shall make a return setting forth the identity of the parties to the transaction, the fees involved, the changes in the capital structure involved, and such other information as the Secretary may require with respect to such transaction.

On November 18, 2002, the IRS published temporary regulations under section 6043(c) (T.D. 9022, 2002-2 C.B. 909). The transactions covered by the reporting

requirement were certain acquisitions of control and substantial changes in the capital structure of a corporation. These regulations required a corporation to attach a form to its income tax return describing these transactions and to file information returns with respect to certain shareholders in such transactions. On November 18, 2002, the IRS also published temporary regulations under section 6045, which provided for information reporting with respect to these transactions by brokers (together with the section 6043(c) temporary regulations, the 2002 temporary regulations). The 2002 temporary regulations were applicable to acquisitions of control and substantial changes in capital structure occurring after December 31, 2001, if the reporting corporation or any shareholder was required to recognize gain (if any) as a result of the application of section 367(a) as a result of the transaction.

The text of the 2002 temporary regulations also served as the text of proposed regulations set forth in a cross-referencing notice of proposed rulemaking published in the Proposed Rules section of the same issue of the **Federal Register** (2002 proposed regulations) (REG-143321-02, 2002-2 C.B. 922). The provisions of the proposed regulations were proposed to apply with respect to any acquisition of control or substantial change in capital structure occurring after the date on which final regulations would be published in the **Federal Register**. The preamble to the notice of proposed rulemaking invited public comments with respect to the potential for duplicate reporting and with respect to the burden of compliance with the reporting requirements.

The IRS received a number of written public comments with respect to the information reporting requirements set forth in the 2002 temporary and proposed regulations. In addition, the IRS met with representatives of the Information Reporting Program Advisory Committee (IRPAC) and other representatives of the securities industry to discuss their concerns and suggestions for revisions to the regulations.

After considering the issues concerning affected taxpayers, the IRS has decided to revise the 2002 temporary regulations. The revised temporary regulations set forth information reporting rules that will help ensure that brokers and sharehold-

ers receive information regarding these corporate transactions, without unduly burdening brokers and other members of the securities industry.

The text of the revised temporary regulations also serves as the text of new proposed regulations (reproposed regulations) set forth in the cross-referencing notice of proposed rulemaking published elsewhere in this issue of the Bulletin. The preamble to that notice of proposed rulemaking invites public comments with respect to the revised temporary and reproposed regulations, particularly with respect to the ability of brokers to obtain the information necessary for reporting under revised §1.6045-3T and proposed §1.6045-3.

Summary of Comments

The commentators noted certain gaps in the transmission of information under the 2002 temporary and proposed regulations between corporations subject to reporting and brokers. Information reporting by brokers depends upon the effective dissemination of information from the corporation to the reporting community, and broker reporting is difficult to effectuate if there are gaps in the process of transmitting this information.

As provided in the 2002 temporary regulations, a reporting corporation would file Forms 1099-CAP, "*Changes in Corporate Control and Capital Structure*," with respect to its shareholders of record, including brokers, under §1.6043-4T(b). Brokers who received Forms 1099-CAP would then file Forms 1099-CAP with respect to their customers pursuant to §1.6045-3T. The commentators pointed out that a large majority of U.S. publicly issued securities are actually held on behalf of brokerage firms through clearing organizations. Pursuant to the 2002 temporary regulations, clearing organizations would receive Forms 1099-CAP from the reporting corporation; however, because clearing organizations are not treated as brokers, they in turn would not be required under §1.6045-3T to file Forms 1099-CAP with respect to their broker-members. Consequently, brokers (who otherwise had the requirement to file a Form 1099-CAP upon receiving one) would not receive Form 1099-CAP if they held their shares through a clearing organization. In addition, brokers may not

be aware of the requirement to report with respect to a particular corporate transaction, or may have difficulty obtaining the information necessary for reporting. Thus, under the 2002 temporary regulations, the actual shareholders of the reporting corporation, the broker's customers, may not receive information returns to assist them in preparing their income tax returns.

To address this issue, commentators suggested an alternative procedure to ensure that brokers receive the required information for reporting and to bridge any potential gaps in the chain of reporting. Commentators recommended that the IRS act as a central repository of information necessary for brokers and issue a publication containing information needed for brokers to satisfy their reporting obligations. Brokers and commercial tax services that publish current developments could access this information, and brokers could use this information in preparing Forms 1099-CAP with respect to their customers. An alternative suggested by commentators was to require the reporting corporation to post essential information for reporting, from its Form 8806, "*Information Return for Acquisition of Control or Substantial Change in Capital Structure*," to an IRS website.

Based on the comments, the revised temporary regulations provide in §1.6043-4T(a)(1)(vi) that reporting corporations may elect on Form 8806 to consent to the publication by the IRS of information necessary for brokers to file information returns with respect to their customers. To provide every corporation with the ability to make this election, the revised temporary regulations require reporting corporations to file Form 8806 even though the corporation may also report the transaction under sections 351, 355, or 368. In order to enable the IRS to publish the information timely, the revised temporary regulations require reporting corporations to file Form 8806 within 45 days after the transaction, and in no event later than January 5 of the year following the calendar year in which the transaction occurs.

The role of clearing organizations was also the subject of comments. Commentators suggested that the regulations use existing processes for distributing information to minimize the cost of and the time required for implementing reporting

by the industry. Those existing processes include the dissemination of information by clearing organizations. Under current practices, important information regarding corporate transactions (including tax information) is disseminated by clearing organizations to their members. The new temporary regulations try to take advantage of this existing information flow by continuing to require corporations to provide a Form 1099-CAP to clearing organizations that are listed as shareholders of record at the time of an acquisition of control or substantial change in capital structure. It is anticipated that clearing organizations will disseminate information obtained from the Form 1099-CAP to their members and that broker-members will use that information (and information obtained from other sources) to satisfy their own reporting obligations under revised §1.6045-3T. Under the revised temporary regulations, a broker is required to report information if the broker knows or has reason to know, based on readily available information, that there was an acquisition of control or substantial change in capital structure with respect to shares held by the broker on behalf of a customer. If a clearing organization disseminates information identifying an acquisition of control or a substantial change in capital structure to a broker-member, the broker-member has readily available information about the transaction and must satisfy its §1.6045-3T reporting obligations with respect to the transaction.

The revised temporary regulations provide that a reporting corporation is not required to file Forms 1099-CAP with respect to its shareholders which are clearing organizations, or to furnish Forms 1099-CAP to such clearing organizations, if the corporation makes the election to permit the IRS to publish information regarding the transaction. The IRS' publication of such information pursuant to the corporation's consent will provide readily available information for brokers, who must satisfy their reporting obligations with respect to the transaction.

Commentators also requested that brokers be permitted to use Form 1099-B, "Proceeds From Broker and Barter Exchange Transactions," for reporting under §1.6045-3T, rather than overhaul their systems to report on Form 1099-CAP. The commentators point out that this would also avoid any confusion stemming

from the issuance of both types of forms to the same taxpayer in the same transaction. The revised temporary regulations provide that Form 1099-B should be used by brokers for reporting under §1.6045-3T. With respect to transactions occurring in 2003, brokers may use either Form 1099-B or 1099-CAP.

Explanation of Provisions

The revised temporary regulations require a domestic corporation involved in certain large taxable transactions to file Form 8806 reporting and describing such transactions. The revised temporary regulations require the filing of Form 8806 within 45 days following an acquisition of control or substantial change in capital structure, as defined in §§1.6043-4T(c) and (d), or, if earlier, by January 5th of the year following the calendar year in which such event occurred.

The revised temporary regulations do not change the definition of *acquisition of control* or *substantial change in capital structure* as set forth in the 2002 temporary regulations. An acquisition of control of a corporation is defined as a transaction or series of related transactions in which stock representing control of that corporation is distributed by a second corporation or in which stock representing control of that corporation is acquired (directly or indirectly) by a second corporation and the shareholders of the first corporation receive cash, stock or other property. For these purposes, control is determined in accordance with the first sentence of section 304(c)(1). With certain limitations, the constructive ownership rules of section 318(a) apply to determine ownership. Acquisitions of control within an affiliated group are excepted from this definition, as are acquisitions in which the fair market value of the stock acquired in the transaction or series of related transactions is less than \$100,000,000.

A corporation has a substantial change in its capital structure if the corporation in a transaction or series of related transactions (a) undergoes a recapitalization with respect to its stock, (b) redeems its stock, (c) merges, consolidates or otherwise combines with another entity or transfers substantially all of its assets to one or more entities, (d) transfers all or part of its assets to another corporation in a title 11 or

similar case and, in pursuance of the plan, distributes stock or securities of that corporation, or (e) changes its identity, form or place of organization. Transactions in which the amount of any cash plus the fair market value of any property (including stock) provided to shareholders of the corporation is less than \$100,000,000 are excepted from this definition, as are transactions within an affiliated group.

The revised temporary regulations require a domestic corporation involved in the specified transactions to issue, with respect to each of its shareholders of record, a Form 1099-CAP reporting the amount of any cash plus the fair market value of any property (including certain stock) exchanged in the transaction. Corporations are not required to report the fair market value of any stock provided to a shareholder if the corporation reasonably determines that the receipt of such stock would not cause the shareholder to recognize gain (if any). Corporations also are not required to report amounts distributed to certain exempt recipients. The list of exempt recipients has been expanded to include brokers.

Penalties under section 6652(l) may be imposed for failing to file required returns under section 6043(c) (including failure to file on magnetic media, as required under section 6011(e) and §1.6011-2). The penalty under section 6652(l) is \$500 for each day the failure continues, but the total amount imposed with respect to a return cannot exceed \$100,000. The revised temporary regulations provide that the information returns required under these regulations shall be treated as one return for purposes of the section 6652(l) penalty, so that the penalty shall not exceed \$500 per day (\$100,000 in total) with respect to any acquisition of control or change in capital structure. Further, as provided in section 6652(l), such penalty does not apply if the failure is due to reasonable cause. Until regulations are promulgated under section 6652(l) to set forth specific standards for determining reasonable cause, the IRS will use the reasonable cause standards set forth in §301.6724-1 as a guideline for determining reasonable cause.

The 2002 temporary regulations under section 6045 required a broker who, as the record holder of stock, received a Form 1099-CAP from a corporation pursuant to the reporting requirements of §1.6043-4T to file a Form 1099-CAP with respect to

the actual owner and furnish such Form 1099-CAP to the actual owner. Under the revised temporary regulations, brokers should not receive Forms 1099-CAP from a corporation and are not required to issue Forms 1099-CAP. Instead, revised §1.6045-3T requires a broker that knows or has reason to know, based on readily available information, that a transaction described in §1.6043-4T(c) or (d) has occurred to file an information return reporting the required information with respect to its customers who are not exempt recipients. In order to allow brokers to use their existing information reporting systems, the new temporary regulations require Form 1099-B, "Proceeds From Broker and Barter Exchange Transactions," to be used for such reporting. It is anticipated that brokers will obtain the information regarding the corporate transactions from the IRS website or an IRS publication, from information provided by clearing organizations, as well as from other sources regularly consulted within the industry.

The revised temporary regulations are effective only for acquisitions of control and substantial changes of capital structure that occur after December 31, 2002, and for which the reporting corporation or any shareholder is required to recognize gain (if any) as a result of the application of section 367(a). The cross-referencing proposed regulations published in this issue of the Bulletin will apply to all acquisitions of control and substantial changes in capital structure occurring after the date that such regulations are published as final regulations (regardless of whether section 367(a) applies).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of

the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these temporary regulations is Nancy L. Rose, Office of Associate Chief Counsel (Procedure and Administration).

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:
Authority: 26 U.S.C. 7805* * *

Par. 2. Section 1.6043-4T is revised to read as follows:

§1.6043-4T Information returns relating to certain acquisitions of control and changes in capital structure (temporary).

(a) *Information returns for an acquisition of control or a substantial change in capital structure—* (1) *General rule.* If there is an acquisition of control (as defined in paragraph (c) of this section) or a substantial change in the capital structure (as defined in paragraph (d) of this section) of a domestic corporation (reporting corporation), the reporting corporation must file a completed Form 8806, "Information Return for Acquisition of Control or Substantial Change in Capital Structure," in accordance with the instructions to that form. Form 8806 will request the information required in paragraphs (a)(1)(i) through (vi) of this section and any other information specified in the instructions.

(i) *Reporting corporation.* Provide the name, address, and taxpayer identification number (TIN) of the reporting corporation.

(ii) *Common parent, if any, of the reporting corporation.* If the reporting corporation was a subsidiary member of an affiliated group filing a consolidated return immediately prior to the acquisition of control or the substantial change in capital structure, provide the name, address, and

TIN of the common parent of that affiliated group.

(iii) *Acquiring corporation.* Provide the name, address and TIN of any corporation that acquired control of the reporting corporation within the meaning of paragraph (c) of this section or combined with or received assets from the reporting corporation pursuant to a substantial change in capital structure within the meaning of paragraph (d) of this section (acquiring corporation). State whether the acquiring corporation is foreign (as defined in section 7701(a)(5)) or is a dual resident corporation (as defined in §1.1503-2(c)(2)). In either case, state whether the acquiring corporation was newly formed prior to its involvement in the transaction.

(iv) *Common parent, if any, of acquiring corporation.* If the acquiring corporation named in paragraph (a)(1)(iii) of this section was a subsidiary member of an affiliated group filing a consolidated return immediately prior to the acquisition of control or the substantial change in capital structure, provide the name, address, and TIN of the common parent of that affiliated group.

(v) *Information about acquisition of control or substantial change in capital structure.* Provide—

(A) A description of the transaction or transactions that gave rise to the acquisition of control or the substantial change in capital structure of the corporation;

(B) The date or dates of the transaction or transactions that gave rise to the acquisition of control or the substantial change in capital structure;

(C) A description of and a statement of the fair market value of any stock provided to the reporting corporation's shareholders in exchange for their stock if the reporting corporation reasonably determines that the shareholders are not required to recognize gain (if any) from the receipt of such stock for U.S. federal income tax purposes; and

(D) A statement of the amount of cash plus the fair market value of any property (including stock if the reporting corporation reasonably determines that its shareholders would be required to recognize gain (if any) on the receipt of such stock, but excluding stock described in paragraph (a)(1)(v)(C) of this section) provided to the reporting corporation's shareholders in exchange for each share of their stock.

(2) *Consent election.* Form 8806 will provide the reporting corporation with the ability to elect to permit the IRS to publish information that will inform brokers of the transaction and enable brokers to satisfy their reporting obligations under §1.6045-3T. The information to be published, on the IRS website and/or in an IRS publication, would be limited to the name and address of the corporation, the date of the transaction, a description of the shares affected by the transaction, and the amount of cash and the fair market value of any property (excluding stock described in paragraph (a)(1)(v)(C) of this section) provided to each class of shareholders in exchange for a share.

(3) *Time for making return*—(i) *In general.* Form 8806 must be filed on or before the 45th day following the acquisition of control or substantial change in capital structure of the corporation, or, if earlier, on or before January 5th of the year following the calendar year in which the acquisition of control or substantial change in capital structure occurs.

(ii) *Transition rule.* If an acquisition of control or a substantial change in capital structure of a corporation occurs after December 31, 2002, and before December 29, 2003, Form 8806 must be filed on or before January 5, 2004.

(4) *Exception where transaction is reported under section 6043(a).* No reporting is required under paragraph (a) of this section with respect to a transaction for which information is required to be reported pursuant to section 6043(a), provided the transaction is properly reported in accordance with that section.

(5) *Exception where shareholders are exempt recipients.* No reporting is required under paragraph (a) of this section if the reporting corporation reasonably determines that all of its shareholders who receive cash, stock or other property pursuant to the acquisition of control or substantial change in capital structure are exempt recipients under paragraph (b)(5) of this section.

(b) *Information returns regarding shareholders*—(1) *General rule.* A corporation that is required to file Form 8806 pursuant to paragraph (a)(1) of this section shall file a return of information on Forms 1096, “*Annual Summary and Transmittal of U.S. Information Returns*,” and 1099-CAP, “*Changes in Corporate*

Control and Capital Structure,” with respect to each shareholder of record in the corporation (before or after the acquisition of control or the substantial change in capital structure) who receives cash, stock, or other property pursuant to the acquisition of control or the substantial change in capital structure and who is not an exempt recipient as defined in paragraph (b)(5) of this section. A corporation is not required to file a Form 1096 or 1099-CAP with respect to a clearing organization if the corporation makes the election described in paragraph (a)(2) of this section.

(2) *Time for making information returns.* Forms 1096 and 1099-CAP must be filed on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which the acquisition of control or the substantial change in capital structure occurs.

(3) *Contents of return.* A separate Form 1099-CAP must be filed with respect to amounts received by each shareholder (who is not an exempt recipient as defined in paragraph (b)(5) of this section) showing—

(i) The name, address, telephone number and TIN of the reporting corporation;

(ii) The name, address and TIN of the shareholder;

(iii) The number and class of shares in the reporting corporation exchanged by the shareholder;

(iv) The aggregate amount of cash and the fair market value of any stock (other than stock described in paragraph (a)(1)(v)(C) of this section) or other property provided to the shareholder in exchange for its stock; and

(v) Such other information as may be required by the instructions to Form 1099-CAP.

(4) *Furnishing of forms to shareholders.* The Form 1099-CAP filed with respect to each shareholder must be furnished to such shareholder on or before January 31 of the year following the calendar year in which the shareholder receives cash, stock, or other property as part of the acquisition of control or the substantial change in capital structure. The Form 1099-CAP filed with respect to a clearing organization must be furnished to the clearing organization on or before January 5th of the year following the calendar year in which the acquisition of control or substantial change in capital structure oc-

curred. A Form 1099-CAP is not required to be furnished to a clearing organization if the reporting corporation makes the election described in paragraph (a)(2) of this section.

(5) *Exempt recipients.* A corporation is not required to file a Form 1099-CAP pursuant to this paragraph (b) of this section with respect to any of the following shareholders that is not a clearing organization:

(i) Any shareholder who receives solely stock described in paragraph (a)(1)(v)(C) of this section in exchange for its stock in the corporation.

(ii) Any shareholder who is required to recognize gain (if any) as a result of the receipt of cash, stock, or other property if the corporation reasonably determines that the amount of such cash plus the fair market value of such stock and other property does not exceed \$1,000. Stock described in paragraph (a)(1)(v)(C) of this section is not taken into account for purposes of this paragraph (b)(5)(ii).

(iii) Any shareholder described in paragraphs (b)(5)(iii)(A) through (M) of this section if the corporation has actual knowledge that the shareholder is described in one of paragraphs (b)(5)(iii)(A) through (M) of this section or if the corporation has a properly completed exemption certificate from the shareholder (as provided in §31.3406(h)-3 of this chapter). The corporation also may treat a shareholder as described in paragraphs (b)(5)(iii)(A) through (M) of this section based on the applicable indicators described in §1.6049-4(c)(1)(ii).

(A) A corporation, as described in §1.6049-4(c)(1)(ii)(A) (except for corporations for which an election under section 1362(a) is in effect).

(B) A tax-exempt organization, as described in §1.6049-4(c)(1)(ii)(B)(1).

(C) An individual retirement plan, as described in §1.6049-4(c)(1)(ii)(C).

(D) The United States, as described in §1.6049-4(c)(1)(ii)(D).

(E) A state, as described in §1.6049-4(c)(1)(ii)(E).

(F) A foreign government, as described in §1.6049-4(c)(1)(ii)(F).

(G) An international organization, as described in §1.6049-4(c)(1)(ii)(G).

(H) A foreign central bank of issue, as described in §1.6049-4(c)(1)(ii)(H).

(I) A securities or commodities dealer, as described in §1.6049-4(c)(1)(ii)(I).

(J) A real estate investment trust, as described in §1.6049-4(c)(1)(ii)(J).

(K) An entity registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1), as described in §1.6049-4(c)(1)(ii)(K).

(L) A common trust fund, as described in §1.6049-4(c)(1)(ii)(L).

(M) A financial institution such as a bank, mutual savings bank, savings and loan association, building and loan association, cooperative bank, homestead association, credit union, industrial loan association or bank, or other similar organization.

(iv) Any shareholder that the corporation, prior to the transaction, associates with documentation upon which the corporation may rely in order to treat payments to the shareholder as made to a foreign beneficial owner in accordance with §1.1441-1(e)(1)(ii) or as made to a foreign payee in accordance with §1.6049-5(d)(1) or presumed to be made to a foreign payee under §1.6049-5(d)(2) or (3). For purposes of this paragraph (b)(5)(iv), the provisions in §1.6049-5(c) (regarding rules applicable to documentation of foreign status and definition of U.S. payor and non-U.S. payor) shall apply. The provisions of §1.1441-1 shall apply by using the terms *corporation* and *shareholder* in place of the terms *withholding agent* and *payee* and without regard to the fact that the provisions apply only to amounts subject to withholding under chapter 3 of the Internal Revenue Code. The provisions of §1.6049-5(d) shall apply by using the terms *corporation* and *shareholder* in place of the terms *payor* and *payee*. Nothing in this paragraph (b)(5)(iv) shall be construed to relieve a corporation of its withholding obligations under section 1441.

(v) Any shareholder if, on January 31 of the year following the calendar year in which the shareholder receives cash, stock, or other property, the corporation did not know and did not have reason to know that the shareholder received such cash, stock, or other property in a transaction or series of related transactions that would result in an acquisition of control or a substantial change in capital structure.

(6) *Coordination with other sections.* In general, no reporting is required under paragraph (b) of this section with respect to amounts that are required to be reported under section 6042 or section 6045,

unless the corporation knows or has reason to know that such amounts are not properly reported in accordance with those sections. A corporation must satisfy the requirements under paragraph (b) of this section with respect to any shareholder of record that is a clearing organization.

(c) *Acquisition of control of a corporation—(1) In general.* For purposes of this section, an acquisition of control of a corporation (first corporation) occurs if, in a transaction or series of related transactions, either—

(i) Stock representing control of the first corporation is distributed by a second corporation to shareholders of the second corporation and the fair market value of such stock on the date of distribution is \$100,000,000 or more; or

(ii) (A) Before an acquisition of stock of the first corporation (directly or indirectly) by a second corporation, the second corporation does not have control of the first corporation;

(B) After the acquisition, the second corporation has control of the first corporation;

(C) The fair market value of the stock acquired in the transaction and in any related transactions as of the date or dates on which such stock was acquired is \$100,000,000 or more; and

(D) The shareholders of the first corporation (determined without applying the constructive ownership rule of section 318(a)) receive cash, stock, or other property pursuant to the acquisition.

(2) *Control.* For purposes of this section, control is determined in accordance with the first sentence of section 304(c)(1).

(3) *Constructive ownership.* (i) Except as otherwise provided in this section, the constructive ownership rules of section 318(a) (except for section 318(a)(4), providing for constructive ownership through an option to acquire stock), modified as provided in section 304(c)(3)(B), shall apply for determining whether there has been an acquisition of control.

(ii) The determination of whether there has been an acquisition of control shall be made without regard to whether the person or persons from whom control was acquired retain indirect control of the first corporation under section 318(a).

(iii) For purposes of paragraph (c)(1)(ii) of this section, section 318(a) shall not apply to cause a second corporation to be

treated as owning, before an acquisition of stock in a first corporation (directly or indirectly) by the second corporation, any stock that is acquired in the first corporation. For example, if the shareholders of a domestic corporation form a new holding company and then transfer their shares in the domestic corporation to the new holding company, the new holding company shall not be treated as having control of the domestic corporation before the acquisition. The new holding company acquires control of the domestic corporation as a result of the transfer. Similarly, if the shareholders of a domestic parent corporation transfer their shares in the parent corporation to a subsidiary of the parent in exchange for shares in the subsidiary, the subsidiary shall not be treated as having control of the parent before the transaction. The subsidiary acquires control of the parent as a result of the transfer.

(4) *Corporation includes group.* For purposes of this paragraph (c), if two or more corporations act pursuant to a plan or arrangement with respect to acquisitions of stock, such corporations will be treated as one corporation for purposes of this section. Whether two or more corporations act pursuant to a plan or arrangement depends on the facts and circumstances.

(5) *Section 338 election.* For purposes of this paragraph (c), an acquisition of stock of a corporation with respect to which an election under section 338 is made is treated as an acquisition of stock (and not as an acquisition of the assets of such corporation).

(d) *Substantial change in capital structure of a corporation—(1) In general.* A corporation has a substantial change in capital structure if it has a change in capital structure (as defined in paragraph (d)(2) of this section) and the amount of any cash and the fair market value of any property (including stock) provided to the shareholders of such corporation pursuant to the change in capital structure, as of the date or dates on which the cash or other property is provided, is \$100,000,000 or more.

(2) *Change in capital structure.* For purposes of this section, a corporation has a change in capital structure if the corporation in a transaction or series of transactions—

(i) Undergoes a recapitalization with respect to its stock;

(ii) Redeems its stock (including deemed redemptions);

(iii) Merges, consolidates or otherwise combines with another corporation or transfers all or substantially all of its assets to one or more corporations;

(iv) Transfers all or part of its assets to another corporation in a title 11 or similar case and, in pursuance of the plan, distributes stock or securities of that corporation; or

(v) Changes its identity, form or place of organization.

(e) *Reporting by successor entity.* If a corporation (transferor) transfers all or substantially all of its assets to another entity (transferee) in a transaction that constitutes a substantial change in the capital structure of transferor, transferor must satisfy the reporting obligations in paragraph (a) or (b) of this section. If transferor does not satisfy the reporting obligations in paragraph (a) or (b) of this section, then transferee must satisfy those reporting obligations. If neither transferor nor transferee satisfies the reporting obligations in paragraphs (a) and (b) of this section, then transferor and transferee shall be jointly and severally liable for any applicable penalties (see paragraph (g) of this section).

(f) *Receipt of property.* For purposes of this section, a shareholder is treated as receiving property (or as having property provided to it) pursuant to an acquisition of control or a substantial change in capital structure if a liability of the shareholder is assumed in the transaction and, as a result of the transaction, an amount is realized by the shareholder from the sale or exchange of stock.

(g) *Penalties for failure to file.* For penalties for failure to file as required under this section, see section 6652(l). The information returns required to be filed under paragraphs (a) and (b) of this section shall be treated as one return for purposes of section 6652(l) and, accordingly, the penalty shall not exceed \$500 for each day the failure continues (up to a maximum of \$100,000) with respect to any acquisition of control or any substantial change in capital structure. Failure to file as required under this section also includes the requirement to file on magnetic media as required by section 6011(e) and §1.6011-2. In addition, criminal penalties under sections

7203, 7206 and 7207 may apply in appropriate cases.

(h) *Examples.* The following examples illustrate the application of the rules of this section. For purposes of these examples, assume the transaction is not reported under sections 6042, 6043(a) or 6045, unless otherwise specified, and assume that the fair market value of the consideration provided to the shareholders exceeds \$100,000,000. The examples are as follows:

Example 1. The shareholders of X, a domestic corporation and parent of an affiliated group, exchange their X stock for stock in Y, a newly-formed foreign holding corporation. After the transaction, Y owns all the outstanding X stock. The X shareholders must recognize gain (if any) on the exchange of their stock as a result of the application of section 367(a). Because the transaction results in an acquisition of control of X, X must comply with the rules in paragraphs (a) and (b) of this section. X must file Form 8806 reporting the transaction. X must also file a Form 1099-CAP with respect to each shareholder who is not an exempt recipient showing the fair market value of the Y stock received by that shareholder, and X must furnish a copy of the Form 1099-CAP to that shareholder. If X elects on the Form 8806 to permit the IRS to publish information regarding the transaction, X is not required to file or furnish Forms 1099-CAP with respect to shareholders that are clearing organizations.

Example 2. C, a domestic corporation, and parent of an affiliated group merges into D, an unrelated domestic corporation. Pursuant to the transaction, the C shareholders exchange their C stock for D stock or for a combination of short term notes and D stock. The transaction does not satisfy the requirements of section 368, and the C shareholders must recognize gain (if any) on the exchange. Because the transaction results in a substantial change in the capital structure of C, C (or D as the successor to C) must comply with the rules in paragraphs (a) and (b) of this section. C must file Form 8806. C (or D as the successor to C) also must file a Form 1099-CAP with respect to each shareholder who is not an exempt recipient showing the fair market value of the short term notes and the fair market value of the D stock provided to that shareholder. In addition, C (or D) must furnish a copy of the Form 1099-CAP to that shareholder.

Example 3. (i) The facts are the same as in *Example 2*, except that C reasonably determines that—

(A) The transaction satisfies the requirements of section 368;

(B) The C shareholders who exchange their C stock solely for D stock will not be required to recognize gain (if any) on the exchange; and

(C) The C shareholders who exchange their C stock for a combination of short term notes and D stock will be required to recognize gain (if any) on the exchange solely with respect to the receipt of the short term notes.

(ii) C is required to file Form 8806 under paragraph (a) of this section. C (or D as the successor to C) must also comply with the rules in paragraph (b) of this section. With respect to each shareholder who receives a combination of short term notes and D stock,

and who is not an exempt recipient, C (or D) must file a Form 1099-CAP showing the fair market value of the short term notes provided to the shareholder, and C (or D) must furnish a copy of the Form 1099-CAP to that shareholder. The Form 1099-CAP should not show the fair market value of the D stock provided to the shareholder. C and D are not required to file and furnish Forms 1099-CAP with respect to shareholders who receive only D stock in exchange for their C stock.

Example 4. The facts are the same as in *Example 3*, except C hires a transfer agent to effectuate the exchange. The transfer agent is treated as a broker under section 6045 and is required to report the fair market value of the short term notes provided to C's shareholders under §1.6045-3T. Under paragraph (b)(6) of this section, C and D are not required to file information returns under paragraph (b) of this section with respect to a shareholder of record, unless C or D knows or has reason to know that the transfer agent does not satisfy its information reporting obligation under §1.6045-3T with respect to that shareholder. Thus, if the transfer agent satisfies its information reporting requirements under §1.6045-3T with respect to shareholder I, an individual who receives both D stock and short term notes, C and D are not required to file a Form 1099-CAP with respect to I. Conversely, if the transfer agent does not have an information reporting obligation under §1.6045-3T with respect to one of C's shareholder's of record (for example, a clearing organization that is an exempt recipient under §1.6045-3T(b)(ii)), or if C or D knows or has reason to know that the transfer agent has not satisfied its information reporting requirement with respect to a shareholder, then C (or D) must provide a Form 1099-CAP to that shareholder.

(i) *Effective date.* This section applies to any acquisition of control and any substantial change in capital structure occurring after December 31, 2001, if the reporting corporation or any shareholder is required to recognize gain (if any) as a result of the application of section 367(a) as a result of the transaction. However, paragraphs (a) through (h) of this section apply to acquisitions of control and substantial changes in capital structure occurring after December 31, 2002, if the reporting corporation or any shareholder is required to recognize gain (if any) as a result of the application of section 367(a) as a result of the transaction. For transactions prior to January 1, 2003, see §1.6043-4T as published in 26 CFR Part 1 (revised as of April 1, 2003). This section expires on November 14, 2005.

Par. 3. Section 1.6045-3T is revised to read as follows:

§1.6045-3T Information reporting for an acquisition of control or a substantial change in capital structure (temporary).

(a) *In general.* Any broker (as defined in §1.6045-1(a)(1)) that holds shares on behalf of a customer in a corporation that the broker knows or has reason to know based on readily available information (including, for example, information from a clearing organization or from information published by the Internal Revenue Service (see §601.601(d)(2) of this chapter)) has engaged in a transaction described in §1.6043-4T(c) (acquisition of control) or §1.6043-4T(d) (substantial change in capital structure), shall file a return of information with respect to the customer, unless the customer is an exempt recipient as defined in paragraph (b) of this section.

(b) *Exempt recipients.* A broker is not required to file a return of information under this section with respect to the following customers:

(1) Any customer who receives only cash in exchange for its stock in the corporation, which must be reported by the broker pursuant to §1.6045-1(a).

(2) Any customer who is an exempt recipient as defined in §1.6043-4T(b)(5) or §1.6045-1(c)(3)(i).

(c) *Form, manner and time for making information returns.* The return required by paragraph (a) of this section must be on Forms 1096, "Annual Summary and Transmittal of U.S. Information Returns," and 1099-B, "Proceeds From Broker and Barter Exchange Transactions," or on an acceptable substitute statement. Such forms must be filed on or before February 28 (March 31 if filed electronically) of the

year following the calendar year in which the acquisition of control or the substantial change in capital structure occurs.

(d) *Contents of return.* A separate Form 1099-B must be prepared for each customer showing—

(1) The name, address and taxpayer identification number (TIN) of the customer;

(2) The name and address of the corporation which engaged in the transaction described in §1.6043-4T(c) or (d);

(3) The number and class of shares in the corporation exchanged by the customer;

(4) The aggregate amount of cash and the fair market value of any stock (other than stock described in 1.6043-4T(a)(1)(v)(C)) or other property provided to the customer in exchange for its stock; and

(5) Such other information as may be required by Form 1099-B.

(e) *Furnishing of forms to customers.* The Form 1099-B prepared for each customer must be furnished to the customer on or before January 31 of the year following the calendar year in which the customer receives stock, cash or other property.

(f) *Single Form 1099.* If a broker is required to file a Form 1099-B with respect to a customer under both this §1.6045-3T and §1.6045-1(b) with respect to the same transaction, the broker may satisfy the requirements of both sections by filing and furnishing one Form 1099-B that contains all the relevant information, as provided in the instructions to Form 1099-B.

(g) *Effective date.* (1) This section applies with respect to any acquisition of

control and any substantial change in capital structure occurring after December 31, 2001, if the reporting corporation or any shareholder is required to recognize gain (if any) as a result of the application of section 367(a) as a result of the transaction. However, paragraphs (a) through (f) of this section apply to acquisitions of control and substantial changes in capital structure occurring after December 31, 2002, if the reporting corporation or any shareholder is required to recognize gain (if any) as a result of the application of section 367(a) as a result of the transaction. For transactions prior to that date, see §1.6045-3T as published in 26 CFR Part 1 (revised as of April 1, 2003). This section expires on November 14, 2005.

(2) For any acquisition of control or any substantial change in capital structure occurring during the 2003 calendar year, a broker may elect to satisfy the requirements of this section by using Form 1099-CAP in lieu of Form 1099-B.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

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

Par. 5. In §602.101, paragraph (b) is amended by removing the following entries in the table as follows:

§602.101 OMB Control numbers

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

| CFR part or section where identified and described | Current OMB control No. |
|--|-------------------------|
| * * * * * | |
| 1.6043-4T | 1545-1812 |
| * * * * * | |
| 1.6045-3T..... | 1545-1812 |
| * * * * * | |

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

Gregory Jenner,
Deputy Assistant Secretary of the
Treasury (Tax Policy).

(Filed by the Office of the Federal Register on December 29, 2003, 8:45 a.m., and published in the issue of the Federal Register for December 30, 2003, 68 F.R. 75119)

Approved December 12, 2003.

Section 7430.—Awarding of Costs and Certain Fees

26 CFR 301.7430-7: *Qualified offers.*

T.D. 9106

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Awards of Attorney's Fees and Other Costs Based Upon Qualified Offers

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the qualified offer rule, including the requirements that an offer must satisfy to be treated as a qualified offer under section 7430(g) and the requirements that a taxpayer must satisfy to qualify as a prevailing party by reason of having made a qualified offer. The regulations implement certain changes made by section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998. The final regulations affect taxpayers seeking attorney's fees and costs.

DATES: *Effective Date:* These regulations are effective December 24, 2003.

Applicability Date: These regulations apply to qualified offers postmarked or delivered after December 24, 2003, in administrative or court proceedings described in section 7430.

FOR FURTHER INFORMATION CONTACT: Tami C. Belouin (202) 622-7950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

These final regulations contain amendments to the Procedure and Administration Regulations (26 CFR part 301) reflecting changes to section 7430 made by section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998,

Public Law 105-206 (112 Stat. 686), to recover reasonable administrative and litigation costs in a court proceeding with respect to the determination or refund of any tax, interest or penalty. Proposed and temporary regulations under sections 7430(c)(4)(E) and 7430(g) were contemporaneously issued on January 3, 2001 (REG-121928-98, 2001-1 C.B. 520, T.D. 8922, 2001-1 C.B. 508 [66 FR 725]). Written comments were submitted in response to the proposed regulations and are discussed in more detail below. The proposed regulations are adopted as revised by this Treasury decision.

Explanation of Revisions and Summary of Comments

These final regulations generally adopt the provisions of the proposed regulations. The changes to the proposed regulations reflected in these final regulations, as well as the comments received, are discussed below.

1. *Adjustments Affected by the Outcome of Another Proceeding*

A taxpayer's tax liability may be affected by the outcome of a separate court or administrative proceeding. The proposed regulations stated that the portion of the liability to be fully resolved, by stipulation of the parties, through another proceeding is ignored for purposes of applying the qualified offer rule. One commentator requested clarification regarding this rule. The final regulations clarify this rule and state that the types of proceeding contemplated include, but are not limited to, state or Federal court proceedings. For example, a taxpayer's tax liability may be affected by the outcome of a separate court proceeding, such as a probate, tort liability, or trademark action.

2. *Specified Amount of Offer*

The proposed regulations provided that a qualified offer must state a specific dollar amount. Commentators noted that there are instances in which it would be difficult to calculate the taxpayer's tax liability and offer a specific dollar amount. To address those situations, the final regulations provide that a qualified offer may specify either a dollar amount of liability or a percentage of the adjustments at issue.

3. *Requirement to Disclose All Relevant Information*

In order for an offer to be treated as a qualified offer, the proposed regulations required a taxpayer to disclose all relevant information concerning any issue raised by the taxpayer subsequent to the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals that remained unresolved at the time the qualified offer was made. This disclosure had to occur contemporaneously with or prior to the making of the qualified offer. One commentator requested that this requirement be modified to lower the standard. The final regulations do not adopt this comment because the proposed regulations reflected the standard set out in Treas. Reg. § 301.7430-1 for exhaustion of administrative remedies.

4. *End of Qualified Offer Period*

One commentator suggested that if a case is removed from the trial calendar within 30 days of the trial date, the period for making a qualified offer should be reopened. The final regulations do not adopt this comment. The Treasury Department and the IRS do not believe that the purpose of the statute would be furthered if a taxpayer were permitted to submit a qualified offer after the period for doing so has expired, even if the case subsequently is continued. Like the statute of limitations, once the qualified offer period has expired, it should not be revived.

5. *Multiple Tax Years*

The proposed regulations do not specifically address the requirements for making a valid qualified offer when multiple tax years are at issue in a court or administrative proceeding. One commentator requested clarification of the application of the qualified offer rule in these situations. The final regulations provide that if adjustments in different tax years arise from separate and distinct issues such that the resolution of issues in one or more tax years will not affect the taxpayer's liability in one or more of the other years at issue in the proceeding, then a qualified offer may be made for less than all of the tax years involved in the proceeding. A qualified

offer, however, must resolve all of the issues for the tax years covered by the offer and also must cover all tax years in the proceeding affected by those issues. A tax year (affected year) is affected by an issue if the treatment of the issue in another tax year involved in the proceeding necessarily affects the treatment of the issue in the affected year. The final regulations include three new examples illustrating the operation of the qualified offer rule in cases involving multiple tax years.

6. *Settlement after Certain Court Rulings*

A federal tax case may be settled after a court has ruled on a motion relating to the merits of one or more of the adjustments covered by a qualified offer, even if the ruling does not fully resolve those adjustments. For example, a court's granting of a motion for partial summary judgment may resolve the underlying legal issue for an adjustment covered by a qualified offer but still leave open issues of substantiation or valuation. The parties at that time may resolve the adjustment based on the court's ruling and the parties' evaluation of the remaining issues not addressed by the court's ruling that affect that adjustment. The final regulations provide that if one or more adjustments covered by a qualified offer are settled following a ruling by the court that substantially resolves those adjustments, then those adjustments will not be treated as having been settled prior to the entry of the judgment by the court and instead will be treated as amounts included in the judgment as a result of the court's determinations. Whether an adjustment covered by a qualified offer is substantially resolved by a court ruling will depend on the facts and circumstances, including the scope of the ruling and the nature and importance of the issues affecting the adjustment that remain to be resolved after the court ruling. The final regulations further provide, however, that rulings relating to discovery, admissibility of evidence, and burden of proof are not treated as rulings that substantially resolve adjustments covered by a qualified offer. These changes have been made in response to the Tax Court's opinion in *Gladden v. Commissioner*, 120 T.C. 446 (2003). The Department of Treasury and the IRS will give further consideration to this issue and may is-

sue additional guidance regarding the matter in the future.

7. *Spousal Defenses*

The proposed regulations do not address specifically how spousal defenses affect the qualified offer rule. The preamble to the temporary regulations stated that the qualified offer rule applies in multiple taxpayer situations, such as those involving joint returns, but did not address the potential aggregation or segregation of the qualified offer or liability in situations that may present special circumstances, such as claims for innocent spouse relief. Commentators requested more specific rules addressing multiple taxpayer situations. The Treasury Department and the IRS have decided not to include additional rules involving multiple taxpayer situations in the final regulations. As the law in this area continues to evolve, the Treasury Department and the IRS may give further consideration to the issues raised and may issue additional guidance regarding how the qualified offer rule applies in these situations.

8. *Recovery of Fees Relating to Settled Issues*

The proposed regulations provided that a prevailing party may not recover fees under the qualified offer rule for any issue that is settled. Recovery is limited to issues that are actually determined by a court. One commentator recommended that the final regulations permit the recovery of fees attributable to adjustments that are settled. The final regulations do not adopt this comment. Section 7430(c)(4)(E)(ii)(I) provides that any case resolved pursuant to a settlement is not eligible for recovery of fees under the qualified offer rule. The qualified offer rule was enacted to encourage settlements. Requiring the government to pay administrative and litigation costs with respect to issues resolved exclusively pursuant to a settlement would be contrary to that goal.

9. *Delivery of Qualified Offer to the Proper Party*

The proposed regulations specify where an offer must be delivered in order to be treated as a qualified offer. One com-

mentator requested further clarification of these provisions and greater flexibility with respect to delivery locations. The Treasury Department and the IRS have considered this comment but no change has been made to the regulations because the regulations already provide specific instructions for the delivery of an offer under a variety of circumstances, as well as a default location for all other situations. Thus, the provision is sufficiently comprehensive. With respect to the request for greater flexibility, the comment was not adopted because it is important that a qualified offer be received by the office with jurisdiction over the case at the time the qualified offer is made in order that the government may act expeditiously on the offer. The locations specified in the regulations are designed to achieve that objective.

Special Analyses

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

Drafting Information

The principal author of these regulations is Tami C. Belouin, Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.7430-7 is added to read as follows:

§301.7430-7 *Qualified offers.*

(a) *In general.* Section 7430(c)(4)(E) (the qualified offer rule) provides that a party to a court proceeding satisfying the timely filing and net worth requirements of section 7430(c)(4)(A)(ii) shall be treated as the prevailing party if the liability of the taxpayer pursuant to the judgment in the proceeding (determined without regard to interest) is equal to or less than the liability of the taxpayer which would have been so determined if the United States had accepted the last qualified offer of the party as defined in section 7430(g). For purposes of this section, the term *judgment* means the cumulative determinations of the court concerning the adjustments at issue and litigated to a determination in the court proceeding. In making the comparison between the liability under the qualified offer and the liability under the judgment, the taxpayer's liability under the judgment is further modified by the provisions of paragraph (b)(3) of this section. The provisions of the qualified offer rule do not apply if the taxpayer's liability under the judgment, as modified by the provisions of paragraph (b)(3) of this section, is determined exclusively pursuant to a settlement, or to any proceeding in which the amount of tax liability is not in issue, including any declaratory judgment proceeding, any proceeding to enforce or quash any summons issued pursuant to the Internal Revenue Code (Code), and any action to restrain disclosure under section 6110(f). If the qualified offer rule applies to the court proceeding, the determination of whether the liability under the qualified offer would have equaled or exceeded the liability pursuant to the judgment is made by reference to the last

qualified offer made with respect to the tax liability at issue in the administrative or court proceeding. An award of reasonable administrative and litigation costs under the qualified offer rule only includes those costs incurred on or after the date of the last qualified offer and is limited to those costs attributable to the adjustments at issue at the time the last qualified offer was made that were included in the court's judgment other than by reason of settlement. The qualified offer rule is inapplicable to reasonable administrative or litigation costs otherwise awarded to a taxpayer who is a prevailing party under any other provision of section 7430(c)(4). This section sets forth the requirements to be satisfied for a taxpayer to be treated as a prevailing party by reason of the taxpayer making a qualified offer, as well as the circumstances leading to the application of the exceptions, special rules, and coordination provisions of the qualified offer rule. Furthermore, this section sets forth the elements necessary for an offer to be treated as a qualified offer under section 7430(g).

(b) *Requirements for treatment as a prevailing party based upon having made a qualified offer—*(1) *In general.* In order to be treated as a prevailing party by reason of having made a qualified offer, the liability of the taxpayer for the type or types of tax and the taxable year or years at issue in the proceeding (as calculated pursuant to paragraph (b)(2) of this section), based on the last qualified offer (as defined in paragraph (c) of this section) made by the taxpayer in the court or administrative proceeding, must equal or exceed the liability of the taxpayer pursuant to the judgment by the court for the same type or types of tax and the same taxable year or years (as calculated pursuant to paragraph (b)(3) of this section). Furthermore, the taxpayer must meet the timely filing and net worth requirements of section 7430(c)(4)(A)(ii). If all of the adjustments subject to the last qualified offer are settled prior to the entry of the judgment by the court, the taxpayer is not a prevailing party by reason of having made a qualified offer. The taxpayer may, however, still qualify as a prevailing party if the requirements of section 7430(c)(4)(A) are met. If one or more adjustments covered by a qualified offer (see paragraph (c)(3)) are settled following a ruling by the court that substantially resolves those ad-

justments, then those adjustments will not be treated as having been settled prior to the entry of the judgment by the court and instead will be treated as amounts included in the judgment as a result of the court's determinations. For purposes of the preceding sentence, rulings relating to discovery, admissibility of evidence, and burden of proof are not rulings that substantially resolve adjustments covered by a qualified offer.

(2) *Liability under the last qualified offer.* For purposes of paragraph (b)(1) of this section, the taxpayer's liability under the last qualified offer is the change in the taxpayer's liability that would have resulted if the United States had accepted the taxpayer's last qualified offer on all of the adjustments that were at issue in the administrative or court proceeding at the time that the offer was made compared to the amount shown on the return or returns (or as previously adjusted). The portion of a taxpayer's liability that is attributable to adjustments raised by either party after the making of the last qualified offer is not included in the calculation of the liability under that offer. The taxpayer's liability under the last qualified offer is calculated without regard to adjustments that the parties have stipulated will be resolved in accordance with the outcome of a separate pending Federal, state, or other judicial or administrative proceeding. For example, the parties may stipulate that the taxpayer's liability will be resolved in accordance with the outcome of an alternative dispute resolution proceeding or a separate court proceeding, such as a probate, tort liability, or trademark action. Furthermore, the taxpayer's liability under the last qualified offer is calculated without regard to interest, unless the taxpayer's liability for, or entitlement to, interest is a contested issue in the administrative or court proceeding and is one of the adjustments included in the last qualified offer.

(3) *Liability pursuant to the judgment.* For purposes of paragraph (b)(1) of this section, the taxpayer's liability pursuant to the judgment is the change in the taxpayer's liability resulting from amounts contained in the judgment as a result of the court's determinations, and amounts contained in settlements not included in the judgment, that are attributable to all adjustments that were included in the last qualified offer compared to the amount shown

on the return or returns (or as previously adjusted). This liability includes amounts attributable to adjustments included in the last qualified offer and settled by the parties prior to the entry of judgment regardless of whether those amounts are actually included in the judgment entered by the court. The taxpayer's liability pursuant to the judgment does not include amounts attributable to adjustments that are not included in the last qualified offer, even if those amounts are actually included in the judgment entered by the court. The taxpayer's liability under the judgment is calculated without regard to adjustments that the parties have stipulated will be resolved in accordance with the outcome of a separate pending Federal, state, or other judicial or administrative proceeding. Furthermore, the taxpayer's liability pursuant to the judgment is calculated without regard to interest, unless the taxpayer's liability for, or entitlement to, interest is a contested issue in the administrative or court proceeding and is one of the adjustments included in the last qualified offer. Where adjustments raised by either party subsequent to the making of the last qualified offer are included in the judgment entered by the court, or are settled prior to the court proceeding, the taxpayer's liability pursuant to the judgment is calculated by treating the subsequently raised adjustments as if they had never been raised.

(c) *Qualified offer*—(1) *In general.* A qualified offer is defined in section 7430(g) to mean a written offer which—

(i) Is made by the taxpayer to the United States during the qualified offer period;

(ii) Specifies the offered amount of the taxpayer's liability (determined without regard to interest, unless interest is a contested issue in the proceeding);

(iii) Is designated at the time it is made as a qualified offer for purposes of section 7430(g); and

(iv) By its terms, remains open during the period beginning on the date it is made and ending on the earliest of the date the offer is rejected, the date the trial begins, or the 90th day after the date the offer is made.

(2) *To the United States.* (i) A qualified offer is made to the United States when it is delivered to the office or personnel within the Internal Revenue Service, Office of Appeals, Office of Chief Counsel (including field personnel) or Depart-

ment of Justice that has jurisdiction over the tax matter at issue in the administrative or court proceeding. If those offices or persons are unknown to the taxpayer making the qualified offer, the taxpayer may deliver the offer to the appropriate office, as follows:

(A) If the taxpayer's initial pleading in a court proceeding has been answered, the taxpayer may deliver the offer to the office that filed the answer.

(B) If the taxpayer's petition in the Tax Court has not yet been answered, the taxpayer may deliver the offer to the Office of Chief Counsel, 1111 Constitution Avenue, NW, Washington, DC 20224.

(C) If the taxpayer's initial pleading in any Federal court, other than the Tax Court, has not yet been answered, the taxpayer may deliver the offer to the Attorney General of the United States, 950 Pennsylvania Ave., NW, Washington, DC 20530-0001. For a suit brought in a United States district court, a copy of the offer should also be delivered to the United States Attorney for the district in which the suit was brought.

(D) In any other situation, the taxpayer may deliver the offer to the office that sent the taxpayer the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

(ii) Until an offer is received by the appropriate personnel or office under this paragraph (c)(2), it is not considered to have been made, with the following exception. If the offer is deposited in the United States mail, in an envelope or other appropriate wrapper, postage prepaid, properly addressed to the appropriate personnel or office under this paragraph (c)(2), the date of the United States postmark stamped on the cover in which the offer is mailed shall be deemed to be the date of receipt of that offer by the addressee. If any offer is deposited with a designated delivery service, as defined in section 7502(f)(2), in lieu of the United States mail, the provisions of section 7502(f)(1) shall apply in determining whether that offer qualifies for this exception.

(3) *Specifies the offered amount.* A qualified offer specifies the offered amount if it clearly specifies the amount for the liability of the taxpayer, calculated as set forth in paragraph (b)(2) of

this section. The offer may be a specific dollar amount of the total liability or a percentage of the adjustments at issue in the proceeding at the time the offer is made. This amount must be with respect to all of the adjustments at issue in the administrative or court proceeding at the time the offer is made and only those adjustments. The specified amount must be an amount, the acceptance of which by the United States will fully resolve the taxpayer's liability, and only that liability (determined without regard to adjustments that the parties have stipulated will be resolved in accordance with the outcome of a separate pending Federal, state, or other judicial or administrative proceeding, or interest, unless interest is a contested issue in the proceeding) for the type or types of tax and the taxable year or years at issue in the proceeding. In cases involving multiple tax years, if adjustments in different tax years arise from separate and distinct issues such that the resolution of issues in one or more tax years will not affect the taxpayer's liability in one or more of the other tax years in the proceeding, then a qualified offer may be made for less than all of the tax years involved. A qualified offer, however, must resolve all of the issues for the tax years covered by the offer and also must cover all tax years in the proceeding affected by those issues. A tax year (affected year) is affected by an issue if the treatment of the issue in another tax year involved in the proceeding necessarily affects the treatment of the issue in the affected year.

(4) *Designated at the time it is made as a qualified offer.* An offer is not a qualified offer unless it designates in writing at the time it is made that it is a qualified offer for purposes of section 7430(g). An offer made at a time when one or more adjustments not included in the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals have been raised by the taxpayer and remain unresolved, is not considered to be a qualified offer unless contemporaneously or prior to the making of the offer, the taxpayer has provided the United States with the substantiation and legal and factual arguments necessary to allow for informed consideration of the merits of those adjustments. For example, a taxpayer will be considered to have

provided the United States with the necessary substantiation and legal and factual arguments if the taxpayer (or a recognized representative of the taxpayer described in §601.502 of this chapter) participates in an Appeals office conference, participates in an Area Counsel conference, or confers with the Department of Justice, and at that time, discloses all relevant information. All relevant information includes, but is not limited to, the legal and factual arguments supporting the taxpayer's position on any adjustments raised by the taxpayer after the issuance of the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals. A taxpayer has disclosed all relevant information if the taxpayer has supplied sufficient information to allow informed consideration of the taxpayer's tax matter to the extent the information and its relevance were known or should have been known to the taxpayer at the time of the conference.

(5) *Remains open.* A qualified offer must, by its terms, remain open for acceptance by the United States from the date it is made, as defined in paragraph (c)(2)(ii) of this section, until the earliest of the date it is rejected in writing by a person with authority to reject the offer, the date the trial begins, or the 90th day after being received by the United States. The offer, by its written terms, may remain open after the occurrence of one or more of the above-referenced events. Once made, the period during which a qualified offer remains open may be extended by the taxpayer prior to its expiration, but an extension cannot be used to make an offer meet the minimum period for remaining open required by this paragraph (c)(5).

(6) *Last qualified offer.* A taxpayer may make multiple qualified offers during the qualified offer period. For purposes of the comparison under paragraph (b) of this section, the making of a qualified offer supersedes any previously made qualified offers. In making the comparison described in paragraph (b) of this section, only the qualified offer made most closely in time to the end of the qualified offer period is compared to the taxpayer's liability under the judgment.

(7) *Qualified offer period.* To constitute a qualified offer, an offer must be made during the qualified offer period.

The qualified offer period begins on the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent to the taxpayer. For this purpose, the date of the notice of claim disallowance will begin the qualified offer period in a refund case. If there has been no notice of claim disallowance in a refund case, the qualified offer period begins on the date on which the answer or other responsive pleading is filed with the court. The qualified offer period ends on the date which is thirty days before the date the case is first set for trial. In determining when the qualified offer period ends for cases in the Tax Court and other Federal courts using calendars for trial, a case will be considered set for trial on the date scheduled for the calendar call. A case may be removed from a trial calendar at any time. Thus, a case may be removed from a trial calendar before the date that precedes by thirty days the date scheduled for that trial calendar. The qualified offer period does not end until the case remains on a trial calendar on the date that precedes by 30 days the scheduled date of the calendar call for that trial session. The qualified offer period may not be extended beyond the periods set forth in this paragraph (c)(7), although the period during which a qualified offer remains open may extend beyond the end of the qualified offer period.

(d) [Reserved].

(e) *Examples.* The following examples illustrate the provisions of this section:

Example 1. Definition of a judgment. The Internal Revenue Service (IRS) audits Taxpayer A for year X and issues a notice of proposed deficiency (30-day letter) proposing to disallow deductions 1, 2, 3, and 4. A files a protest and participates in a conference with the Internal Revenue Service Office of Appeals (Appeals). Appeals allows deduction 1, and issues a statutory notice of deficiency for deductions 2, 3, and 4. A's petition to the United States Tax Court for year X never mentions deduction 2. Prior to trial, A concedes deduction 3. After the trial, the Tax Court issues an opinion allowing A to deduct a portion of deduction 4. As used in paragraph (a) of this section, the term judgment means the cumulative determinations of the court concerning the adjustments at issue in the court proceeding. Thus, the term judgment does not include deduction 1 because it was never at issue in the court proceeding. Similarly, the term judgment does not include deduction 2 because it was not placed at issue by A in the court proceeding. Although deduction 3 was at issue in the court proceeding, it is not included in the term judgment because it was not determined by the court, but rather

by concession or settlement. For purposes of section 7430(c)(4)(E), the term judgment only includes the portion of deduction 4 disallowed by the Tax Court.

Example 2. Liability under the offer and liability under the judgment. Assume the same facts as in *Example 1* except that A makes a qualified offer after the Appeals conference, which is not accepted by the IRS. A's offer is with respect to all adjustments at issue at that time. Those adjustments are deductions 2, 3, and 4. At the conclusion of the litigation, A's entitlement to an award based upon the qualified offer will depend, among other things, on a comparison of the change in A's liability for income tax for year X resulting from the judgment of the Tax Court with the change that would have resulted had the IRS accepted A's qualified offer. In making this comparison, the term judgment (as discussed in *Example 1*) is modified by including the amounts of settled or conceded adjustments that were at issue at the time the qualified offer was made. Any settled or conceded adjustments that were not at issue at the time the qualified offer was made, either because the settlement or concession occurred before the offer or because the adjustment was not raised until after the offer, are not included in the comparison. Thus, A's offer on deductions 2, 3, and 4 is compared with the change in A's liability resulting from the Tax Court's determination of deduction 4, and the concessions of issues 2 and 3 by A.

Example 3. Offer must resolve full liability. Assume the same facts as in *Example 2* except that A's offer after the Appeals conference explicitly states that it is only with respect to adjustments 2 and 3 and not with respect to adjustment 4. Even if A's liability pursuant to the judgment, calculated under paragraph (b)(3) of this section as illustrated in *Example 2*, is equal to or less than it would have been had the IRS accepted A's offer after the Appeals conference, A is not a prevailing party under section 7430(c)(4)(E). A qualified offer must include all adjustments at issue at the time the offer is made. Since A's offer excluded adjustment 4, which was an adjustment at issue at the time the offer was made, it does not constitute a qualified offer pursuant to paragraph (b)(2) of this section.

Example 4. Offer must resolve full liability. Assume the same facts as in *Example 1*, except that A makes a qualified offer that is accepted by the IRS. After the offer is accepted, A attempts to reduce the amount A will pay pursuant to the offer by applying net operating loss carryovers to the years in issue. Because the net operating losses were not at issue when the offer was made, A's offer was a qualified offer. Whether A is entitled to apply net operating losses to reduce the amount stated in the offer will depend upon the application of contract principles, local court rules, and, because net operating losses are at issue, section 6511(d) and related provisions.

Example 5. Qualified offer rule for multiple tax years, partial resolution offer is a qualified offer. Taxpayer B receives a notice of deficiency for taxable years 2001, 2002, and 2003. For 2001, the statutory notice disallows business deductions. For 2002, the statutory notice increases income for unreported lottery winnings. For 2003, the statutory notice disallows a child care credit. B submits a qualified offer only with respect to 2002. Since the adjustments for the three tax years are separate and distinct, B may submit a qualified offer for a single year. If B's liability under the judgment is equal to

or less than the qualified offer with respect to 2002, irrespective of 2001 and 2003, B is a prevailing party for 2002 for purposes of section 7430(g). Assuming B satisfies the remaining requirements of section 7430, B may recover reasonable administrative and litigation costs that are attributable to 2002 from the date of the qualified offer. To qualify for any costs with respect to 2001 or 2003, B must satisfy the requirements of section 7430(c)(4).

Example 6. Qualified offer rule for multiple tax years, partial resolution offer is not a qualified offer. Assume the same facts as in *Example 5* except that with respect to 2002, in addition to increasing B's income for the unreported lottery winnings, the statutory notice also disallows a charitable contribution deduction. B submits a settlement offer that purports to be a qualified offer, but only covers the unreported lottery winnings. B's offer is not a qualified offer because it does not address the charitable contribution issue, and thus, does not fully resolve B's liability for 2002.

Example 7. Qualified offer rule for multiple tax years, partial resolution offer is not a qualified offer. Taxpayer C receives a notice of deficiency for taxable years 2001, 2002, and 2003 adjusting the amount of a depreciation deduction due to the Internal Revenue Service's increase to the recovery period. C submits a settlement offer relating only to 2003 that purports to be a qualified offer. C's offer is not a qualified offer because the issue in the three tax years is not separable given that the treatment of the issue in one of the years necessarily affects the treatment of the issue in the other years, and C's offer only applies to one of the years in the proceeding. In cases involving multiple tax years with nonseparable tax issues affecting all tax years, an offer is not a qualified offer unless it resolves the liability for all tax years at issue in the administrative or judicial proceeding.

Example 8. Qualified offer rule inapplicable when all issues settled. Taxpayer D receives a notice of proposed deficiency (30-day letter) proposing to disallow both a personal interest deduction in the amount of \$10,000 (Adjustment 1), and a charitable contribution deduction in the amount of \$2,000 (Adjustment 2), and to include in income \$4,000 of unreported interest income (Adjustment 3). D timely files a protest with Appeals. At the Appeals conference, D presents substantiation for the charitable contribution and presents arguments that the interest paid was deductible mortgage interest and that the interest received was held in trust for Taxpayer E. At the conference, D also provides the Appeals officer assigned to D's case a written offer to settle the case for a deficiency of \$2,000, exclusive of interest. The offer states that it is a qualified offer for purposes of section 7430(g) and that it will remain open for acceptance by the IRS for a period in excess of 90 days. After considering D's substantiation and arguments, the Appeals Officer accepts the \$2,000 offer to settle the case in full. Although D's offer is a qualified offer, because all three adjustments contained in the qualified offer were settled, the qualified offer rule is inapplicable.

Example 9. Qualified offer rule inapplicable when all issues contained in the qualified offer are settled; subsequently raised adjustments ignored. Assume the same facts as in *Example 8* except that D's qualified offer was for a deficiency of \$1,800 and the IRS rejected that offer. Subsequently, the IRS

issued a statutory notice of deficiency disallowing the three adjustments contained in *Example 8*, and, in addition, disallowing a home office expense in the amount of \$5,000 (Adjustment 4). After petitioning the Tax Court, D presents the field attorney assigned to the case with a written offer, which is not designated as a qualified offer for purposes of section 7430(g), to settle the three adjustments that had been the subject of the qualified offer, plus adjustment 4, for a total deficiency of \$2,500. After negotiating with D, a settlement is reached on the three adjustments that were the subject of the rejected qualified offer, for a deficiency of \$1,800. Adjustment 4 is litigated in the Tax Court and the court determines that D is entitled to the full \$5,000 deduction for that adjustment. Consequently, a decision is entered by the Tax Court reflecting the \$1,800 settlement amount, which matches exactly the amount of D's only qualified offer in the case. Although the determined liability for adjustments 1, 2, and 3, equals that of the rejected qualified offer, because all three adjustments contained in the qualified offer were settled, the qualified offer rule is inapplicable.

Example 10. Exclusion of adjustments made after the qualified offer is made. Assume the same facts as in *Example 9* except the settlement is reached only on adjustments 1 and 2, for a liability of \$1,500. Adjustments 3 and 4 are tried in the Tax Court and in accordance with the court's opinion, the taxpayer has a \$300 deficiency attributable to Adjustment 3, and a \$1,550 deficiency attributable to adjustment 4. Consequently, a decision is entered reflecting the \$1,500 settled amount, the \$300 liability on adjustment 3, and the \$1,550 liability on adjustment 4. The \$3,350 deficiency reflected in the Tax Court's decision exceeds the last (and only) qualified offer made by D. For purposes of determining whether D is a prevailing party as a result of having made a qualified offer in the proceeding, the liability attributable to adjustment 4, which was raised after the last qualified offer was made, is not included in the comparison of D's liability under the judgment with D's offered liability under the last qualified offer. Thus, D's \$1,800 liability under the judgment, as modified for purposes of the qualified offer rule comparison, is equal to D's offered liability under the last qualified offer. Because D's liability under the last qualified offer equals or exceeds D's liability under the judgment, as calculated under paragraph (b)(3) of this section, D is a prevailing party for purposes of section 7430. Assuming D satisfies the remaining requirements of section 7430, D may recover those reasonable administrative and litigation costs attributable to adjustment 3. To qualify for any further award of reasonable administrative and litigation costs, D must satisfy the requirements of section 7430(c)(4)(A).

Example 11. Qualified offer in a refund case. Taxpayer E timely files an amended return claiming a refund of \$1,000. This refund claim results from several omitted deductions which, if allowed, would reduce E's tax liability from \$10,000 to \$9,000. E receives a notice of claim disallowance and files a complaint with the appropriate United States District Court. Subsequently, E makes a qualified offer for a refund of \$500. The offer is rejected and after trial the court finds E is entitled to a refund of \$700. The change in E's liability from the tax shown on the return that would have resulted from the acceptance of E's qualified offer is a reduction in that liability of

\$500. The change in E's liability from the tax shown on the return resulting from the judgment of the court is a reduction in that liability of \$700. Because E's liability under the qualified offer exceeds E's liability under the judgment, E is a prevailing party for purposes of section 7430. Assuming E satisfies the remaining requirements of section 7430, E may recover those reasonable litigation costs incurred on or after the date of the qualified offer. To qualify for any further award of reasonable administrative and litigation costs E must satisfy the requirements of section 7430(c)(4)(A).

Example 12. End of qualified offer period when case is removed from Tax Court trial calendar more than 30 days before scheduled trial calendar. Taxpayer F has petitioned the Tax Court in response to the issuance of a notice of deficiency. F receives notice that the case will be heard on the July trial session in F's city of residence. The scheduled date for the calendar call for that trial session is July 1st. On May 15th, F's motion to remove the case from the July trial session and place it on the October trial session for that city is granted. The scheduled date for the calendar call for the October trial session is October 1st. On May 31st, F delivers a qualified offer to the field attorney assigned to the case. On August 31st, F delivers a revised qualified offer to the field attorney assigned to the case. Neither offer is accepted. The case is tried during the October trial session, and at some time thereafter, a decision is entered by the court. Assume the judgment in the case, as calculated under paragraph (b)(3) of this section, is greater than the amount offered, as calculated under paragraph (b)(2) of this section, in the qualified offer delivered on May 31st, but less than the amount offered, as similarly calculated, in the qualified offer delivered on August 31st. Because the qualified offer period did not end until September 1st, and the offer of August 31st otherwise satisfied the requirements of paragraph (c) of this section, the offer delivered on August 31st is a qualified offer. Furthermore, because the August 31st qualified offer is closer in time to the end of the qualified offer period than the May 31st qualified offer, the August 31st qualified offer is the last qualified offer made by F. Consequently, the August 31st offer is the qualified offer that is compared to the judgment for purposes of determining whether F is a prevailing party under section 7430(c)(4)(E). Because F's liability under the August 31st qualified offer equals or exceeds F's liability under the judgment as calculated under paragraph (b)(3) of this section, F is a prevailing party for purposes of section 7430.

Example 13. End of qualified offer period when case is removed from Tax Court trial calendar less than 30 days before scheduled trial calendar. Assume the same facts as in *Example 12* except that F's motion was granted on June 15th. Because the qualified offer period ended on June 1st when the case remained on the July trial session on the date that preceded by 30 days the scheduled date of the calendar call for that trial session, the offer delivered on May 31st was F's last qualified offer. The August 31st offer is not a qualified offer for purposes of this rule. Consequently, F is not a prevailing party under the qualified offer rule. Therefore, F must satisfy the requirements of section 7430(c)(4)(A) to qualify for any award of reasonable administrative and litigation costs.

Example 14. When a qualified offer can be made and to whom it must be made. During the examination of Taxpayer G's return, the IRS issues a notice of deficiency without having first issued a 30-day letter. After receiving the notice of deficiency, G timely petitions the Tax Court. The next day G mails an offer to the office that issued the notice of deficiency, which offer satisfies the requirements of paragraphs (c)(3) through (6) of this section. This is the only written offer made by G during the administrative or court proceeding, and by its terms it is to remain open for a period in excess of 90 days after the date of mailing to the office issuing the notice of deficiency. The office that issued the notice of deficiency transmitted the offer to the field attorney with jurisdiction over the Tax Court case. After answering the case, the field attorney refers the case to Appeals pursuant to Rev. Proc. 87-24, 1987-1 C.B. 720. See §601.601(d)(2)(ii)(b) of this chapter. After careful consideration, Appeals rejects the offer and holds a conference with G during which some adjustments are settled. The remainder of the adjustments are tried in the Tax Court and G's liability resulting from the Tax Court's determinations, when added to G's liability resulting from the settled adjustments, is less than G's liability would have been under the offer rejected by Appeals. Because the Tax Court case had not yet been answered when the offer was sent, G properly mailed the offer to the office that issued the notice of deficiency. Thus, G's offer satisfied the requirements of paragraph (c)(2) of this section. Furthermore, even though G did not receive a 30-day letter, G's offer was

made after the beginning of the qualified offer period, satisfying the requirements of paragraph (c)(7) of this section, because the issuance of the statutory notice provided G with notice of the IRS's determination of a deficiency, and the docketing of the case provided G with an opportunity for administrative review in the Internal Revenue Service Office of Appeals under Rev. Proc. 87-24. See §601.601(d)(2)(ii)(b) of this chapter. Because G's offer satisfied all of the requirements of paragraph (c) of this section, the offer was a qualified offer and G is a prevailing party.

Example 15. Substitution of parties permitted under last qualified offer. Taxpayer H receives a 30-day letter and participates in a conference with the Office of Appeals but no agreement is reached. Subsequently, H receives a notice of deficiency and petitions the Tax Court. Upon receiving the Internal Revenue Service's answer to the petition, H sends a qualified offer to the field attorney who signed the answer, by United States mail. The qualified offer stated that it would remain open for more than 90 days. Thirty days after making the offer, H dies and, on motion under Rule 63(a) of the Tax Court's Rules of Practice and Procedure by H's personal representative, I is substituted for H as a party in the Tax Court proceeding. I makes no qualified offers to settle the case and the case proceeds to trial, with the Tax Court issuing an opinion partially in favor of I. Even though I was not a party when the qualified offer was made by H, that offer constitutes a qualified offer because by its terms, when made, it was to remain open until at least the earlier of the date it is rejected, the date of

trial, or 90 days. If the liability of I under the qualified offer, as determined under paragraph (b)(2) of this section, equals or exceeds the liability under the judgment of the Tax Court, as determined under paragraph (b)(3) of this section, I will be a prevailing party for purposes of an award of reasonable litigation costs under section 7430.

(f) *Effective date.* This section is applicable with respect to qualified offers made in administrative or court proceedings described in section 7430 after December 24, 2003.

§301.7430-7T [Removed]

Par. 3. Section 301.7430-7T is removed.

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

Approved December 19, 2003.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 24, 2003, 8:45 a.m., and published in the issue of the Federal Register for December 29, 2003, 68 F.R. 74848)

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 2004-3

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

Notice 88-73, 1988-2 C.B. 383, provides guidelines for determining the

weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability.

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

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

The rate of interest on 30-year Treasury Securities for December 2003 is 5.07 percent. Pursuant to Notice 2002-26, 2002-1 C.B. 743, the Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2031.

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

| Month | Year | Weighted Average | 90% to 105% Permissible Range | 90% to 110% Permissible Range |
|---------|------|------------------|-------------------------------|-------------------------------|
| January | 2004 | 5.25 | 4.72 to 5.51 | 4.72 to 5.77 |

Drafting Information

The principal authors of this notice are Paul Stern and Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For fur-

ther information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through

Friday. Mr. Stern may be reached at 1-202-283-9703. Mr. Montanaro may be reached at 1-202-283-9714. The telephone numbers in the preceding sentences are not toll-free.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Regulations Governing Practice Before the Internal Revenue Service

REG-122379-02

AGENCY: Office of the Secretary, Treasury.

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

SUMMARY: This notice proposes modifications of the regulations governing practice before the Internal Revenue Service (Circular 230). These regulations affect individuals who are eligible to practice before the IRS. The proposed modifications set forth best practices for tax advisors providing advice to taxpayers relating to Federal tax issues or submissions to the IRS and modify the standards for certain tax shelter opinions. This document also provides notice of a public hearing regarding the proposed regulations.

DATES: Comments: Written or electronically generated comments must be received by February 13, 2004.

Public hearing: Outlines of topics to be discussed at the public hearing scheduled for February 18, 2004, in the Auditorium of the Internal Revenue Building at 1111 Constitution Avenue, NW, Washington, DC 20224, must be received by February 11, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-122379-02), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-122379-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at: www.irs.gov/reg.s.

FOR FURTHER INFORMATION CONTACT: Concerning issues for comment, Heather L. Dostaler or Bridget E. Tombul at (202) 622-4940; concerning submissions of comments, Guy Traynor of the Publications and Regulations Branch at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by March 1, 2004. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the Office of Professional Responsibility, including whether the information will have practical utility;

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

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

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

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

The collections of information (disclosure requirements) in these proposed regulations are in Sec. 10.35(d). Section 10.35(d) requires a practitioner providing a tax shelter opinion to make certain dis-

closures in the beginning of marketed tax shelter opinions, limited scope opinions and opinions that fail to conclude at a confidence level of at least more likely than not. In addition, certain relationships between the practitioner and a person promoting or marketing a tax shelter must be disclosed. A practitioner may be required to make one or more disclosure at the beginning of an opinion. The collection of this material helps to ensure that taxpayers who receive a tax shelter opinion are informed of any facts or circumstances that might limit the taxpayer's use of the opinion. The collection of information is mandatory.

Estimated total annual disclosure burden is 13,333 hours.

Estimated annual burden per disclosing practitioner varies from 5 to 10 minutes, depending on individual circumstances, with an estimated average of 8 minutes.

Estimated number of disclosing practitioners is 100,000.

Estimated annual frequency of responses is on occasion.

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

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

Background

Section 330 of title 31 of the United States Code authorizes the Secretary of the Treasury to regulate the practice of representatives before the Treasury Department. The Secretary has published the regulations in Circular 230 (31 CFR part 10). On February 23, 1984, the regulations were amended to provide standards for tax shelter opinions (49 FR 6719). On May 5, 2000, an advance notice of proposed rulemaking was published (REG-111835-99, published in the Bulletin as Announcement 2000-51, 2000-1 C.B. 1141 [65 FR 30375]) which requested comments

regarding amendments to the standards of practice governing tax shelters and other general matters. On January 12, 2001, a notice of proposed rulemaking (REG-111835-99, 2001-1 C.B. 834 [66 FR 3276]) was published that proposed amendments to the regulations relating to practice before the Internal Revenue Service in general and addressing tax shelter opinions in particular. On July 26, 2002, final regulations (T.D. 9011, 2002-2 C.B. 356 [67 FR 48760]) were issued incorporating only the non-tax shelter related matters. The IRS and the Treasury Department announced that regulations governing standards for tax shelter opinions would be proposed again at a later date.

This document proposes new proposed amendments to the standards governing tax shelter opinions and withdraws proposed amendments to §§10.33, 10.35 and 10.36 of the regulations governing practice before the IRS that were published in 2001. See 66 FR 3276 (Jan. 12, 2001).

Explanation of Provisions

Tax advisors play an increasingly important role in the Federal tax system, which is founded on principles of voluntary compliance. The tax system is best served when the public has confidence in the honesty and integrity of the professionals providing tax advice. To restore, promote, and maintain the public's confidence in those individuals and firms, these proposed regulations set forth best practices applicable to all tax advisors. These regulations also amend the mandatory requirements for practitioners who provide certain tax shelter opinions. These regulations are limited to practice before the IRS and do not alter or supplant other ethical standards applicable to practitioners.

The standards set forth in these proposed regulations differ from the January 12, 2001 proposed regulations in several ways. First, §10.33 prescribes best practices for all tax advisors. Second, §10.35 combines and modifies the standards applicable to marketed and more likely than not tax shelter opinions in former §10.33 (tax shelter opinions used to market tax shelters) and former §10.35 (more likely than not tax shelter opinions) of the January 12, 2001, proposed regulations. Third, these regulations revise proposed

§10.36, which provides procedures for ensuring compliance with §§10.33 and 10.35. Finally, provisions relating to advisory committees to the Office of Professional Responsibility are provided in new §10.37. The Treasury Department and the IRS will publish conforming amendments to §§10.22 and 10.52 in a separate notice of proposed rulemaking.

Best Practices

To ensure the integrity of the tax system, tax professionals should adhere to best practices when providing advice or assisting their clients in the preparation of a submission to the IRS. Section 10.33 describes the best practices to be observed by all tax advisors in providing clients with the highest quality representation. These best practices include: (1) communicating clearly with the client regarding the terms of the engagement and the form and scope of the advice or assistance to be rendered; (2) establishing the relevant facts, including evaluating the reasonableness of any assumptions or representations; (3) relating applicable law, including potentially applicable judicial doctrines, to the relevant facts; (4) arriving at a conclusion supported by the law and the facts; (5) advising the client regarding the import of the conclusions reached; and (6) acting fairly and with integrity in practice before the IRS.

Standards for Certain Tax Shelter Opinions

Section 10.35 prescribes requirements for practitioners providing *more likely than not* and *marketed* tax shelter opinions. A more likely than not tax shelter opinion is a tax shelter opinion that reaches a conclusion of at least more likely than not with respect to one or more material Federal tax issue(s). A marketed tax shelter opinion is a tax shelter opinion, including a more likely than not tax shelter opinion, that a practitioner knows, or has reason to know, will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending a tax shelter to one or more taxpayers.

Definition of Tax Shelter Opinion

These proposed regulations retain the definition of *tax shelter* proposed in January 2001 by applying the definition found in section 6662 to all taxes under the Internal Revenue Code. A number of commentators expressed concern that this definition is overly broad, encompasses routine tax matters, and is difficult to administer by practitioners and the IRS. After careful consideration of these issues, the Treasury Department and the IRS have determined that the definition in the proposed regulations best defines the scope of these regulations. Section 10.35 has been modified, however, to address commentators' concerns by excluding from the definition of a tax shelter opinion preliminary advice provided pursuant to an engagement in which the practitioner is expected subsequently to provide an opinion that satisfies the requirements of this section. In addition, under §10.35(a)(3)(ii), a practitioner may provide an opinion that is limited to some, but not all, material Federal tax issues that may be relevant to the treatment of a tax shelter item if the taxpayer and the practitioner agree to limit the scope of the opinion. Such a limited scope opinion cannot be a marketed tax shelter opinion, and all limited scope opinions must contain the appropriate disclosures described below.

Requirements for Tax Shelter Opinions

The requirements for all more likely than not and marketed tax shelter opinions include: (1) identifying and considering all relevant facts and not relying on any unreasonable factual assumptions or representations; (2) relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts and not relying on any unreasonable legal assumptions, representations or conclusions; (3) considering all material Federal tax issues and reaching a conclusion, supported by the facts and the law, with respect to each material Federal tax issue; and (4) providing an overall conclusion as to the Federal tax treatment of the tax shelter item or items and the reasons for that conclusion.

In addition to the exception to the requirements for limited scope opinions discussed above, in the case of a marketed tax shelter opinion, a practitioner is not expected to identify and ascertain facts pe-

cular to a taxpayer to whom the transaction is marketed, but the opinion must include the appropriate disclosure described below. Moreover, if a practitioner is unable to reach a conclusion with respect to one or more material Federal tax issue(s) or to reach an overall conclusion in a tax shelter opinion, the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues or to reach an overall conclusion and describe the reasons that the practitioner is unable to reach such a conclusion. If the practitioner fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more material Federal tax issue(s), the opinion must include the appropriate disclosures described below.

Required Disclosures

Section 10.35(d) provides disclosures that are required to be made in the beginning of marketed tax shelter opinions, limited scope opinions, and opinions that fail to reach a conclusion at a confidence level of at least more likely than not. In addition, certain relationships between the practitioner and a person promoting or marketing a tax shelter must be disclosed. A practitioner may be required to make more than one of the disclosures described below.

1. Relationship Between Practitioner and Promoter

Under §10.35(d)(1), a practitioner must disclose if the practitioner has a compensation arrangement with any person (other than the client for whom the opinion is prepared) with respect to the promoting, marketing or recommending of a tax shelter discussed in the opinion. A practitioner also must disclose if there is any referral agreement between the practitioner and any person (other than the client for whom the opinion is prepared) engaged in the promoting, marketing or recommending of the tax shelter discussed in the opinion.

2. Marketed Tax Shelter Opinion

Under §10.35(d)(2), a practitioner must disclose that a marketed opinion may not be sufficient for a taxpayer to use for the purpose of avoiding penalties under section 6662(d) of the Code. The practitioner also must state that taxpayers should seek advice from their own tax advisors.

3. Limited Scope Opinion

Under §10.35(d)(3), a practitioner must disclose in a limited scope opinion that additional issue(s) may exist that could affect the Federal tax treatment of the tax shelter addressed in the opinion, that the opinion does not consider or reach a conclusion with respect to those additional issues and that the opinion was not written, and cannot be used by the recipient, for the purpose of avoiding penalties under section 6662(d) of the Code with respect to those issues outside the scope of the opinion.

4. Opinions That Fail to Reach a Conclusion at a Confidence Level of at Least More Likely Than Not

Under §10.35(d)(4), a practitioner must disclose that the opinion fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more material Federal tax issue(s) addressed by the opinion and that the opinion was not written, and cannot be used by the recipient, for the purpose of avoiding penalties under section 6662(d) of the Code with respect to such issue(s).

Procedures to Ensure Compliance

Section 10.36 provides that tax advisors with responsibility for overseeing a firm's practice before the IRS should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices described in §10.33. In the case of tax shelter opinions, a practitioner with this oversight responsibility must take reasonable steps to ensure that the firm has adequate procedures in effect for purposes of complying with §10.35.

Advisory Committees on the Integrity of Tax Professionals

Section 10.37 authorizes the Director of the Office of Professional Responsibility to establish one or more advisory committees composed of at least five individuals authorized to practice before the IRS. Under procedures prescribed by the Director and at the request of the Director, an advisory committee may review and make recommendations regarding professional standards or best practices for tax advisors or may advise the Director

whether a practitioner may have violated §§10.35 or 10.36.

Proposed Effective Date

These regulations are proposed to apply on the date that final regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. Persons authorized to practice before the IRS have long been required to comply with certain standards of conduct. The added disclosure requirements for tax shelter opinions imposed by these regulations will not have a significant economic impact on a substantial number of small entities because, as previously noted, the estimated burden of disclosures is minimal. This is because practitioners have the information needed to determine whether some of the disclosures are required before the opinion is prepared and for the other disclosures the regulations provide practitioners with the language to be included in the opinion. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

Before the regulations are adopted as final regulations, consideration will be given to any written comments and electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

The public hearing is scheduled for February 18, 2004, at 10 a.m., and will be held in the Auditorium, Internal Revenue

Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. All visitors must present photo identification to enter the building. Visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by February 13, 2004, and submit an outline of the topics to be discussed and the time to be devoted to each topic by February 11, 2004. A period of 10 minutes will be allocated to each person for making comments.

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

Drafting Information

The principal authors of the regulations are Heather L. Dostaler, Bridget E. Tombul, and Brinton T. Warren of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division, but other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 31 CFR part 10 is proposed to be amended as follows

Paragraph 1. The authority citation for subtitle A, part 10 continues to read as follows:

[Authority: Sec. 3, 23 Stat. 258, secs. 2–12, 60 Stat. 237 *et. seq.*; 5 U.S.C. 301, 500, 551–559; 31 U.S.C. 330; Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949–1953 Comp., P. 1017.]

PART 10—PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Par. 2. Section 10.33 is revised to read as follows:

§10.33 Best practices for tax advisors.

(a) *Best practices.* Tax advisors should provide clients with the highest quality representation concerning Federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the Internal Revenue Service. Best practices include the following:

(1) Communicating clearly with the client regarding the terms of the engagement. For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.

(2) Establishing the facts, determining which facts are relevant, and evaluating the reasonableness of any assumptions or representations.

(3) Relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

(4) Arriving at a conclusion supported by the law and the facts.

(5) Advising the client regarding the import of the conclusions reached, including, for example, whether a taxpayer may avoid penalties for a substantial understatement of income tax under section 6662(d) of the Internal Revenue Code if a taxpayer acts in reliance on the advice.

(6) Acting fairly and with integrity in practice before the Internal Revenue Service.

(b) *Effective date.* This section is effective on the date that final regulations are published in the **Federal Register**.

Par. 3. Section 10.35 is added to read as follows:

§10.35 Requirements for certain tax shelter opinions.

(a) *In general.* A practitioner providing a *more likely than not tax shelter opinion* or a *marketed tax shelter opinion* must comply with each of the following requirements.

(1) *Factual matters.* (i) The practitioner must use reasonable efforts to identify and ascertain the facts, which may relate to future events if a transaction is prospective

or proposed, and determine which facts are relevant. The opinion must identify and consider all relevant facts.

(ii) The practitioner must not base the opinion on any unreasonable factual assumptions (including assumptions as to future events), such as a factual assumption that the practitioner knows or should know is incorrect or incomplete. For example, it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits, or to make an assumption with respect to a material valuation issue. In the case of any *marketed tax shelter opinion*, the practitioner is not expected to identify or ascertain facts peculiar to a taxpayer to whom the transaction may be marketed, but the opinion must include the appropriate disclosure(s) required under paragraph (d) of this section.

(iii) The practitioner must not base the opinion on any unreasonable factual representations, statements or findings of the taxpayer or any other person, such as a factual representation that the practitioner knows or should know is incorrect or incomplete. For example, a practitioner may not rely on a taxpayer's factual representation that a transaction has a business purpose if the representation fails to include a specific description of the business purpose or the practitioner knows or should know that the representation is incorrect or incomplete.

(2) *Relate law to facts.* (i) The practitioner must relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

(ii) The practitioner must not assume the favorable resolution of any material Federal tax issue except as provided in paragraphs (a)(3)(ii) and (b) of this section, or otherwise base an opinion on any unreasonable legal assumptions, representations, or conclusions.

(iii) The practitioner's opinion must not contain internally inconsistent legal analyses or conclusions.

(3) *Evaluation of material Federal tax issues.* (i) The practitioner must consider all material Federal tax issues except as provided in paragraphs (a)(3)(ii) and (b) of this section.

(ii) The practitioner may provide an opinion that considers less than all of the material Federal tax issues if—

(A) The taxpayer and the practitioner agree to limit the scope of the opinion to one or more Federal tax issue(s);

(B) The opinion is not a *marketed tax shelter opinion*; and

(C) The opinion includes the appropriate disclosure(s) required under paragraph (d) of this section.

(iii) The practitioner must provide his or her conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each material Federal tax issue. If the practitioner is unable to reach a conclusion with respect to one or more material Federal tax issue(s), the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues. The practitioner must describe the reasons for the conclusions, including the facts and analysis supporting the conclusions, or describe the reasons that the practitioner is unable to reach a conclusion as to one or more material Federal tax issue(s). If the practitioner fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more material Federal tax issue(s), the opinion must include the appropriate disclosure(s) required under paragraph (d) of this section.

(iv) The practitioner must not take into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled.

(4) *Overall conclusion.* The practitioner must provide an overall conclusion as to the likelihood that the Federal tax treatment of the tax shelter item or items is the proper treatment and the reasons for that conclusion. If the practitioner is unable to reach an overall conclusion, the opinion must state that the practitioner is unable to reach an overall conclusion and describe the reasons for the practitioner's inability to reach a conclusion.

(b) *Competence to provide opinion; reliance on opinions of others.* (1) The practitioner must be knowledgeable in all of the aspects of Federal tax law relevant to the opinion being rendered. If the practitioner is not sufficiently knowledgeable to render an informed opinion with respect to particular material Federal tax issues, the practitioner may rely on the opinion of another practitioner with respect to these issues unless the practitioner knows or should know that such opinion should not be relied on. If a practitioner relies on the opinion of an-

other practitioner, the relying practitioner must identify the other opinion and set forth the conclusions reached in the other opinion.

(2) The practitioner must be satisfied that the combined analysis of the opinions, taken as a whole, satisfies the requirements of this section.

(c) *Definitions.* For purposes of this section—

(1) A *practitioner* includes any individual described in §10.2(e).

(2) The term *tax shelter* includes any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code. A tax shelter may give rise to one or more tax shelter items.

(3) A *tax shelter item* is, with respect to a tax shelter, an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property.

(4) *Tax shelter opinion*—(i) *In general.* A *tax shelter opinion* is written advice by a practitioner concerning the Federal tax aspects of any Federal tax issue relating to a tax shelter item or items.

(ii) *Excluded advice.* A tax shelter opinion does not include written advice provided to a client during the course of an engagement pursuant to which the practitioner is expected subsequently to provide written advice to the client that satisfies the requirements of this section, or written advice concerning the qualification of a qualified plan.

(iii) *Included advice.* A tax shelter opinion includes the Federal tax aspects or tax risks portion of offering materials prepared by or at the direction of a practitioner. Similarly, a financial forecast or projection prepared by or at the direction of a practitioner is a tax shelter opinion if it is predicated on assumptions regarding Federal tax aspects of the investment.

(5) A *more likely than not tax shelter opinion* is a tax shelter opinion that reaches a conclusion at a confidence level of at least more likely than not (that is, greater than 50 percent) that one or more material Federal tax issues would be resolved in the taxpayer's favor.

(6) A *marketed tax shelter opinion* is a tax shelter opinion, including a more likely than not tax shelter opinion, that a practi-

tioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending the tax shelter to one or more taxpayers.

(7) A *material Federal tax issue* is any Federal tax issue for which the Internal Revenue Service has a reasonable basis for a successful challenge and the resolution of which could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstance, on the Federal tax treatment of a taxpayer's tax shelter item or items.

(d) *Required disclosures.* An opinion must contain all of the following disclosures that apply—(1) *Relationship between promoter and practitioner.* A practitioner must disclose in the beginning of the opinion the existence of—

(i) Any compensation arrangement, such as a referral fee or a fee-sharing arrangement, between the practitioner (or the practitioner's firm) and any person (other than the client for whom the opinion is prepared) with respect to the promoting, marketing or recommending of a tax shelter discussed in the opinion; or

(ii) Any referral agreement between the practitioner (or the practitioner's firm) and a person (other than the client for whom the opinion is prepared) engaged in the promoting, marketing or recommending of the tax shelter discussed in the opinion.

(2) *Marketed tax shelter opinions.* A practitioner must disclose in the beginning of a *marketed tax shelter opinion* that with respect to any material Federal tax issue for which the opinion reaches a conclusion at a confidence level of at least more likely than not—

(i) The opinion may not be sufficient for a taxpayer to use for the purpose of avoiding penalties relating to a substantial understatement of income tax under section 6662(d) of the Internal Revenue Code; and

(ii) Taxpayers should seek advice based on their individual circumstances with respect to those material Federal tax issues from their own tax advisor(s).

(3) *Limited scope opinions.* If a practitioner provides an opinion that is limited to one or more Federal tax issue(s) agreed to by the taxpayer and the practitioner, the practitioner must disclose in the beginning of the opinion that—

(i) The opinion is limited to the one or more Federal tax issue(s) agreed to by the taxpayer and the practitioner and addressed in the opinion;

(ii) Additional issue(s) may exist that could affect the Federal tax treatment of the tax shelter addressed in the opinion and the opinion does not consider or provide a conclusion with respect to any additional issue(s); and

(iii) With respect to any material Federal tax issue(s) outside the limited scope of the opinion, the opinion was not written, and cannot be used by the recipient, for the purpose of avoiding penalties relating to a substantial understatement of income tax under section 6662(d) of the Internal Revenue Code.

(4) *Opinions that fail to reach a more likely than not conclusion.* If a practitioner does not reach a conclusion at a confidence level of at least more likely than not with respect to a material Federal tax issue addressed by the opinion, the practitioner must disclose in the beginning of the opinion that—

(i) The opinion does not reach a conclusion at a confidence level of at least more likely than not that with respect to one or more material Federal tax issues addressed by the opinion; and

(ii) With respect to those material Federal tax issues, the opinion was not written, and cannot be used by the recipient, for the purpose of avoiding penalties relating to a substantial understatement of income tax under section 6662(d) of the Internal Revenue Code.

(e) *Effect of opinion that meets these standards.* An opinion that meets these requirements satisfies the practitioner's responsibilities under this section, but the persuasiveness of the opinion with regard to the tax issues in question and the taxpayer's good faith reliance on the opinion will be separately determined under applicable provisions of the law and regulations.

(f) *Effective date.* This section applies to tax shelter opinions rendered after the date that final regulations are published in the **Federal Register**.

Par. 4. Section 10.36 is added to read as follows:

§10.36 Procedures to ensure compliance.

(a) *Best practices for tax advisors.* Tax advisors with responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues or of preparing or assisting in the preparation of submissions to the Internal Revenue Service should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices described in §10.33.

(b) *Requirements for certain tax shelter opinions.* Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with §10.35. A practitioner will be subject to discipline for failing to comply with the requirements of this paragraph if—

(1) The practitioner through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with §10.35, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with §10.35; or

(2) The practitioner knows or has reason to know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a practice, in connection with their practice with the firm, that does not comply with §10.35 and the practitioner, through willfulness, recklessness, or gross incompetence fails to take prompt action to correct the noncompliance.

(c) *Effective date.* Paragraph (a) of this section is effective on the date that final regulations are published in the **Federal Register**. Paragraph (b) of this section applies to tax shelter opinions rendered after the date that final regulations are published in the **Federal Register**.

Par. 5. Section 10.37 is added to read as follows:

§10.37 Establishment of Advisory Committees.

(a) *Advisory committees.* To promote and maintain the public's confidence in tax advisors, the Director of the Office of Professional Responsibility is authorized to establish one or more advisory committees composed of at least five individuals authorized to practice before the Internal Revenue Service. Under procedures prescribed by the Director, an advisory committee may review and make recommendations regarding professional standards or best practices for tax advisors, or more particularly, whether a practitioner may have violated §§10.35 or 10.36.

(b) *Effective date.* This section is effective on the date that final regulations are published in the **Federal Register**.

Par. 6. Section 10.93 is revised to read as follows:

§10.93 Effective date.

Except as otherwise provided in each section and subject to §10.91, Part 10 is applicable on July 26, 2002.

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

Approved December 19, 2003.

George B. Wolfe,
*Deputy General Counsel,
Office of the Secretary.*

(Filed by the Office of the Federal Register on December 29, 2003, 8:45 a.m., and published in the issue of the Federal Register for December 30, 2003, 68 F.R. 75186)

Notice of Proposed Rulemaking

Gross Estate; Election to Value on Alternate Valuation Date

REG-139845-02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the election under section 2032 to value a decedent's gross estate on the alternate valuation date.

The proposed regulations reflect a change to the law made by the Deficit Reduction Act of 1984. The proposed regulations affect estates that are required to file Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*.

DATES: Written or electronic comments and requests for a public hearing must be received by March 24, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-139845-02), 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-139845-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at: www.irs.gov/regs.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Theresa Melchiorre, (202) 622-7830; concerning submissions of comments or to request a hearing, Treena Garrett, (202) 622-3401 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

As a general rule, section 2031 provides that the value of a decedent's gross estate is to be determined as of the date of the decedent's death. Section 2032 provides that the executor may elect to value the property on an alternate valuation date. Prior to the enactment of the Deficit Reduction Act of 1984, Public Law 98-369 (98 Stat. 494), section 2032(c) and §20.2032-1(b) of the Estate Tax Regulations required the election to be made on a timely filed estate tax return, including extensions of time to file actually granted. The Deficit Reduction Act amended section 2032, effective for estates of decedents dying after July 18, 1984, by redesignating section 2032(c) as section 2032(d) and amending section 2032(d) to provide that the election may be made on the estate tax return, whether it is filed timely or late, as long as the return is filed no more than 1 year after the

due date, including extensions. Temporary Regulation §301.9100-6T(b), issued on September 5, 1984, reflects this change to the law and provides a transition rule for estates of decedents dying before July 19, 1984. The temporary regulation, however, also provides that once a return that fails to make the election is filed, the election may not be made on a subsequent return unless the subsequent return is filed by the due date (including extensions) of the original return. This limitation is not found in §§301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations that apply to all requests for an extension of time to make an election submitted to the IRS on or after December 31, 1997.

The Deficit Reduction Act of 1984 also added new section 2032(c) that provides that, in the case of estates of decedents dying after July 18, 1984, the election to use the alternate valuation method may be made only if the election results in a reduction in both the value of the gross estate and the actual estate tax liability. The Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2085), amended section 2032(c)(2) to provide that the election may be made only if the election results in a decrease both in the value of the gross estate and in the sum of the estate tax and generation-skipping transfer tax liability (reduced by credits allowable against these taxes).

Explanation of Provisions

These proposed regulations will amend §20.2032-1(b) to reflect the change made to section 2032 by the Deficit Reduction Act of 1984. In addition, the proposed regulations, when finalized, will remove temporary regulation §301.9100-6T(b) of the Procedure and Administration Regulations so that estates that fail to make the alternate valuation election on the last estate tax return filed before the due date or the first return filed after the due date will be able to request an extension of time to make the election under the provisions of §§301.9100-1 and 301.9100-3. However, in view of the statutory 1 year limitation imposed under section 2032(d)(2), no request for an extension of time will be granted if the request is submitted to the IRS more than 1 year after the due date of the return (including extensions of time to

file actually granted). The proposed regulations also provide guidance on making a protective election under section 2032.

Special Analyses

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

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is Theresa Melchiorre, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 20 and 301 are proposed to be amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

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

Par. 2. Section 20.2032-1(b) is revised to read as follows:

§20.2032-1 *Alternate valuation.*

* * * * *

(b) *Method and effect of election*—(1) *In general.* The election to use the alternate valuation method is made on the return of tax imposed by section 2001. For purposes of this paragraph (b), the term *return of tax imposed by section 2001* means the last estate tax return filed by the executor on or before the due date of the return (including extensions of time to file actually granted) or, if a timely return is not filed, the first estate tax return filed by the executor after the due date, provided the return is filed no later than 1 year after the due date (including extensions of time to file actually granted). Once the election is made, it is irrevocable, provided that an election may be revoked on a subsequent return filed on or before the due date of the return (including extensions of time to file actually granted). The election may be made only if it will decrease both the value of the gross estate and the sum (reduced by allowable credits) of the estate tax and the generation-skipping transfer tax with respect to the property includible in the decedent's gross estate. If the election is made, the alternate valuation method applies to all property included in the gross estate and cannot be applied to only a portion of the property.

(2) *Protective election.* If, based on the return of tax as filed, use of the alternate valuation method would not result in a decrease in both the value of the gross estate and the sum (reduced by allowable credits) of the estate tax and the generation-skipping transfer tax liability of the estate, a protective election may be made to use the alternate valuation method if it is subsequently determined that such a decrease

would occur. A protective election made on the return of tax imposed by section 2001 is irrevocable, provided that it may be revoked on a subsequent return filed on or before the due date of the return (including extensions of time to file actually granted). Absent such revocation, if it is later determined that use of the alternate valuation method would result in a decrease in both the value of the gross estate and in the sum (reduced by allowable credits) of the estate tax and generation-skipping transfer tax liability of the estate, the protective election becomes effective and cannot thereafter be revoked.

(3) *Requests for extension of time to make the election.* A request for an extension of time to make the election pursuant to §§301.9100-1 and 301.9100-3 of this chapter will not be granted unless the request is submitted to the Internal Revenue Service no later than 1 year after the due date of the return (including extensions of time to file actually granted).

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PART 301—PROCEDURE AND ADMINISTRATION

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

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

§301.9100-6T [Amended]

Par. 4. Section 301.9100-6T is amended by:

1. Removing the language “paragraph (b)(2)” from paragraph (a)(2) introductory text, and adding the language “paragraph (a)(2)” in its place.

2. Removing paragraph (b).

3. Redesignating paragraphs (c) through (s) as paragraphs (b) through (r), respectively.

4. Removing the language “paragraph (c)(2)” from the last sentence in newly designated paragraph (b)(2) and adding the language “paragraph (b)(2)” in its place.

5. Removing the language “paragraph (l)” from the second, fourth and last sentences in newly designated paragraph (k) and adding the language “paragraph (k)” in its place.

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

(Filed by the Office of the Federal Register on December 23, 2003, 8:45 a.m., and published in the issue of the Federal Register for December 24, 2003, 68 F.R. 74534)

Withdrawal of Previous Proposed Rules; Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing

Information Reporting Relating to Taxable Stock Transactions

REG-143321-02; REG-156232-03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of previous proposed rules; notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: This document withdraws proposed regulations published in the **Federal Register** on November 18, 2002 (REG-143321-02, 2002-2 C.B. 922). In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9101) relating to information reporting relating to taxable stock transactions. This document contains proposed regulations under section 6043(c) requiring information reporting by a corporation if control of the corporation is acquired or if the corporation has a recapitalization or other substantial change in capital structure. This document also contains proposed regulations under section 6045 concerning information reporting requirements for brokers with respect to transactions described in section 6043(c). The text of the temporary regulations serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by March 29, 2004. Outlines of topics to be discussed at the public hearing scheduled for March 31, 2004, at 10 a.m., must be received by March 10, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-156232-03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-156232-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at www.irs.gov/regs. The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Nancy L. Rose (202) 622-4910; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Robin Jones at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The forms referenced in these regulations have been, or will be, approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

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.

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

Background

This document withdraws the Notice of Proposed Rulemaking (REG-143321-02) that was published in the **Federal Register** on November 18, 2002 (67 FR 65496). Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR Part 1) relating to sections

6043 and 6045. The temporary regulations set forth information reporting requirements relating to acquisitions of control and substantial changes in capital structure. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments and these proposed regulations.

On November 18, 2002, the IRS published temporary regulations under section 6043(c) (T.D. 9022, 2002-2 C.B. 909). The transactions covered by the reporting requirement were certain acquisitions of control and substantial changes in the capital structure of a corporation. These regulations required a corporation to attach a form to its income tax return describing these transactions and to file information returns with respect to certain shareholders in such transactions. On November 18, 2002, the IRS also published temporary regulations under section 6045, which provided for information reporting with respect to these transactions by brokers (together with the section 6043(c) temporary regulations, the "2002 temporary regulations"). The 2002 temporary regulations were effective for acquisitions of control and substantial changes in capital structure occurring after December 31, 2001, if the reporting corporation or any shareholder was required to recognize gain (if any) as a result of the application of section 367(a) as a result of the transaction.

The text of the 2002 temporary regulations also served as the text of proposed regulations set forth in a cross-referencing notice of proposed rulemaking published in the Proposed Rules section of the same issue of the **Federal Register** (2002 proposed regulations) (REG-143321-02). The provisions of the proposed regulations were proposed to be effective with respect to any acquisition of control or substantial change in capital structure occurring after the date on which final regulations would be published in the **Federal Register**. The preamble to the notice of proposed rulemaking invited public comments with respect to the potential for duplicate reporting and with respect to the burden of compliance with the reporting requirements.

The IRS received a number of written public comments with respect to the information reporting requirements set forth in the 2002 temporary and proposed regulations. In addition, the IRS met

with representatives of the Information Reporting Program Advisory Committee (IRPAC) and other representatives of the securities industry to discuss their concerns and suggestions for revisions to the regulations.

After considering the issues concerning affected taxpayers, the IRS has decided to revise the 2002 temporary regulations. The revised temporary regulations set forth information reporting rules that will help ensure that brokers and shareholders receive information regarding these corporate transactions, without unduly burdening brokers and other members of the securities industry. The text of the revised temporary regulations also serves as the text of these proposed regulations (reproposed regulations).

Summary of Comments and Explanation of Provisions

The commentators noted certain gaps in the transmission of information under the 2002 temporary and proposed regulations between corporations subject to reporting and brokers. Information reporting by brokers depends upon the effective dissemination of information from the corporation to the reporting community, and broker reporting is difficult to effectuate if there are gaps in the process of transmitting this information.

As provided in the 2002 temporary and proposed regulations, a reporting corporation would file Forms 1099-CAP, "*Changes in Corporate Control and Capital Structure*," with respect to its shareholders of record, including brokers, under §1.6043-4T(b) and proposed §1.6043-4(b). Brokers who received Forms 1099-CAP would then file Forms 1099-CAP with respect to their customers pursuant to §1.6045-3T and proposed §1.6045-3. The commentators pointed out that a large majority of U.S. publicly issued securities are actually held on behalf of brokerage firms through clearing organizations. Pursuant to the 2002 temporary and proposed regulations, clearing organizations would receive Forms 1099-CAP from the reporting corporation; however, because clearing organizations are not treated as brokers, they in turn would not be required under §1.6045-3T and reproposed §1.6045-3 to file Forms 1099-CAP with respect to their

broker-members. Consequently, brokers (who had the requirement to file a Form 1099-CAP upon receiving one) would not receive Form 1099-CAP if they held their shares through a clearing organization. In addition, brokers may not be aware of the requirement to report with respect to a particular corporate transaction, or may have difficulty obtaining the information necessary for reporting. Thus, under the 2002 temporary and proposed regulations, the actual shareholders of the reporting corporation, the broker's customers, may not receive information returns to assist them in preparing their income tax returns.

To address this issue, commentators suggested an alternative procedure to ensure that brokers receive the required information for reporting and to bridge any potential gaps in the chain of reporting. Commentators recommended that the IRS act as a central repository of information necessary for brokers and issue a publication containing information needed for brokers to satisfy their reporting obligations. Brokers and commercial tax services that publish current developments could access this information, and brokers could use this information in preparing Forms 1099-CAP with respect to their customers. An alternative suggested by commentators was to require the reporting corporation to post essential information for reporting, from its Form 8806, "*Information Return for Acquisition of Control or Substantial Change in Capital Structure*," to an IRS website.

Based on the comments, revised §1.6043-4T(a)(1)(vi) and repropoed §1.6043-4(a)(1)(vi) provide that reporting corporations may elect on Form 8806 to consent to the publication by the IRS of information necessary for brokers to file information returns with respect to their customers. To provide every corporation with the ability to make this election, the revised temporary regulations require reporting corporations to file Form 8806 even though the corporation may also report the transaction under sections 351, 355, or 368. In order to enable the IRS to publish the information timely, the revised temporary regulations require reporting corporations to file Form 8806 within 45 days after the transaction, and in no event later than January 5 of the year following the calendar year in which the transaction occurs.

The role of clearing organizations was also the subject of comments. Commentators suggested that the regulations utilize existing processes for distributing information to minimize the cost of and the time required for implementing reporting by the industry. Those existing processes include the dissemination of information by clearing organizations. Under current practices, important information regarding corporate transactions (including tax information) is disseminated by clearing organizations to their members. The revised temporary and repropoed regulations try to take advantage of this existing information flow by continuing to require corporations to provide a Form 1099-CAP to clearing organizations that are listed as shareholders of record at the time of an acquisition of control or substantial change in capital structure. It is anticipated that clearing organizations will disseminate information obtained from the Form 1099-CAP to their members and that broker-members will use that information (and information obtained from other sources) to satisfy their own reporting obligations under §1.6045-3T and repropoed §1.6045-3. Under the revised regulations, a broker is required to report information if the broker knows or has reason to know, based on readily available information, that there was an acquisition of control or substantial change in capital structure with respect to shares held by the broker on behalf of a customer. If a clearing organization disseminates information identifying an acquisition of control or a substantial change in capital structure to a broker-member, the broker-member has readily available information about the transaction and must satisfy its reporting obligations under §1.6045-3T and repropoed §1.6045-3 with respect to the transaction.

The revised temporary and repropoed regulations provide that a reporting corporation is not required to file Forms 1099-CAP with respect to its shareholders which are clearing organizations, or to furnish Forms 1099-CAP to such clearing organizations, if the corporation makes the election to permit the IRS to publish information regarding the transaction. The IRS' publication of such information pursuant to the corporation's consent will provide readily available information for

brokers, who must satisfy their reporting obligations with respect to the transaction.

Commentators also requested that brokers be permitted to utilize Form 1099-B for reporting under §1.6045-3T and repropoed §1.6045-3, rather than overhaul their systems to report on Form 1099-CAP. The commentators point out that this would also avoid any confusion stemming from the issuance of both types of forms to the same taxpayer in the same transaction. The revised temporary regulations and repropoed regulations provide that Form 1099-B should be used by brokers for reporting under §1.6045-3T and repropoed §1.6045-3. With respect to transactions occurring in 2003, brokers may use either Form 1099-B or 1099-CAP.

Proposed Effective Date

The provisions of these regulations are proposed to be applicable for any acquisition of control and change in capital structure occurring after the date on which these regulations are published in the **Federal Register** as final regulations.

Special Analyses

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

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of

the proposed rules and how they can be made easier to understand. Comments are particularly requested with respect to the ability of brokers to obtain the information necessary for reporting under the proposed rules. All comments will be available for public inspection and copying. A public hearing has been scheduled for March 31, 2004, beginning at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by March 10, 2004. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the

deadline for reviewing outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of this notice of proposed rulemaking is Nancy L. Rose, Office of Associate Chief Counsel (Procedure and Administration).

* * * * *

Withdrawal of a Previous Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking published in the **Federal Register** on November 18, 2002 (REG-143321-02) is withdrawn.

Proposed Amendments to the Regulations

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

PART 1— INCOME TAXES

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

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

Par. 2. Section 1.6043-4 is added to read as follows:

§1.6043-4 Information returns relating to certain acquisitions of control and changes in capital structure.

[The text of proposed §1.6043-4 is the same as the text of §1.6043-4T published elsewhere in this issue of the Bulletin]

Par. 3. Section 1.6045-3 is added to read as follows:

§1.6045-3 Information reporting for acquisitions of control or substantial changes in capital structure.

[The text of proposed §1.6045-3 is the same as the text of §1.6045-3T published elsewhere in this issue of the Bulletin]

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

(Filed by the Office of the Federal Register on December 29, 2003, 8:45 a.m., and published in the issue of the Federal Register for December 30, 2003, 68 F.R. 75182)

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

Announcement 2004-6

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.

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

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

| Name | Address | Designation | Effective Date |
|-------------------|-----------------|-------------|------------------|
| Baxley II, Milton | Gainesville, FL | CPA | October 24, 2003 |

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 |
|-------------------------|-------------------|----------------|-------------------------------------|
| Nietupski, John E. | Springfield, MA | Enrolled Agent | Indefinite from October 15, 2005 |
| Roberts, Dennis C. | Oklahoma City, OK | Attorney | Indefinite from October 27, 2003 |
| Waldo-Grant, Barbara A. | Grand Rapids, MI | Enrolled Agent | Indefinite from November 1, 2003 |
| Naylor, Dale C. | El Cajon, CA | Enrolled Agent | Indefinite from November 12, 2003 |
| Schlude, Richard M. | Wilkes Barre, PA | Enrolled Agent | Indefinite from November 19, 2003 |
| Stern, Samuel L. | Robbinsdale, MN | Attorney | Indefinite from November 19, 2003 |
| Robles, Michael | Dallas, TX | CPA | Indefinite from December 1, 2003 |
| Young Jr., Donald A. | Redondo Beach, CA | Enrolled Agent | December 1, 2003 to August 31, 2004 |
| Hitchcock, William C. | Irvine, CA | Enrolled Agent | Indefinite from December 30, 2003 |

| Name | Address | Designation | Date of Suspension |
|-------------------|----------------|----------------|--|
| Willms, Bryant E. | Lee Summit, MO | Enrolled Agent | January 1, 2004 to December 31, 2004 |

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date

the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

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

| Name | Address | Designation | Date of Suspension |
|-------------------------|--------------------|----------------|---|
| Greene, Marvin | Chicago, IL | CPA | Indefinite from October 21, 2003 |
| Bolusky, Eric B. | Perkins, OK | Attorney | Indefinite from October 21, 2003 |
| Crutchfield Jr., Ernest | Latty, OH | Enrolled Agent | Indefinite from October 21, 2003 |
| Covey, Charles | Gladstone, MO | CPA | Indefinite from October 23, 2003 |
| Prosperi, Arnold P. | Jupiter Island, FL | Attorney | Indefinite from November 24, 2003 |
| Lucas, Christopher | Overland Park, KS | Attorney | Indefinite from November 24, 2003 |
| Ramsey, Henry A. | Burnet, TX | CPA | Indefinite from December 15, 2003 |

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the In-

ternal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

| Name | Address | Date of Designation |
|-----------------------|----------------|---------------------|
| Pettyplace, Edward F. | Sacramento, CA | January 30, 2004 |

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 List¹

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2003–27 through 2003–52 is in Internal Revenue Bulletin 2003–52, dated December 29, 2003.

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¹ A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2003-27 through 2003-52 is in Internal Revenue Bulletin 2003-52, dated December 29, 2003.