

## **HIGHLIGHTS OF THIS ISSUE**

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

### **INCOME TAX**

#### **Rev. Rul. 2007-25, page 956.**

**Low-income housing credit; satisfactory bond; “bond factor” amounts for the period January through June 2007.** This ruling provides the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through June 2007.

#### **Rev. Rul. 2007-26, page 970.**

**ICE Futures; United Kingdom.** This ruling holds that ICE Futures, which is a United Kingdom Recognised Investment Exchange, is a qualified board or exchange within the meaning of section 1256(g)(7)(C) of the Code.

#### **T.D. 9316, page 962.**

#### **REG-146247-06, page 977.**

Final, temporary, and proposed regulations under section 368 of the Code provide guidance regarding the satisfaction of the continuity of interest requirement for corporate reorganizations. The regulations provide that in determining whether a proprietary interest in the target corporation is preserved, the consideration to be exchanged for the proprietary interests in the target corporation shall be valued on the last business day before there is a binding contract that contains fixed consideration.

#### **T.D. 9317, page 957.**

Final and temporary regulations concern the application of section 199 of the Code, which provides a deduction for income attributable to domestic production activities. The regulations provide guidance on certain transactions involving online software and clarify the rules regarding the application of section 199 to agricultural and horticultural cooperatives.

#### **REG-158677-05, page 975.**

Proposed regulations under section 1361 of the Code clarify that if a bank is an S corporation within the meaning of section 1361(a)(1), its status as an S corporation does not affect the applicability of the special rules for banks under the Code.

#### **Notice 2007-31, page 971.**

This notice announces a new working arrangement for the automatic exchange of information entered into between the Service and the U.S. Virgin Islands Bureau of Internal Revenue. Because of this new working arrangement, the notice provides new interim rules, pending the issuance of regulations under sections 932(c) and 7654(e) of the Code, concerning the statute of limitations on assessment with respect to taxpayers claiming to be *bona fide* residents of the U.S. Virgin Islands for taxable years ending on or after December 31, 2006. Taxpayers may rely on this notice until regulations are issued. Notice 2007-19 amended and supplemented.

#### **Rev. Proc. 2007-28, page 974.**

This document provides guidance to individuals who fail to meet the eligibility requirements of section 911(d)(1) of the Code because adverse conditions in a foreign country preclude the individual from meeting those requirements. A current list of countries for tax year 2006 and the dates those countries are subject to the section 911(d)(4) waiver is provided.

### **ADMINISTRATIVE**

#### **Announcement 2007-40, page 978.**

This document contains corrections to temporary regulations (T.D. 9313, 2007-13 I.R.B. 805) that provide guidance regarding the qualification of certain transactions as reorganizations described in section 368(a)(1)(D) of the Code where no stock and/or securities of the acquiring corporation are issued and distributed in the transaction.

**Announcements of Disbarments and Suspensions begin on page 978.**  
**Finding Lists begin on page ii.**



# The IRS Mission

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

applying the tax law with integrity and fairness to all.

## Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

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

### **Part II.—Treaties and Tax Legislation.**

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

### **Part III.—Administrative, Procedural, and Miscellaneous.**

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

### **Part IV.—Items of General Interest.**

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

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

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

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

## Section 42.—Low-Income Housing Credit

**Low-income housing credit; satisfactory bond; “bond factor” amounts for the period January through June 2007.** This ruling provides the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through June 2007.

### Rev. Rul. 2007–25

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided

guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of bond factor amounts for dispositions occurring during each calendar month.

Rev. Proc. 99–11, 1999–1 C.B. 275, established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of

the low-income housing tax credits under § 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99–11 for dispositions of qualified low-income buildings or interests therein during the period January through June 2007.

Table 1 Rev. Rul. 2007–25 Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits											
	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Jan '07	17.39	32.44	45.52	56.97	66.95	69.23	71.86	74.74	78.09	81.82	85.82
Feb '07	17.39	32.44	45.52	56.97	66.95	69.08	71.70	74.56	77.89	81.60	85.57
Mar '07	17.39	32.44	45.52	56.97	66.95	68.92	71.53	74.39	77.71	81.40	85.33
Apr '07	17.39	32.44	45.52	56.97	66.95	68.77	71.37	74.22	77.52	81.19	85.11
May '07	17.39	32.44	45.52	56.97	66.95	68.62	71.22	74.05	77.35	81.00	84.89
Jun '07	17.39	32.44	45.52	56.97	66.95	68.47	71.06	73.89	77.17	80.81	84.68

Table 1 (cont'd) Rev. Rul. 2007–25 Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits											
	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	2004	2005	2006	2007							
Jan '07	89.79	93.41	96.70	97.21							
Feb '07	89.50	93.07	96.27	97.21							
Mar '07	89.22	92.75	95.89	97.21							
Apr '07	88.96	92.46	95.57	97.21							
May '07	88.72	92.18	95.28	97.21							
Jun '07	88.48	91.93	95.02	97.21							

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see: Rev. Rul. 98-3, 1998-1 C.B. 248; Rev. Rul. 2001-2, 2001-1 C.B. 255; Rev. Rul. 2001-53, 2001-2 C.B. 488; Rev. Rul. 2002-72, 2002-2 C.B. 759; Rev. Rul. 2003-117, 2003-2 C.B. 1051; Rev. Rul. 2004-100, 2004-2 C.B. 718; Rev. Rul. 2005-67, 2005-2 C.B. 771; and Rev. Rul. 2006-51, 2006-41 I.R.B. 632.

#### DRAFTING INFORMATION

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

## Section 199.—Income Attributable to Domestic Production Activities

26 CFR 1.199-3: Domestic production gross receipts.

### T.D. 9317

#### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

#### Computer Software Under Section 199(c)(5)(B)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations concerning the application of section 199 of the Internal Revenue Code, which provides a deduction for income attributable to domestic production activities. The final regulations are necessary to provide guidance regarding certain transactions involving online software and to clarify the rules regarding the application of section 199 to certain cooperatives. The regulations will affect taxpayers engaged

in certain domestic production activities involving computer software and taxpayers engaged in certain domestic production activities in cooperative form.

**DATES: Effective Date:** These regulations are effective March 20, 2007.

**Applicability Date:** For dates of applicability, see §1.199-8(i)(4) and (i)(7).

**FOR FURTHER INFORMATION CONTACT:** Paul Handleman or Lauren Ross Taylor, (202) 622-3040 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document amends 26 CFR part 1 to provide rules relating to the deduction for income attributable to domestic production activities under section 199 of the Internal Revenue Code (Code). Section 199 was added to the Code by section 102 of the American Jobs Creation Act of 2004 (Public Law 108-357, 118 Stat. 1418), and amended by section 403(a) of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 25) and section 514 of the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109-222, 120 Stat. 345). On June 1, 2006, the IRS and Treasury Department published in the **Federal Register** final regulations under section 199 (T.D. 9263, 2006-25 I.R.B. 1063 [71 FR 31268]). Also on June 1, 2006, the IRS and Treasury Department published in the **Federal Register** temporary and proposed regulations under section 199 providing guidance on certain transactions involving computer software (T.D. 9262, 2006-24 I.R.B. 1040 [71 FR 31074] and REG-111578-06, 2006-24 I.R.B. 1060 [71 FR 31128], respectively). Written and electronic comments responding to the temporary and proposed regulations were received. After consideration of the comments, the proposed regulations are adopted as amended by this Treasury decision.

##### General Overview

Section 199(a)(1) allows a deduction equal to 9 percent (3 percent in the case of taxable years beginning in 2005 or 2006, and 6 percent in the case of taxable years

beginning in 2007, 2008, or 2009) of the lesser of (A) the qualified production activities income (QPAI) of the taxpayer for the taxable year, or (B) taxable income (determined without regard to section 199) for the taxable year (or, in the case of an individual, adjusted gross income (AGI)).

##### Qualified Production Activities Income

Section 199(c)(1) defines QPAI for any taxable year as an amount equal to the excess (if any) of (A) the taxpayer's domestic production gross receipts (DPGR) for such taxable year, over (B) the sum of (i) the cost of goods sold (CGS) that are allocable to such receipts; and (ii) other expenses, losses, or deductions (other than the deduction under section 199) that are properly allocable to such receipts.

Section 199(c)(4)(A)(i) defines DPGR, in part, to mean the taxpayer's gross receipts that are derived from any lease, rental, license, sale, exchange, or other disposition of qualifying production property (QPP) that was manufactured, produced, grown, or extracted (MPGE) by the taxpayer in whole or in significant part within the United States. Section 199(c)(5) defines QPP to mean: (A) tangible personal property; (B) any computer software; and (C) any property described in section 168(f)(4) (certain sound recordings).

##### Patrons of Certain Cooperatives

Section 199(d)(3)(A) provides that any person who receives a qualified payment from a specified agricultural or horticultural cooperative shall be allowed for the taxable year in which such payment is received a deduction under section 199(a) equal to the portion of the deduction allowed under section 199(a) to such cooperative which is (i) allowed with respect to the portion of the QPAI to which such payment is attributable, and (ii) identified by such cooperative in a written notice mailed to such person during the payment period described in section 1382(d).

Section 199(d)(3)(B) provides that the taxable income of a specified agricultural or horticultural cooperative shall not be reduced under section 1382 by reason of that portion of any qualified payment as does not exceed the deduction allowable under section 199(d)(3)(A) with respect to such payment.

Section 199(d)(3)(C) provides that, for purposes of section 199, the taxable income of a specified agricultural or horticultural cooperative shall be computed without regard to any deduction allowable under section 1382(b) or (c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions).

Section 199(d)(3)(E) provides that, for purposes of section 199(d)(3), the term *qualified payment* means, with respect to any person, any amount that (i) is described in section 1385(a)(1) or (3), (ii) is received by such person from a specified agricultural or horticultural cooperative, and (iii) is attributable to QPAI with respect to which a deduction is allowed to such cooperative under section 199(a).

#### *Authority to Prescribe Regulations*

Section 199(d)(8) authorizes the Secretary to prescribe such regulations as are necessary to carry out the purposes of section 199, including regulations that prevent more than one taxpayer from being allowed a deduction under section 199 with respect to any activity described in section 199(c)(4)(A)(i).

#### *Temporary Regulations*

Section 1.199-3T(i)(6)(ii) provides that gross receipts derived from customer and technical support, telephone and other telecommunication services, online services (such as Internet access services, online banking services, providing access to online electronic books, newspapers, and journals), and other similar services do not constitute gross receipts derived from a lease, rental, license, sale, exchange, or other disposition of computer software.

However, §1.199-3T(i)(6)(iii) provides two exceptions under which gross receipts derived by a taxpayer from providing computer software to customers for the customers' direct use while connected to the Internet will be treated as being derived from the lease, rental, license, sale, exchange, or other disposition of such computer software. Such gross receipts will be treated as DPGR if all the other requirements of section 199 are met (for example, the taxpayer MPGE computer software in whole or in significant part within the United States).

The exception in §1.199-3T(i)(6)(iii)(A) applies to a taxpayer that

derives gross receipts from providing computer software to customers for the customers' direct use while connected to the Internet (online software) and also derives gross receipts from customers that are unrelated to the taxpayer from the lease, rental, license, sale, exchange, or other disposition of computer software affixed to a tangible medium or downloaded from the Internet. The exception in §1.199-3T(i)(6)(iii)(B) applies if a taxpayer derives gross receipts from providing online software and an unrelated person derives, on a regular and ongoing basis in the unrelated person's business, gross receipts from the lease, rental, license, sale, exchange, or other disposition of substantially identical software to its customers affixed to a tangible medium or by allowing its customers to download the substantially identical computer software from the Internet.

Section 1.199-3T(i)(6)(iv) defines substantially identical software as computer software that, from a customer's perspective, has the same functional result as the online software and has a significant overlap of features or purpose with the online software. Section 1.199-3T(i)(6)(iv)(B) provides a safe harbor under which all computer software games are deemed to be substantially identical software.

The exceptions outlined in §1.199-3T(i)(6)(iii) permit gross receipts derived from providing online software to be treated as gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of software. However, because the rules for online software are exceptions, all other provisions of the temporary and final regulations do not necessarily apply to online software. Specifically, §1.199-3T(i)(6)(iv)(E) provides that the computer software maintenance agreement exception provided in §1.199-3(i)(4)(i)(B)(5) does not apply to online software. Section 1.199-3(i)(4)(i)(B)(5) provides that a taxpayer may include in DPGR, the gross receipts derived from services performed pursuant to a qualified computer software maintenance agreement.

#### **Summary of Comments and Explanation of Provisions**

A commentator suggested that the online software exceptions should apply to

transactions where access to computer software is provided over any public or private communications network and not just the Internet. The final regulations adopt this suggestion.

A commentator suggested that the final regulations provide an example where computer software would not be considered substantially identical software. This suggestion has been adopted.

Commentators noted that, in the future, some computer software will only be available over the Internet. In addition, newly developed computer software provided over the Internet may not have a substantially identical counterpart. The IRS and Treasury Department recognize that the computer software industry is evolving and current industry trends may result in a more limited applicability of the online software exceptions provided in the final regulation. However, there are significant differences between transactions which provide customers with access to online software and transactions involving the transfer of software to customers affixed to a tangible medium or by download. Accordingly, in order to give meaning to the statutory language requiring a lease, rental, license, sale, exchange, or other disposition, the online software exceptions have been narrowly tailored and are intended to apply only to gross receipts derived from providing customers access to computer software for the customers' direct use while connected to the Internet and only when the taxpayer (or another person) also derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of the computer software (or substantially identical software) affixed to a tangible medium or by download. The final regulations clarify that, with respect to online software, taxpayers are providing customers with access to the taxpayers' software as opposed to actually transferring the software to customers either affixed to a tangible medium or by allowing them to download the computer software from the Internet.

Commentators suggested that the rule in §1.199-3T(i)(6)(iv)(E), precluding the application of the qualified computer software maintenance provision to online software, be deleted because it places taxpayers providing access to online software at a competitive disadvantage with taxpayers providing computer software to customers

either affixed to a tangible medium or by allowing them to download the computer software from the Internet. In addition, commentators suggest that the advertising exception in §1.199-3(i)(5) should be extended to include online software. The final regulations do not adopt these suggestions. As previously noted, the online software exceptions have been narrowly tailored and the IRS and Treasury Department do not believe the exceptions should be extended beyond gross receipts derived from providing customers access to computer software for the customers' direct use. Therefore, the final regulations do not extend the exception for qualified computer software maintenance agreements in §1.199-3(i)(4)(i)(B)(5) or the advertising exception in §1.199-3(i)(5) to online software.

The final regulations in §1.199-3(i)(5)(ii)(B) do, however, extend the advertising exception to computer software that is provided to customers either affixed to a tangible medium (for example, a disk or DVD) or by allowing them to download the computer software from the Internet. However, the advertising exception only applies to advertising placed or integrated into software that is either affixed to a tangible medium or provided through download and does not apply to advertising incorporated into online software. In addition, the IRS and Treasury Department have clarified that, except as otherwise provided in §1.199-3(i)(5)(ii), gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of QPP, a qualified film, or utilities do not include advertising income or product-placement income.

A commentator expressed concern that the exception for qualified computer software maintenance agreements in §1.199-3(i)(4)(i)(B)(5) does not apply if the taxpayer separately offers maintenance in subsequent years. The mere fact that a taxpayer separately offers maintenance in subsequent years does not preclude eligibility for the exception.

A commentator interpreted the rule in §1.199-3T(i)(6)(iii)(E) as possibly treating gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of future updates, cyclical releases, and rewrites of the underlying software as non-DPGR if the underlying software is online software. The rule in

§1.199-3T(i)(6)(iii)(E) only provides that the qualified computer software maintenance agreement exception does not apply to online software. Therefore, to the extent a taxpayer providing online software derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of future updates, cyclical releases, and rewrites of the underlying software, the gross receipts are DPGR assuming all the other requirements of §1.199-3 are met.

A commentator noted that *Example 6* in the temporary regulations concludes that the gross receipts derived from storage of customers' data and telephone support are non-DPGR. *Example 6* is silent as to the amount of gross receipts derived from the storage of customers' data and telephone support and does not address whether the *de minimis* exception in §1.199-3(i)(4)(i)(B)(6) is available. Numerous examples in the final regulations under section 199 also conclude that gross receipts are non-DPGR without reference to the *de minimis* exception in §1.199-3(i)(4)(i)(B)(6). However, assuming all the requirements are met, the *de minimis* exception in §1.199-3(i)(4)(i)(B)(6) can apply when an example concludes the gross receipts are non-DPGR.

The IRS and Treasury Department received a comment letter on the application of section 199 to agricultural and horticultural cooperatives under §1.199-6 of the final regulations (71 FR 31312) published on June 1, 2006. The commentator noted that the sentence in §1.199-6(h) stating that the cooperative may not apply section 199(d)(3) and §1.199-6 to any portion of the section 199 deduction that is not passed through to its patrons is inconsistent with section 199(d)(3) which has no such limitation. These final regulations amend §1.199-6(h) to remove the sentence.

In addition, consistent with the change to §1.199-6(h), these final regulations amend §1.199-6(l) to remove the phrase, "To the extent a cooperative passes through the section 199 deduction to a patron" and add the phrase, "by the patron."

The final regulations also amend §1.199-6(c) to clarify that a cooperative's QPAI is computed without taking into account any deduction allowable under

section 1382(b) or (c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions).

### Effective Date

Section 199 applies to taxable years beginning after December 31, 2004. These final regulations are applicable for taxable years beginning on or after March 20, 2007. In addition, §1.199-8(i)(1) provides that, in certain circumstances, a taxpayer may rely on the guidance in Notice 2005-14, 2005-1 C.B. 498, see §601.602(d)(2), the proposed regulations under section 199 that were published in the **Federal Register** on November 4, 2005 (REG-105847-05, 2005-2 C.B. 987 [70 FR 67220]), or the final regulations under section 199 that were published in the **Federal Register** on June 1, 2006 (71 FR 31268). Regardless of which guidance a taxpayer applies, the taxpayer may apply these final regulations to taxable years beginning after December 31, 2004, and before March 20, 2007.

### 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 this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation 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 Paul Handleman and Lauren Ross Taylor, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

**PART 1—INCOME TAXES**

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

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

Par. 2. Section 1.199-0 is amended by:

1. Revising the entries for §§1.199-3(i)(5)(i) and (ii), 1.199-3(i)(6)(ii) through (v), 1.199-6(c), and 1.199-8(i)(4).

2. Adding a new entry for §1.199-8(i)(7).

The revisions and addition read as follows:

*§1.199-0 Table of contents.*

\* \* \* \* \*

*§1.199-3 Domestic production gross receipts.*

\* \* \* \* \*

(i) \* \* \*

(5) \* \* \*

(i) In general.

(ii) Exceptions.

(A) Tangible personal property.

(B) Computer software.

(C) Qualified film.

\* \* \* \* \*

(6) \* \* \*

(ii) Gross receipts derived from services.

(iii) Exceptions.

(iv) Definitions and special rules.

(A) Substantially identical software.

(B) Safe harbor for computer software games.

(C) Regular and ongoing basis.

(D) Attribution.

(E) Qualified computer software maintenance agreements.

(F) Advertising income and product-placement income.

(v) Examples.

\* \* \* \* \*

*§1.199-6 Agricultural and horticultural cooperatives.*

\* \* \* \* \*

(c) Determining cooperative's qualified production activities income and taxable income.

\* \* \* \* \*

*§1.199-8 Other rules.*

\* \* \* \* \*

(i) \* \* \*

(4) Computer software.

\* \* \* \* \*

(7) Agricultural and horticultural cooperatives.

\* \* \* \* \*

Par. 3. Section 1.199-3 is amended by:

1. Revising paragraphs (i)(5)(i) and (i)(5)(ii).

2. Removing the language "(i)(5)(ii)" each place it appears in paragraph (i)(5)(iii) and adding the language "(i)(5)(ii)(C)" in its place.

3. Revising paragraphs (i)(6)(ii), (i)(6)(iii), (i)(6)(iv), and (i)(6)(v).

The revisions read as follows:

*§1.199-3 Domestic production gross receipts.*

\* \* \* \* \*

(i) \* \* \*

(5) \* \* \*

(i) *In general.* Except as provided in paragraph (i)(5)(ii) of this section, gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of QPP, a qualified film, or utilities do not include advertising income and product-placement income.

(ii) *Exceptions—(A) Tangible personal property.* A taxpayer's gross receipts that are derived from the lease, rental, license, sale, exchange, or other disposition of newspapers, magazines, telephone directories, periodicals, and other similar printed publications that are MPGE in whole or in significant part within the United States include advertising income from advertisements placed in those media, but only if the gross receipts, if any, derived from the lease, rental, license, sale, exchange, or other disposition of the newspapers, magazines, telephone directories, or periodicals are (or would be) DPGR.

(B) *Computer software.* A taxpayer's gross receipts that are derived from the

lease, rental, license, sale, exchange, or other disposition of computer software that is MPGE in whole or in significant part within the United States include advertising income and product-placement income with respect to that computer software, but only if the gross receipts, if any, derived from the lease, rental, license, sale, exchange, or other disposition of computer software are (or would be) DPGR. For this purpose, advertising income and product-placement income mean compensation for placing or integrating advertising or a product into the computer software. This paragraph (i)(5)(ii)(B) does not extend to the exceptions provided in paragraph (i)(6)(iii) of this section. See paragraph (i)(6)(iv)(F) of this section.

(C) *Qualified film.* A taxpayer's gross receipts that are derived from the lease, rental, license, sale, exchange, or other disposition of a qualified film include advertising income and product-placement income with respect to that qualified film, but only if the gross receipts, if any, derived from the lease, rental, license, sale, exchange, or other disposition of a qualified film are (or would be) DPGR. For this purpose, advertising income and product-placement income mean compensation for placing or integrating advertising or a product into the qualified film.

\* \* \* \* \*

(6) \* \* \*

(ii) *Gross receipts derived from services.* Gross receipts derived from customer and technical support, telephone and other telecommunication services, online services (such as Internet access services, online banking services, providing access to online electronic books, newspapers, and journals), and other similar services do not constitute gross receipts derived from a lease, rental, license, sale, exchange, or other disposition of computer software.

(iii) *Exceptions.* Notwithstanding paragraph (i)(6)(ii) of this section, if a taxpayer derives gross receipts from providing customers access to computer software MPGE in whole or in significant part by the taxpayer within the United States for the customers' direct use while connected to the Internet or any other public or private communications network (online software), then such gross receipts will be treated as being derived from the lease,

rental, license, sale, exchange, or other disposition of computer software only if—

(A) The taxpayer also derives, on a regular and ongoing basis in the taxpayer's business, gross receipts from the lease, rental, license, sale, exchange, or other disposition to customers that are not related persons (as defined in paragraph (b)(1) of this section) of computer software that—

(1) Has only minor or immaterial differences from the online software;

(2) Has been MPGE by the taxpayer in whole or in significant part within the United States; and

(3) Has been provided to such customers either affixed to a tangible medium (for example, a disk or DVD) or by allowing them to download the computer software from the Internet; or

(B) Another person derives, on a regular and ongoing basis in its business, gross receipts from the lease, rental, license, sale, exchange, or other disposition of substantially identical software (as described in paragraph (i)(6)(iv)(A) of this section) (as compared to the taxpayer's online software) to its customers pursuant to an activity described in paragraph (i)(6)(iii)(A)(3) of this section.

(iv) *Definitions and special rules*—(A) *Substantially identical software*. For purposes of paragraph (i)(6)(iii)(B) of this section, *substantially identical software* is computer software that—

(1) From a customer's perspective, has the same functional result as the online software described in paragraph (i)(6)(iii) of this section; and

(2) Has a significant overlap of features or purpose with the online software described in paragraph (i)(6)(iii) of this section.

(B) *Safe harbor for computer software games*. For purposes of paragraph (i)(6)(iv)(A) of this section, all computer software games are deemed to be substantially identical software. For example, computer software sports games are deemed to be substantially identical to computer software card games.

(C) *Regular and ongoing basis*. For purposes of paragraph (i)(6)(iii) of this section, in the case of a newly-formed trade or business or a taxpayer in its first taxable year, the taxpayer is considered to be engaged in an activity described in paragraph (i)(6)(iii) of this section on a regular and ongoing basis if the taxpayer

reasonably expects that it will engage in the activity on a regular and ongoing basis.

(D) *Attribution*. For purposes of paragraph (i)(6)(iii)(A) of this section—

(1) All members of an expanded affiliated group (as defined in §1.199-7(a)(1)) are treated as a single taxpayer; and

(2) In the case of an EAG partnership (as defined in §1.199-3T(i)(8)), the EAG partnership and all members of the EAG to which the EAG partnership's partners belong are treated as a single taxpayer.

(E) *Qualified computer software maintenance agreements*. Paragraph (i)(4)(i)(B)(5) of this section does not apply if the computer software is online software under paragraph (i)(6)(iii) of this section.

(F) *Advertising income and product-placement income*. Paragraph (i)(5)(ii)(B) of this section does not apply if the computer software is online software under paragraph (i)(6)(iii) of this section. If a taxpayer provides a customer with access to online software in conjunction with providing computer software to such customer either affixed to a tangible medium or by download, paragraph (i)(5)(ii)(B) of this section will only apply to compensation for the placement or integration of advertising or a product into the computer software transferred to such customer either affixed to the tangible medium or by download.

(v) *Examples*. The following examples illustrate the application of this paragraph (i)(6):

*Example 1.* L is a bank and produces computer software within the United States that enables its customers to receive online banking services for a fee. Under paragraph (i)(6)(ii) of this section, gross receipts derived from online banking services are attributable to a service and do not constitute gross receipts derived from a lease, rental, license, sale, exchange, or other disposition of computer software. Therefore, L's gross receipts derived from the online banking services are non-DPGR.

*Example 2.* M is an Internet auction company that produces computer software within the United States that enables its customers to participate in Internet auctions for a fee. Under paragraph (i)(6)(ii) of this section, gross receipts derived from online auction services are attributable to a service and do not constitute gross receipts derived from a lease, rental, license, sale, exchange, or other disposition of computer software. M's activities constitute the provision of online services. Therefore, M's gross receipts derived from the Internet auction services are non-DPGR.

*Example 3.* N provides telephone services, voice-mail services, and e-mail services. N produces computer software within the United States that runs all

of these services. Under paragraph (i)(6)(ii) of this section, gross receipts derived from telephone and related telecommunication services are attributable to a service and do not constitute gross receipts derived from a lease, rental, license, sale, exchange, or other disposition of computer software. Therefore, N's gross receipts derived from the telephone and other telecommunication services are non-DPGR.

*Example 4.* O produces tax preparation computer software within the United States. O derives, on a regular and ongoing basis in its business, gross receipts from both the sale to customers that are unrelated persons of O's computer software that has been affixed to a compact disc as well as from the sale to customers of O's computer software that customers have downloaded from the Internet. O also derives gross receipts from providing customers access to the computer software for the customers' direct use while connected to the Internet. The computer software sold on compact disc or by download has only minor or immaterial differences from the online software, and O does not provide any other goods or services in connection with the online software. Under paragraph (i)(6)(iii)(A) of this section, O's gross receipts derived from providing access to the online software will be treated as derived from the lease, rental, license, sale, exchange, or other disposition of computer software and are DPGR (assuming all the other requirements of this section are met).

*Example 5.* The facts are the same as in *Example 4*, except that O does not sell the tax preparation computer software to customers affixed to a compact disc or by download. In addition, one of O's competitors, P, derives, on a regular and ongoing basis in its business, gross receipts from the sale to customers of P's substantially identical tax preparation computer software that has been affixed to a compact disc as well as from the sale to customers of P's substantially identical tax preparation computer software that customers have downloaded from the Internet. Under paragraph (i)(6)(iii)(B) of this section, O's gross receipts derived from providing access to its tax preparation online software will be treated as derived from the lease, rental, license, sale, exchange, or other disposition of computer software and are DPGR (assuming all the other requirements of this section are met).

*Example 6.* Q produces payroll management computer software within the United States. For a fee, Q provides customers access to the payroll management computer software for the customers' direct use while connected to the Internet. This is Q's sole method of providing access to its payroll management computer software to customers. In conjunction with the payroll management computer software, Q provides storage of customers' data and telephone support. One of Q's competitors, R, derives, on a regular and ongoing basis in its business, gross receipts from the sale to customers of R's substantially identical payroll management software that has been affixed to a compact disc as well as from the sale to customers of R's substantially identical payroll management software that customers have downloaded from the Internet. Under paragraph (i)(6)(iii)(B) of this section, Q's gross receipts derived from providing access to its payroll management online software will be treated as derived from the lease, rental, license, sale, exchange, or other disposition of computer software and are DPGR (assuming all the other requirements



of this section are met). However, Q's gross receipts derived from the fees that are properly allocable to the storage of customers' data and telephone support are non-DPGR.

*Example 7.* The facts are the same as in *Example 6*, except that R produces inventory computer software, not payroll management computer software. R's inventory computer software is not substantially identical software as defined in paragraph (i)(6)(iv)(A) of this section because R's inventory software, from a customer's perspective, does not have the same functional result as Q's payroll management computer software and does not have significant overlap of features or purpose with Q's payroll management computer software. No other person provides substantially identical software to customers affixed to a compact disc or by download. Under paragraph (i)(6)(ii) of this section, gross receipts derived from providing access to Q's payroll online software do not constitute gross receipts derived from a lease, rental, license, sale, exchange or other disposition of payroll computer software. Therefore, Q's gross receipts derived from the payroll management computer software are non-DPGR.

*Example 8.* S produces computer software games within the United States. S derives, on a regular and ongoing basis in its business, gross receipts from both the sale to customers that are not related to S of S's computer software games that have been affixed to a compact disc as well as from the sale to customers of S's computer software games that customers have downloaded from the Internet. S also derives gross receipts from providing customers access to the computer software games for the customers' direct use while connected to the Internet (online software games). The computer software games sold on compact disc or by download have only minor or immaterial differences from the online software games, and S does not provide any other goods or services in connection with the online software games. Under paragraph (i)(6)(iii)(A) of this section, S's gross receipts derived from providing customers access to its online software games will be treated as derived from the lease, rental, license, sale, exchange, or other disposition of computer software and are DPGR (assuming all the other requirements of this section are met).

*Example 9.* The facts are the same as in *Example 8*, except S's gross receipts also include advertising income from integrating advertisers' logos into the computer software games. Under paragraph (i)(5)(ii)(B) of this section, for S's computer software games sold affixed to a compact disc or by download, S's advertising income is treated as gross receipts derived from the sale of the computer software games and, therefore, is DPGR (assuming all the other requirements of this section are met). However, under paragraphs (i)(5)(i) and (i)(6)(iv)(F) of this section, for S's online software games, S's advertising income is not derived from the lease, rental, license, sale, exchange, or other disposition of computer software and, therefore, is non-DPGR.

Par. 4. Section 1.199-3T is amended by revising paragraphs (i)(1), (i)(2), (i)(3), (i)(4), (i)(5), and (i)(6) to read as follows:

*§1.199-3T Domestic production gross receipts (temporary).*

\* \* \* \* \*

(i) *Derived from the lease, rental, license, sale, exchange or other disposition.*

(1) through (6) [Reserved]. For further guidance, see §1.199-3(i)(1) through (6).

\* \* \* \* \*

Par. 5. Section 1.199-6 is amended by:

1. Revising paragraphs (c) and (l).

2. Removing the language "qualified production activities income (QPAI) (as defined in §1.199-1(c))" from paragraph (e) and adding "QPAI" in its place.

3. Removing the language "However, the cooperative may not apply section 199(d)(3) and this section to any portion of the section 199 deduction that is not passed through to its patrons." from paragraph (h).

The revisions read as follows:

*§1.199-6 Agricultural and horticultural cooperatives.*

\* \* \* \* \*

(c) *Determining cooperative's qualified production activities income and taxable income.* For purposes of determining its section 199 deduction, the cooperative's qualified production activities income (QPAI) (as defined in §1.199-1(c)) and taxable income are computed without taking into account any deduction allowable under section 1382(b) or (c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions).

\* \* \* \* \*

(l) *No double counting.* A qualified payment received by a patron of a cooperative is not taken into account by the patron for purposes of section 199.

Par. 6. Section 1.199-8 is amended by:

1. Revising paragraph (i)(4).

2. Adding new paragraph (i)(7).

The revision and addition read as follows:

*§1.199-8 Other rules.*

\* \* \* \* \*

(i) \* \* \*

(4) *Computer software.* Section 1.199-3(i)(5)(ii)(B) and (i)(6)(ii) through (v) are applicable for taxable years beginning on or after March 20, 2007. A

taxpayer may apply §1.199-3(i)(5)(ii)(B) and (i)(6)(ii) through (v) to taxable years beginning after December 31, 2004, and before March 20, 2007.

\* \* \* \* \*

(7) *Agricultural and horticultural cooperatives.* Section 1.199-6(c) is applicable for taxable years beginning on or after March 20, 2007. A taxpayer may apply §1.199-6(c) to taxable years beginning after December 31, 2004, and before March 20, 2007.

Par. 7. Section 1.199-8T is amended by revising paragraphs (i)(1), (i)(2), (i)(3), and (i)(4) to read as follows:

*§1.199-8T Other rules (temporary).*

\* \* \* \* \*

(i) *Effective dates.* (1) through (4) [Reserved]. For further guidance, see §1.199-8(i)(1) through (4).

\* \* \* \* \*

Kevin M. Brown,  
Deputy Commissioner for  
Services and Enforcement.

Approved March 14, 2007.

Eric Solomon,  
Assistant Secretary  
of the Treasury.

(Filed by the Office of the Federal Register on March 19, 2007, 8:45 a.m., and published in the issue of the Federal Register for March 20, 2007, 72 F.R. 12969)

## Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

### T.D. 9316

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

### Corporate Reorganizations; Guidance on the Measurement of Continuity of Interest

AGENCY: Internal Revenue Service (IRS), Treasury.

**ACTION:** Final and temporary regulations.

**SUMMARY:** This document contains final and temporary regulations that provide guidance regarding the satisfaction of the continuity of interest requirement for corporate reorganizations. These regulations affect corporations and their shareholders. The text of the temporary regulations also serves as the text of the proposed regulations (REG-146247-06) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

**DATES:** *Effective Date:* These regulations are effective March 20, 2007.

*Applicability Date:* For dates of applicability, see §1.368-1T(e)(8)(ii).

**FOR FURTHER INFORMATION CONTACT:** Lisa S. Dobson at (202) 622-7790 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

### **Background and Explanation of Provisions**

The Internal Revenue Code of 1986 (Code) provides general nonrecognition treatment for reorganizations described in section 368 of the Code. In addition to complying with the statutory and certain other requirements, to qualify as a reorganization, a transaction generally must satisfy the continuity of interest (COI) requirement. COI requires that, in substance, a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization.

On August 10, 2004, the IRS and Treasury Department published a notice of proposed rulemaking (REG-129706-04, 2004-2 C.B. 479) in the **Federal Register** (69 FR 48429) (2004 proposed regulations) identifying certain circumstances in which the determination of whether a proprietary interest in the target corporation is preserved would be made by reference to the value of the issuing corporation's stock on the day before there is an agreement to effect the potential reorganization. On September 16, 2005, the IRS and Treasury Department published final regulations in the **Federal Register** (T.D. 9225, 2005-2 C.B. 716 [70 FR 54631]) (2005 final regulations) which retained the general

framework of the 2004 proposed regulations but made several modifications in response to the comments received regarding the proposed regulations. Specifically, the 2005 final regulations provide that in determining whether a proprietary interest in the target corporation is preserved, the consideration to be exchanged for the proprietary interests in the target corporation pursuant to a contract to effect the potential reorganization is valued on the last business day before the first date such contract is a binding contract (the signing date), if the contract provides for fixed consideration (the signing date rule).

After consideration of comments relating to the 2005 final regulations, the IRS and Treasury Department are revising those regulations as set forth in this Treasury decision. These temporary regulations provide guidance for measuring whether the COI requirement is satisfied. The following sections specifically describe the revisions.

#### *A. Applicability of the Signing Date Rule*

For purposes of determining whether COI is satisfied, the 2005 final regulations require the consideration to be exchanged for the proprietary interests in the target corporation to be valued on the last business day before the first date such contract is a binding contract, if such contract provides for fixed consideration. As noted in the preamble to the 2005 final regulations, the signing date rule is based on the principle that, where a binding contract provides for fixed consideration, the target corporation shareholders can generally be viewed as being subject to the economic fortunes of the issuing corporation as of the signing date. However, if the contract does not provide for fixed consideration, the signing date value of the issuing corporation stock is not relevant for purposes of determining the extent to which a proprietary interest in the target corporation is preserved.

These temporary regulations continue to apply the signing date rule where the contract provides for fixed consideration. If the contract does not provide for fixed consideration, the temporary regulations provide that the signing date rule is not applicable. Further, these temporary regulations clarify that where fixed consideration includes other property that is identified by

value, that specified value is the value of such other property to be used in determining whether COI is satisfied.

#### *B. Definition of Fixed Consideration*

As noted above, the temporary regulations provide that the signing date rule only applies to contracts that provide for fixed consideration. These temporary regulations modify the definition of fixed consideration.

The 2005 final regulations provide four circumstances in which a contract will be treated as providing for fixed consideration. Generally, under the 2005 final regulations, a contract provides for fixed consideration if (1) the contract states the number of shares of the issuing corporation plus the amount of money and any other property to be exchanged for all proprietary interests in the target corporation; (2) the contract states the number of shares of the issuing corporation plus the amount of money and any other property to be exchanged for each proprietary interest in the target corporation; (3) the contract states the percentage of proprietary interests in the target corporation to be exchanged for stock of the issuing corporation; or (4) the contract states the percentage of each proprietary interest in the target corporation to be exchanged for stock of the issuing corporation.

These temporary regulations combine the first two circumstances into one sentence that defines fixed consideration. No substantive change to these two definitions of fixed consideration is intended with this amendment.

The target corporation shareholders are generally subject to the economic fortunes of the issuing corporation as of the signing date only if the contract specifies the number of shares of the issuing corporation to be exchanged for all or each proprietary interest in the target corporation. Accordingly, the temporary regulations provide that the signing date rule is applicable in these situations. The IRS and Treasury Department request comments regarding whether it is appropriate to include in the definition of fixed consideration a contract that specifies a fixed percentage of the shares of the issuing corporation to be exchanged for all or each proprietary interest in the target corporation.

The temporary regulations eliminate the third and fourth circumstances described in the 2005 final regulations from the definition of fixed consideration. Because these types of transactions do not specify the number of shares of the issuing corporation to be received in the exchange, the target corporation shareholders are not subject to the economic fortunes of the issuing corporation as of the signing date. These provisions were removed because, in such situations, applying the signing date rule may produce inappropriate results.

A commentator noted that a transaction in which a fixed percentage of target corporation shares is exchanged for issuing corporation shares could inappropriately be precluded from satisfying COI due to the application of the signing date rule. For example, if the number of the issuing corporation shares to be received by the target corporation shareholders depends on the value of the issuing corporation shares on the closing date, and the issuing corporation shares appreciate significantly between the signing date and the closing date, the signing date rule could prevent a transaction from satisfying COI notwithstanding the fact that a substantial part of the value of the proprietary interests in the target corporation is exchanged for proprietary interests in the issuing corporation.

Further, the temporary regulations continue to treat a contract that provides for a shareholder election between shares of the issuing corporation stock and the money or other property to be exchanged for the proprietary interests in the target corporation as a contract that provides for fixed consideration in the circumstances described below.

### *C. Shareholder Elections*

The 2005 final regulations contain a rule generally stating that a contract that permits the target corporation shareholders to elect to receive stock and/or money and/or other property with respect to their target corporation stock will be treated as providing for fixed consideration if the contract also provides the minimum number of shares of the issuing corporation stock and the maximum amount of money or other property to be exchanged for all of the proprietary interests in the target corporation, the minimum percentage of the

number of shares of each class of proprietary interests in the target corporation to be exchanged for stock of the issuing corporation, or the minimum percentage (by value) of the proprietary interests in the target corporation to be exchanged for stock of the issuing corporation. The 2005 final regulations further include two special rules prescribing certain assumptions to be made in the determination of whether COI is satisfied in shareholder election cases. For example, in the case in which the contract states the minimum number of shares of the issuing corporation stock and the maximum amount of money or other property to be exchanged for all of the proprietary interests in the target corporation, the determination of whether a proprietary interest in the target corporation is preserved is made by assuming the issuance of the minimum number of shares of each class of stock of the issuing corporation and the maximum amount of money or other property allowable under the contract and without regard to the number of shares of each class of stock of the issuing corporation and the amount of money or other property actually exchanged for proprietary interests in the target corporation.

These temporary regulations treat certain transactions that allow for shareholder elections as providing for fixed consideration regardless of whether the agreement specifies the maximum amount of money or other property, or the minimum amount of issuing corporation stock, to be exchanged in the transaction. As noted above, if the target corporation shareholders can generally be viewed as subject to the economic fortunes of the issuing corporation as of the signing date, it is appropriate to treat the contract as providing for fixed consideration and to apply the signing date rule. The IRS and Treasury Department believe that these circumstances exist in cases where the target corporation shareholders may elect to receive issuing corporation stock in exchange for their target corporation stock at an exchange rate based on the value of the issuing corporation stock on the signing date. For example, if the issuing corporation stock has a value of \$1 per share on the last business date before the first date on which the contract is binding, and the agreement provides that the target corporation shareholders may exchange each share of target corporation stock for either \$1 or issu-

ing corporation stock (based on the signing date value), the target corporation shareholders that choose to exchange their target corporation stock for stock of the issuing corporation are subject to the economic fortunes of the issuing corporation with respect to such stock as of the signing date. Accordingly, the IRS and Treasury Department believe that it is appropriate in such a case to apply the signing date rule to value the stock of the issuing corporation for purposes of testing whether the transaction satisfies the COI requirement.

Additionally, the IRS and Treasury Department are concerned that the assumptions in the shareholder election rule in the 2005 final regulations may create confusion about whether COI is satisfied based on the delivery of stock that does not in fact preserve the target corporation shareholders' proprietary interest in the target corporation when such result was not intended. For example, the rule might appear to suggest that stock that is redeemed in connection with the potential reorganization will nonetheless be treated as preserving the target corporation shareholders' proprietary interests in the target corporation, although this result would be contrary to Treas. Reg. 1.368-1(e)(1). Further, these assumptions could prevent a transaction from satisfying COI even though a substantial part of the value of the proprietary interests in the target corporation is actually exchanged for proprietary interests in the issuing corporation.

Because of this potential for confusion, and because these assumptions are not relevant to the revised shareholder election provision, the temporary regulations remove the assumptions so that the determination of whether COI is preserved depends on the actual consideration exchanged. Example 9 of the Temporary Regulations has been modified to illustrate the revised rules regarding shareholder elections.

### *D. Contract Modifications*

The 2005 final regulations generally provide that a modification of the contract results in a new signing date. However, the 2005 final regulations provide that a modification that has the sole effect of providing for the issuance of additional shares of issuing corporation stock to the target corporation shareholders will not

be treated as a modification if the execution of the transaction pursuant to the original agreement would have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had been no modification. One commentator suggested that this rule be broadened to include modifications that decrease the money or other property that will be delivered to the target corporation shareholders. These temporary regulations reflect this broadening.

Further, the IRS and Treasury Department believe that the signing date rule should also apply to provide certainty regarding the value of the issuing corporation stock used for purposes of testing COI if the transaction fails to qualify as a tax-free reorganization. For this reason, the IRS and Treasury Department believe that the exception to the modification rule should also be available for certain types of modifications if the transaction fails to satisfy COI at the time of the execution of the contract. Accordingly, these temporary regulations provide that certain contract modifications will not result in a new signing date if the terms of the original contract would have prevented the transaction from qualifying as a reorganization.

#### *E. Contingent Consideration*

The 2005 final regulations provide that contingent consideration will generally prevent a contract from being treated as providing for fixed consideration. However, the 2005 final regulations provide for a limited exception to that general rule. The exception applies to cases in which the contingent consideration consists solely of stock of the issuing corporation and the execution of the potential reorganization would have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if none of the contingent consideration was delivered to the target shareholders. The IRS and Treasury Department received a number of comments regarding the effect of contingent consideration on the application of the signing date rule.

A number of commentators suggested that the scope of the exception should be expanded to include cases in which the de-

livery of the contingent consideration to the target corporation shareholders does not decrease the ratio of the value of the shares of issuing corporation stock to the value of the money or other property (determined as of the last business day before the first date there is a binding contract) to be delivered to the target corporation shareholders relative to the ratio of the value of the shares of the issuing corporation stock to the value of the money or other property (determined as of the last business day before the first date there is a binding contract) to be delivered to the target corporation shareholders if none of the contingent consideration were delivered to the target corporation shareholders. These temporary regulations modify and expand the applicability of the signing date rule to certain transactions that provide for contingent adjustments (*i.e.*, increases or decreases) to the consideration.

As described above, the signing date rule is based on the principle that, where a binding contract provides for fixed consideration, the target corporation shareholders can generally be viewed as being subject to the economic fortunes of the issuing corporation as of the signing date. The IRS and Treasury Department believe that where this principle holds true, the signing date rule should apply regardless of whether the transaction potentially qualifies as a reorganization, and regardless of whether the contract provides for certain contingent adjustments to the otherwise fixed consideration. Accordingly, these temporary regulations provide that, generally, a contract that otherwise qualifies as providing for fixed consideration will be treated as providing for fixed consideration even if it provides for contingent adjustments to the consideration, and regardless of whether the transaction would have satisfied COI in the absence of any contingent adjustments. However, if the terms of the contingent adjustments potentially prevent the target corporation shareholders from being subject to the economic fortunes of the issuing corporation as of the signing date, the contract will not be treated as providing for fixed consideration.

Accordingly, these temporary regulations provide that a contract will not be treated as providing for fixed consideration if it provides for contingent adjustments to the consideration that prevent (to

any extent) the target shareholders from being subject to the economic benefits and burdens of ownership of the issuing corporation as of the signing date. For example, a contract will not be treated as providing for fixed consideration if it provides for contingent adjustments in the event that the value of the stock of the issuing corporation, the value of the assets of the issuing corporation, or the value of any surrogate for either the value of the stock of the issuing corporation or the assets of the issuing corporation increase or decrease after the last business day before the first date there is a binding contract, or if the terms of the contingent adjustment provide that any increase or decrease in the number of shares of the issuing corporation will be computed using any value of the issuing corporation shares after the last business day before the first date the contract is a binding contract.

#### *F. Anti-Dilution Provisions*

These temporary regulations also clarify that if the issuing corporation's capital structure is altered and the number of shares of the issuing corporation to be issued to the target corporation shareholders is altered pursuant to a customary anti-dilution clause, the signing date value of the issuing corporation's shares must be adjusted to take this alteration into account.

#### *G. Other Issues*

The IRS and Treasury Department continue to study other issues related to the determination of whether the COI requirement is satisfied.

#### **Effective Date**

These temporary regulations are effective March 20, 2007 and apply to transactions occurring pursuant to a binding contract entered into after September 16, 2005. These temporary regulations provide transitional relief for certain transactions occurring pursuant to a binding contract entered into after September 16, 2005, and on or before March 20, 2007. Parties to transactions within the scope of the transitional relief may elect to apply the 2005 final regulations instead of these temporary regulations. Certain parties must adopt consistent treatment to obtain this relief.

## 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 5 U.S.C. 553(b) and (d) do not apply to these regulations. For applicability of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, 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 Lisa S. Dobson of the Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

## Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

### PART 1—INCOME TAXES

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

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

Par. 2. Section 1.368-1 is amended by:

1. Revising paragraph (e)(2).

2. Revising and redesignating the text of paragraph (e)(8) as paragraph (e)(8)(i).

3. Adding paragraph (e)(8)(ii).

The revisions and addition read as follows:

#### *§1.368-1 Purpose and scope of exception of reorganization exchanges.*

\* \* \* \* \*

(e) \* \* \*

(2) [Reserved]. For further guidance, see §1.368-1T(e)(2).

\* \* \* \* \*

(8) *Effective dates*—(i) *In general.* Paragraphs (e)(1) and (e)(3) through (e)(7) of this section apply to transactions occurring after January 28, 1998, except

that they do not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. Paragraph (e)(1)(ii) of this section, however, applies to transactions occurring after August 30, 2000, unless the transaction occurs pursuant to a written agreement that is (subject to customary conditions) binding on that date and at all times thereafter. Taxpayers who entered into a binding agreement on or after January 28, 1998, and before August 30, 2000, may request a private letter ruling permitting them to apply the final regulations to their transaction. A private letter ruling will not be issued unless the taxpayer establishes to the satisfaction of the IRS that there is not a significant risk of different parties to the transaction taking inconsistent positions, for Federal tax purposes, with respect to the applicability of the final regulations to the transaction.

(ii) *Signing date rule.* [Reserved]. For further guidance, see §1.368-1T(e)(8)(ii).

Par. 3. Section 1.368-1T is added to read as follows:

#### *§1.368-1T Purpose and scope of exception of reorganization exchanges (temporary).*

(a) through (e)(1) [Reserved]. For further guidance, see §1.368-1(a) through (e)(1).

(e)(2) *Measuring continuity of interest.*

(i) *In general.* In determining whether a proprietary interest in the target corporation is preserved, the consideration to be exchanged for the proprietary interests in the target corporation pursuant to a contract to effect the potential reorganization shall be valued on the last business day before the first date such contract is a binding contract, if such contract provides for fixed consideration. If a portion of the consideration provided for in such a contract consists of other property identified by value, then this specified value of such other property is used for purposes of determining the extent to which a proprietary interest in the target corporation is preserved. If the contract does not provide for fixed consideration, this paragraph (e)(2)(i) is not applicable.

(ii) *Binding contract*—(A) *In general.* A binding contract is an instrument enforceable under applicable law against the parties to the instrument. The presence of a

condition outside the control of the parties (including, for example, regulatory agency approval) shall not prevent an instrument from being a binding contract. Further, the fact that insubstantial terms remain to be negotiated by the parties to the contract, or that customary conditions remain to be satisfied, shall not prevent an instrument from being a binding contract.

(B) *Modifications*—(1) *In general.* If a term of a binding contract that relates to the amount or type of the consideration the target shareholders will receive in a potential reorganization is modified before the closing date of the potential reorganization, and the contract as modified is a binding contract, the date of the modification shall be treated as the first date there is a binding contract.

(2) *Modification of a transaction that preserves continuity of interest.* Notwithstanding paragraph (e)(2)(ii)(B)(1) of this section, a modification of a term that relates to the amount or type of consideration the target shareholders will receive in a transaction that would have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had been no modification will not be treated as a modification if—

(i) The modification has the sole effect of providing for the issuance of additional shares of issuing corporation stock to the target corporation shareholders;

(ii) The modification has the sole effect of decreasing the amount of money or other property to be delivered to the target corporation shareholders; or

(iii) The modification has the effect of decreasing the amount of money or other property to be delivered to the target corporation shareholders and providing for the issuance of additional shares of issuing corporation stock to the target corporation shareholders.

(3) *Modification of a transaction that does not preserve continuity of interest.* Notwithstanding paragraph (e)(2)(ii)(B)(1) of this section, a modification of a term that relates to the amount or type of consideration the target shareholders will receive in a transaction that would not have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had

been no modification will not be treated as a modification if—

(i) The modification has the sole effect of providing for the issuance of fewer shares of issuing corporation stock to the target corporation shareholders;

(ii) The modification has the sole effect of increasing the amount of money or other property to be delivered to the target corporation shareholders; or

(iii) The modification has the effect of increasing the amount of money or other property to be delivered to the target corporation shareholders and providing for the issuance of fewer shares of issuing corporation stock to the target corporation shareholders.

(C) *Tender offers.* For purposes of this paragraph (e)(2), a tender offer that is subject to section 14(d) of the Securities and Exchange Act of 1934 [15 U.S.C. 78n(d)(1)] and Regulation 14D (17 CFR 240.14d-1 through 240.14d-101) and is not pursuant to a binding contract, is treated as a binding contract made on the date of its announcement, notwithstanding that it may be modified by the offeror or that it is not enforceable against the offerees. If a modification (not pursuant to a binding contract) of such a tender offer is subject to the provisions of Regulation 14d-6(c) (17 CFR 240.14d-6(c)) and relates to the amount or type of the consideration received in the tender offer, then the date of the modification shall be treated as the first date there is a binding contract.

(iii) *Fixed Consideration—(A) In general.* A contract provides for fixed consideration if it provides the number of shares of each class of stock of the issuing corporation, the amount of money, and the other property (identified either by value or by specific description), if any, to be exchanged for all the proprietary interests in the target corporation, or to be exchanged for each proprietary interest in the target corporation. A contract that provides a target corporation shareholder with an election to receive a number of shares of stock of the issuing corporation and/or money and/or other property in exchange for all of the shareholder's proprietary interests in the target corporation, or each of the shareholder's proprietary interests in the target corporation, provides for fixed consideration if the determination of the number of shares of issuing corporation stock to be

provided to the target corporation shareholder is determined using the value of the issuing corporation stock on the last business day before the first date there is a binding contract.

(B) *Contingent adjustments to the consideration—(1) In general.* Except as provided in paragraph (e)(2)(iii)(B)(2) of this section, a contract that provides for contingent adjustments to the consideration will be treated as providing for fixed consideration if it would satisfy the requirements of paragraph (e)(2)(iii)(A) of this section without the contingent adjustment provision.

(2) *Exceptions.* A contract will not be treated as providing for fixed consideration if the contract provides for contingent adjustments to the consideration that prevent (to any extent) the target corporation shareholders from being subject to the economic benefits and burdens of ownership of the issuing corporation stock after the last business day before the first date the contract is a binding contract. For example, a contract will not be treated as providing for fixed consideration if the contract provides for contingent adjustments to the consideration in the event that the value of the stock of the issuing corporation, the value of the assets of the issuing corporation, or the value of any surrogate for either the value of the stock of the issuing corporation or the assets of the issuing corporation increase or decrease after the last business day before the first date there is a binding contract; or in the event the contract provides for contingent adjustments to the number of shares of the issuing corporation stock to be provided to the target corporation shareholders computed using any value of the issuing corporation shares after the last business day before the first date there is a binding contract.

(C) *Escrows.* Placing part of the consideration to be exchanged for proprietary interests in the target corporation in escrow to secure target's performance of customary pre-closing covenants or customary target representations and warranties will not prevent a contract from being treated as providing for fixed consideration.

(D) *Anti-dilution clauses.* The presence of a customary anti-dilution clause will not prevent a contract from being treated as providing for fixed consideration. However, the absence of such a clause will prevent a contract from being treated as pro-

viding for fixed consideration if the issuing corporation alters its capital structure between the first date there is an otherwise binding contract to effect the transaction and the effective date of the transaction in a manner that materially alters the economic arrangement of the parties to the binding contract. If the number of shares of the issuing corporation to be issued to the target corporation shareholders is altered pursuant to a customary anti-dilution clause, the value of the shares determined under paragraph (e)(2)(i) of this section must be adjusted accordingly.

(E) *Dissenters' rights.* The possibility that some shareholders may exercise dissenters' rights and receive consideration other than that provided for in the binding contract will not prevent the contract from being treated as providing for fixed consideration.

(F) *Fractional shares.* The fact that money may be paid in lieu of issuing fractional shares will not prevent a contract from being treated as providing for fixed consideration.

(iv) *Valuation of new issuances.* For purposes of applying paragraph (e)(2)(i) of this section, any class of stock, securities, or indebtedness that the issuing corporation issues to the target corporation shareholders pursuant to the potential reorganization and that does not exist before the first date there is a binding contract to effect the potential reorganization is deemed to have been issued on the last business day before the first date there is a binding contract to effect the potential reorganization.

(v) *Examples.* For purposes of the examples in this paragraph (e)(2)(v), P is the issuing corporation, T is the target corporation, S is a wholly owned subsidiary of P, all corporations have only one class of stock outstanding, A is an individual, no transactions other than those described occur, and the transactions are not otherwise subject to recharacterization. The following examples illustrate the application of this paragraph (e)(2):

*Example 1. Application of signing date rule.* On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. Pursuant to the contract, the T shareholders will receive 40 P shares and \$60 of cash in exchange for all of the outstanding stock of T. Twenty of the P shares, however, will be placed in escrow to secure customary target representations and warranties. The P stock is listed on an established market. On January 2 of Year 1, the value of the P stock is \$1 per

share. On June 1 of Year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the P stock is \$.25 per share. None of the stock placed in escrow is returned to P. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for \$40 of P stock and \$60 of cash, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

*Example 2. Treatment of forfeited escrowed stock.*

(i) *Escrowed stock.* The facts are the same as in *Example 1* except that T's breach of a representation results in the escrowed consideration being returned to P. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. Pursuant to paragraph (e)(1)(i) of §1.368-1, for continuity of interest purposes, the T stock is exchanged for \$20 of P stock and \$60 of cash, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

(ii) *Escrowed stock and cash.* The facts are the same as in paragraph (i) of this *Example 2* except that the consideration placed in escrow consists solely of eight of the P shares and \$12 of the cash. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. Pursuant to paragraph (e)(1)(i) of §1.368-1, for continuity of interest purposes, the T stock is exchanged for \$32 of P stock and \$48 of cash, and the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

*Example 3. Redemption of stock received pursuant to binding contract.* The facts are the same as in *Example 1* except that A owns 50 percent of the outstanding stock of T immediately prior to the merger and receives 10 P shares and \$30 in the merger and an additional 10 P shares upon the release of the stock placed in escrow. In connection with the merger, A and S agree that, immediately after the merger, S will purchase any P shares that A acquires in the merger for \$1 per share. Shortly after the merger, S purchases A's P shares for \$20. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the trans-

action satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. In addition, S is a person related to P under paragraph (e)(4)(i)(A) of §1.368-1. Accordingly, A is treated as exchanging his T shares for \$50 of cash. Because, for continuity of interest purposes, the T stock is exchanged for \$20 of P stock and \$80 of cash, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

*Example 4. Modification of binding contract—continuity not preserved.*

The facts are the same as in *Example 1* except that on April 1 of Year 1, the parties modify their contract. Pursuant to the modified contract, which is a binding contract, the T shareholders will receive 50 P shares (an additional 10 shares) and \$75 of cash (an additional \$15 of cash) in exchange for all of the outstanding T stock. On March 31 of Year 1, the value of the P stock is \$.50 per share. Under this paragraph (e)(2), although there was a binding contract providing for fixed consideration as of January 3 of Year 1, terms of that contract relating to the consideration to be provided to the target shareholders were modified on April 1 of Year 1. The execution of the transaction without modification would have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had been no modification. However, because the modified contract provides for additional P stock and cash to be exchanged for all the proprietary interests in T, the exception in paragraph (e)(2)(ii)(B)(2) of this section does not apply to preserve the original signing date. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on March 31 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for \$25 of P stock and \$75 of cash, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

*Example 5. Modification of binding contract disregarded—continuity preserved.*

The facts are the same as in *Example 4* except that, pursuant to the modified contract, which is a binding contract, the T shareholders will receive 60 P shares (an additional 20 shares as compared to the original contract) and \$60 of cash in exchange for all of the outstanding T stock. In addition, on March 31 of Year 1, the value of the P stock is \$.40 per share. Under this paragraph (e)(2), although there was a binding contract providing for fixed consideration as of January 3 of Year 1, terms of that contract relating to the consideration to be provided to the target shareholders were modified on April 1 of Year 1. Nonetheless, the modification has the sole effect of providing for the issuance of additional P shares to the T shareholders. In addition, the execution of the terms of the contract without regard to the modification would have resulted in the preservation of a substantial part of the value of the T shareholders' proprietary interest in T because, for continuity of interest purposes, the T stock would have been exchanged for \$40 of P stock and \$60 of cash. Pursuant to paragraph (e)(2)(ii)(B)(2) of this section, the modification is not treated as a modification for purposes of paragraph (e)(2)(ii)(B)(1) of this

section. Accordingly, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for \$60 of P stock and \$60 of cash, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore the transaction satisfies the continuity of interest requirement.

*Example 6. New issuance.* The facts are the same as in *Example 1*, except that, instead of cash, the T shareholders will receive a new class of P securities that will be publicly traded. In the aggregate, the securities will have a stated principal amount of \$60 and bear interest at the average LIBOR (London Interbank Offered Rates) during the 10 days prior to the potential reorganization. If the T shareholders had been issued the P securities on January 2 of Year 1, the P securities would have had a value of \$60 (determined by reference to the value of comparable publicly traded securities). Whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock and the P securities to be issued to the T shareholders on January 2 of Year 1. Under paragraph (e)(2)(iv) of this section, for purposes of valuing the new P securities, they will be treated as having been issued on January 2 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for \$40 of P stock and \$60 of other property, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

*Example 7. Fixed consideration—continuity not preserved.*

On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. Pursuant to the contract, 60 shares of the T stock will be exchanged for \$80 of cash and 40 shares of the T stock will be exchanged for 20 shares of P stock. On January 2 of Year 1, the value of the P stock is \$1 per share. On June 1 of Year 1, T merges with and into P pursuant to the terms of the contract. This contract provides for fixed consideration and therefore whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. However, applying the signing date rule, the P stock represents only 20 percent of the value of the total consideration to be received by the T shareholders. Accordingly, based on the economic realities of the exchange, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

*Example 8. Anti-dilution clause.* (i) *Absence of anti-dilution clause.*

On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. Pursuant to the contract, the T shareholders will receive 40 P shares and \$60 of cash in exchange for all of the outstanding stock of T. The contract does not contain a customary anti-dilution provision. The P stock is listed on an established market. On January 2 of Year 1, the value of the P stock is \$1 per share. On April 10 of Year 1, P issues its stock to effect a stock split; each shareholder of P receives an additional share of P for each P share that it holds. On April 11 of Year 1, the value of the P stock is \$.50 per share. Because P altered its capital structure between January 3 and

June 1 of Year 1 in a manner that materially alters the economic arrangement of the parties, under paragraph (e)(2)(iii)(D) of this section, the contract is not treated as a binding contract that provides for fixed consideration. Accordingly, whether the transaction satisfies the continuity of interest requirement cannot be determined by reference to the value of the P stock on January 2 of Year 1.

(ii) *Adjustment for anti-dilution clause.* The facts are the same as in paragraph (i) of this *Example 8* except that the contract contains a customary anti-dilution provision, and the T shareholders receive 80 P shares and \$60 of cash in exchange for all of the outstanding stock of T. Under paragraph (e)(2)(iii)(D) of this section, the contract is treated as a binding contract that provides for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is generally determined by reference to the value of the P stock on January 2 of Year 1. However, under paragraph (e)(2)(iii)(D) of this section, the value of the P stock on January 2 of Year 1 must be adjusted to take the stock split into account. For continuity of interest purposes, the T stock is exchanged for \$40 of P stock ( $(\$1 \div 2) \times 80$ ) and \$60 of cash. Therefore, the transaction satisfies the continuity of interest requirement.

*Example 9. Shareholder election.* On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. On January 2 of Year 1, the value of the P stock and the T stock is \$1 per share. Pursuant to the contract, at the shareholders' election, each share of T will be exchanged for cash of \$1, or alternatively, P stock. The contract provides that the determination of the number of shares of P stock to be exchanged for a share of T stock is made using the value of the P stock on the last business day before the first date there is a binding contract (*i.e.*, \$1 per share). Accordingly, the contract provides for fixed consideration, and the determination of whether the transaction satisfies the continuity of interest requirement is based on the number of shares of P stock the T shareholders receive in the exchange and by reference to the value of the P stock on January 2 of Year 1.

*Example 10. Contingent adjustment based on the value of the issuing corporation stock—continuity not preserved.* On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. On January 2 of Year 1, the value of the P stock is \$1 per share. Pursuant to the contract, if the value of the P stock does not decrease after January 2 of Year 1, the T shareholders will receive 40 P shares and \$60 of cash in exchange for all of the outstanding stock of T. Furthermore, the contract provides that the T shareholders will receive \$.16 of additional P shares and \$.24 for every \$.01 decrease in the value of one share of P stock after January 2 of Year 1. On June 1 of Year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the P stock is \$.40 per share. Pursuant to the terms of the contract, the consideration is adjusted so that the T shareholders receive 24 more P shares ( $(60 \times \$.16)/\$.40$ ) and \$14.40 more cash ( $60 \times \$.24$ ) than they would absent an adjustment. Accordingly, at closing the T shareholders receive 64 P shares and \$74.40 of cash. Because the contract provides that additional P shares and cash will be delivered to the T shareholders if the

value of the stock of P decreases after January 2 of Year 1, under paragraph (e)(2)(iii)(B)(2) of this section, the contract is not treated as providing for fixed consideration, and therefore whether the transaction satisfies the continuity of interest requirement cannot be determined by reference to the value of the P stock on January 2 of Year 1. For continuity of interest purposes, the T stock is exchanged for \$25.60 of P stock ( $64 \times \$.40$ ) and \$74.40 of cash and the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

*Example 11. Contingent adjustment to boot based on the value of the target corporation stock—continuity not preserved.* On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. On January 2 of Year 1, T has 100 shares outstanding, and each T share is worth \$1. On January 2 of Year 1, each P share is worth \$1. Pursuant to the contract, if the value of the T stock does not increase after January 3 of Year 1, the T shareholders will receive 40 P shares and \$60 of cash in exchange for all of the outstanding stock of T. Furthermore, the contract provides that the T shareholders will receive \$1 of additional cash for every \$.01 increase in the value of one share of T stock after January 3 of Year 1. On June 1 of Year 1, the value of the T stock is \$1.40 per share and the value of the P stock is \$.75 per share. Pursuant to the terms of the contract, the consideration is adjusted so that the T shareholders receive \$40 more cash ( $40 \times \$1$ ) than they would absent an adjustment. Accordingly, at closing the T shareholders receive 40 P shares and \$100 of cash. Because the contract provides the number of shares of P stock and the amount of money to be exchanged for all the proprietary interests in T, and the contingent adjustment to the cash consideration is not based on changes in the value of the P stock, P assets, or any surrogate thereof, after January 2 of Year 1, there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. For continuity of interest purposes, the T stock is exchanged for \$40 of P stock ( $40 \times \$1$ ) and \$100 of cash. Therefore, the transaction does not satisfy the continuity of interest requirement.

*Example 12. Contingent adjustment to stock based on the value of the target corporation stock—continuity preserved.* On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. On that date T has 100 shares outstanding, and each T share is worth \$1. On January 2 of Year 1, each P share is worth \$1. Pursuant to the contract, if the value of the T stock does not decrease after January 3 of Year 1, the T shareholders will receive 40 P shares and \$60 of cash in exchange for all of the outstanding stock of T. Furthermore, the contract provides that the T shareholders will receive \$.40 less P stock and \$.60 less cash for every \$.01 decrease in the value of one share of T stock after January 3 of Year 1. The contract also provides that the number of P shares by which the consideration will be reduced as a result of this adjustment will be determined based on the

value of the P stock on January 2 of Year 1. On June 1 of Year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the T stock is \$.70 per share and the value of the P stock is \$.75 per share. Pursuant to the terms of the contract, the consideration is adjusted so that the T shareholders receive 12 fewer P shares ( $(30 \times \$.40)/\$1$ ) and \$18 less cash ( $30 \times \$.60$ ) than they would absent an adjustment. Accordingly, at closing the T shareholders receive 28 P shares and \$42 of cash. Because the contract provides for the number of shares of P stock and the amount of money to be exchanged for all of the proprietary interests in T, the contract does not provide for contingent adjustments to the consideration based on a change in value of the P stock, P assets, or any surrogate thereof, after January 2 of Year 1, and the adjustment to the number of P shares the T shareholders receive is determined based on the value of the P shares on January 2 of Year 1, there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. For continuity of interest purposes, the T stock is exchanged for \$28 of P stock ( $28 \times \$1$ ) and \$42 of cash. Therefore, the transaction satisfies the continuity of interest requirement.

(e)(3) through (7) [Reserved]. For further guidance, see §1.368-1(e)(3) through (7).

(8) *Effective dates.* (i) [Reserved]. For further guidance, see §1.368-1(e)(8)(i).

(ii) *Signing date rule.* Paragraph (e)(2) of this section applies to transactions occurring pursuant to binding contracts entered into after September 16, 2005. For transactions occurring pursuant to binding contracts entered into after September 16, 2005, and on or before March 20, 2007, the parties to the transaction may elect to apply the provisions of §1.368-1(e)(2) as contained in 26 CFR part 1, revised April 1, 2006, instead of the provisions of this paragraph (e)(2). However, the target corporation, the issuing corporation, the controlling corporation of the acquiring corporation if stock thereof is provided as consideration in the transaction, and any direct or indirect transferee of transferred basis property from any of the foregoing, may not elect to apply the provisions of §1.368-1(e)(2) as contained in 26 CFR part 1, revised April 1, 2006, unless all such taxpayers elect to apply the provisions of such regulations. This election requirement will be satisfied if none of the specified parties adopts inconsistent treatment.

The applicability of this section expires on or before March 19, 2010.



Kevin M. Brown,  
Deputy Commissioner for  
Services and Enforcement.

Approved March 14, 2007.

Eric Solomon,  
Assistant Secretary of  
the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on March 19, 2007, 8:45 a.m., and published in the issue of the Federal Register for March 20, 2007, 72 F.R. 12974)

## Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.

A revenue ruling holds that ICE Futures, which is a United Kingdom Recognised Investment Exchange, is a qualified board or exchange within the meaning of section 1256(g)(7)(C) of the Code. See Rev. Rul. 2007-26, page 970.

## Section 481.—Adjustments Required by Changes in Method of Accounting

A revenue ruling holds that ICE Futures, which is a United Kingdom Recognised Investment Exchange, is a qualified board or exchange within the meaning of section 1256(g)(7)(C) of the Code. See Rev. Rul. 2007-26, page 970.

## Section 932.—Coordination of United States and Virgin Islands Income Taxes

A notice provides interim rules regarding the statute of limitations on assessment and exchange of information concerning individuals claiming to be *bona fide* residents of the U.S. Virgin Islands. See Notice 2007-31, page 971.

## Section 1256.—Section 1256 Contracts Marked to Market

(Also §§ 446, 481, 7805; 1.446-1, 301.7805-1.)

**ICE Futures; United Kingdom.** This ruling holds that ICE Futures, which is a United Kingdom Recognised Investment Exchange, is a qualified board or exchange within the meaning of section 1256(g)(7)(C) of the Code.

## Rev. Rul. 2007-26

### ISSUE

Is ICE Futures, which is a United Kingdom Recognised Investment Exchange, a qualified board or exchange within the meaning of section 1256(g)(7)(C) of the Internal Revenue Code?

### LAW

Section 1256(g)(7) of the Code provides that the term “qualified board or exchange” means:

(A) a national securities exchange which is registered with the Securities and Exchange Commission,

(B) a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission, or

(C) any other exchange, board of trade, or other market which the Secretary determines has rules adequate to carry out the purposes of section 1256.

### HOLDING

The Internal Revenue Service determines that ICE Futures, which is a United Kingdom Recognised Investment Exchange, is a qualified board or exchange within the meaning of section 1256(g)(7)(C) of the Code.

### EFFECTIVE DATE

Under the authority of section 7805(b)(8) of the Code, this revenue ruling is effective for ICE Futures Contracts (commodity futures contracts and futures contract options) entered into on or after April 1, 2007.

### CHANGE IN METHOD OF ACCOUNTING

A change in the treatment of ICE Futures Contracts to comply with this revenue ruling is a change in method of accounting within the meaning of sections 446 and 481 of the Code and the regulations thereunder. The Commissioner grants consent to taxpayers to change to the section 1256 mark to market method for the first taxable year during which the taxpayer holds an ICE Futures Contract

that was entered into on or after April 1, 2007. Such a taxpayer need not file a Form 3115, *Application for Change in Accounting Method*. ICE Futures Contracts that were entered into before April 1, 2007, are not covered by the change in method for which consent is granted. Because the change is being made on a “cut-off” basis, there is no potential omission or duplication of income or deductions, and therefore no adjustment under section 481 is required.

### DRAFTING INFORMATION

The principal author of this revenue ruling is K. Scott Brown of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Mr. Brown at (202) 622-3920 (not a toll-free call).

## Section 6501.—Limitations on Assessment and Collection

A notice provides interim rules regarding the statute of limitations on assessment and exchange of information concerning individuals claiming to be *bona fide* residents of the U.S. Virgin Islands. See Notice 2007-31, page 971.

## Section 7654.—Coordination of United States and Certain Possession Individual Income Taxes

A notice provides interim rules regarding the statute of limitations on assessment and exchange of information concerning individuals claiming to be *bona fide* residents of the U.S. Virgin Islands. See Notice 2007-31, page 971.

## Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

A revenue ruling holds that ICE Futures, which is a United Kingdom Recognised Investment Exchange, is a qualified board or exchange within the meaning of section 1256(g)(7)(C) of the Code. See Rev. Rul. 2007-26, page 970.

# Part III. Administrative, Procedural, and Miscellaneous

## Statute of Limitations and Exchange of Information Concerning Certain Individuals Filing Income Tax Returns With the U.S. Virgin Islands

### Notice 2007-31

#### SECTION 1. PURPOSE

This notice announces that for taxable years ending on or after December 31, 2006, the U.S. federal statute of limitations for all U.S. citizens and residents claiming to be *bona fide* residents of the U.S. Virgin Islands generally will commence upon the filing of an income tax return with the U.S. Virgin Islands.

This notice amends and supplements Notice 2007-19, 2007-11 I.R.B. 689, which the Treasury Department and the Internal Revenue Service (IRS) issued on February 21, 2007. Notice 2007-19 provided interim rules under sections 932(c) and 7654(e) concerning the statute of limitations on assessment of the U.S. income tax liability (if any) of a U.S. citizen or resident alien who takes the position that he or she is a *bona fide* resident of the U.S. Virgin Islands and the U.S. filing obligations of such an individual. It also announced that the Treasury Department and the IRS were studying the feasibility of an automatic exchange of information program with the U.S. Virgin Islands and the elimination of the reporting requirements set forth in the notice.

Since the issuance of Notice 2007-19, the U.S. Virgin Islands Bureau of Internal Revenue (BIR) and the IRS have entered into a new working arrangement concerning the routine (automatic) exchange of information (the “Working Arrangement”) under the Tax Implementation Agreement between the United States of America and the Virgin Islands dated February 24, 1987 (the “Implementation Agreement”). In light of the Working Arrangement, this notice also provides new interim rules under sections 932(c) and 7654(e) concerning the statute of limitations on assessment and U.S. filing obligations of

certain individuals who file returns with the U.S. Virgin Islands. Finally, this notice announces that the Treasury Department and the IRS intend to issue regulations under sections 932(c) and 7654(e) that incorporate these new interim rules. Until the regulations are issued, taxpayers may rely on this notice (and when appropriate, may also rely on Notice 2007-19).

#### SECTION 2. EXCHANGE OF INFORMATION

On March 21, 2007, the IRS and BIR officials serving as the competent authorities of the United States and the U.S. Virgin Islands, respectively, entered into the Working Arrangement, which provides guidelines and procedures for the routine exchange of information under the Implementation Agreement. The Working Arrangement applies to taxable years ending on or after December 31, 2006. The Working Arrangement will be terminated if for any reason the Implementation Agreement is terminated. The Working Arrangement may also be terminated upon written notice by either the IRS or the BIR. The text of the Working Arrangement is attached.

#### SECTION 3. INTERIM RULES

Under the authority of section 7654(e), an individual income tax return filed under section 932(c)(2) with the U.S. Virgin Islands by a U.S. citizen or resident alien (USVI Form 1040) who takes the position that he or she is a *bona fide* resident of the U.S. Virgin Islands for the entire taxable year (or an individual who files a joint return for the taxable year with such an individual) will be deemed to be a U.S. income tax return of that individual for purposes of section 6501(a), provided that the IRS and BIR have entered into an agreement for the routine exchange of information satisfying the requirements of the Commissioner of the IRS. The Working Arrangement announced in section 2 of this notice satisfies this condition. Therefore, a return filed with the U.S. Virgin Islands under section 932(c)(2) will be deemed to be a U.S. income tax return for purposes of

section 6501(a) as described in this paragraph. In the event that the Working Arrangement is terminated and in the absence of a successor agreement, the interim rules provided in Notice 2007-19 will apply.

For example, assume that N, a U.S. citizen and calendar year taxpayer, takes the position that he is a *bona fide* resident of the U.S. Virgin Islands for the 2006 taxable year. On March 30, 2007, N files USVI Form 1040 (2006) with the U.S. Virgin Islands. N does not file Form 1040, *U.S. Individual Income Tax Return* (U.S. Form 1040), with the IRS (as described previously in Notice 2007-19). Under these circumstances and the rules provided in this notice, the 3-year period of limitations under section 6501(a) will expire on April 15, 2010, and the IRS will make no further assessment of income tax for N’s 2006 taxable year after that date except as otherwise authorized by section 6501.

#### SECTION 4. EFFECTIVE DATE

This notice applies for taxable years ending on or after December 31, 2006.

With respect to taxable years ending before December 31, 2006, the interim rules provided in Notice 2007-19 are still effective if a taxpayer so chooses. Consequently, a “non-covered person” within the meaning of Notice 2007-19 may choose to apply the interim rules of that notice to a taxable year ending before December 31, 2006, by filing U.S. Form 1040 with the IRS as provided in the notice. A “covered person” within the meaning of Notice 2007-19 who chooses to apply the interim rules of that notice to a taxable year ending before December 31, 2006, need only provide the documentation specified in the notice upon examination.

#### SECTION 5. DRAFTING INFORMATION

The principal author of this notice is J. David Varley of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Varley at (202) 435-5262 (not a toll-free call).

**WORKING ARRANGEMENT BETWEEN  
INTERNAL REVENUE SERVICE  
DEPUTY COMMISSIONER (INTERNATIONAL), LMSB  
AND  
BUREAU OF INTERNAL REVENUE  
UNITED STATES VIRGIN ISLANDS  
CONCERNING ROUTINE (AUTOMATIC) EXCHANGE OF INFORMATION**

**I. Introduction**

This Working Arrangement between the competent authorities of the United States and the U.S. Virgin Islands (the “parties”) sets forth the agreement of the parties with respect to an initiative to facilitate information sharing for tax administration purposes in conjunction with Internal Revenue Service (IRS) Notices 2007-19 and 2007-31.

**II. Authority**

The authority for this Working Arrangement is the Tax Implementation Agreement between the United States of America and the Virgin Islands dated February 24, 1987 (the “Implementation Agreement”). Pursuant to Article 4(2)(c) of the Implementation Agreement, this Working Arrangement expands the information to be routinely (automatically) exchanged by the U.S. Virgin Islands to the IRS under Article 4(2)(b) of the Implementation Agreement.

**III. Purpose**

This Working Arrangement serves to carry out the purposes of Notices 2007-19 and 2007-31, by establishing a new routine exchange of information program between the IRS and the U.S. Virgin Islands Bureau of Internal Revenue (BIR) concerning income tax information of certain taxpayers who file an income tax return with U.S. Virgin Islands under section 932(c)(2) of the Internal Revenue Code of 1986, as amended (the “Code”). The IRS will use the information to identify and examine such taxpayers and to encourage those taxpayers to comply with U.S. federal income tax laws and regulations. This Working Arrangement and any requests for information or information exchanged pursuant to it and the Implementation Agreement constitute tax convention information under Code section 6105.

**IV. Procedures and Requirements**

Unless otherwise agreed to by the parties or specified in the request for information, the parties agree as follows:

- A. The IRS will specify the information to be provided by the BIR in a written request for information to the BIR.
- B. The BIR will provide electronic files of the requested information, including all income tax returns with schedules, statements, and attachments. The electronic files will be saved, indexed, and transmitted by the BIR to the IRS in accordance with instructions provided in the request for information.
- C. All income tax returns will be date stamped by the BIR in a clearly legible manner that does not obstruct any taxpayer information on the return.
- D. The BIR will provide all requested information in accordance with the following schedule:
  1. With respect to all income tax returns that are timely filed with the BIR, within 90 days after the original due date or, to the extent the taxpayer timely files pursuant to a valid extension, within 90 days after the extended due date.
  2. With respect to all delinquent returns, amended returns, and any other requested information filed with the BIR and not covered by paragraph D.1. (above), within 90 days after the end of the calendar-year quarter during which the requested information was received by the BIR.

**V. Disclosure, Safeguards, and Recordkeeping Requirements**

- A. All information obtained under this Working Arrangement must be safeguarded in accordance with the Implementation Agreement as well as the safeguards described in IRS Publication 1075, *Tax Information Security Guidelines for Federal, State, and Local Agencies*.
- B. Nothing in this Working Arrangement will cause the IRS or BIR to disclose information that is normally protected by governmental, attorney/client, or attorney work product privileges consistent with applicable laws, or any other information that is prohibited from disclosure. See IRM Section 11.3.32.17, *Restrictions on Disclosure of Returns and Return Information*.
- C. Neither the IRS nor the BIR will disclose return information that would identify a confidential informant or seriously impair any civil or criminal tax investigation.

D. To the extent the BIR withholds a tax return and/or return information pursuant to paragraphs B. or C. (above), the BIR will provide the IRS with a privilege log that explains in sufficient detail the reason(s) for withholding the information.

**VI. Costs**

Pursuant to Article 5(3) of the Implementation Agreement, the IRS and the BIR agree not to charge each other for the costs of reproduction of information routinely exchanged. Further, prior to making any claim for reimbursement of extraordinary costs incurred in providing assistance, the BIR will consult with and provide an estimate of such costs to the IRS.

**VII. Third Party Rights**

This Working Arrangement does not confer any rights or benefits on any third party.

**VIII. Taxable Periods**

This Working Arrangement applies to income tax returns and other information filed with the USVI for taxable years ending on or after December 31, 2006.

**IX. Amendment or Termination**

This Working Arrangement will become effective on the date of the last signature below and will remain in force until terminated. This Working Arrangement will terminate on the first of the following to occur:

- A. Termination of the Implementation Agreement, in which event this Working Arrangement will automatically terminate on the date on which termination of the Implementation Agreement becomes effective pursuant to Article 9 of the Implementation Agreement; or
- B. Mailing or other delivery of written notice of termination by the IRS or the BIR to the other party. However, not less than 30 days prior to delivering such written notice, the terminating party must advise the other party in writing of its reasons for wishing to terminate this Working Arrangement. A notice of termination will be effective with respect to taxable years ending on or after December 31<sup>st</sup> of the following year. For example, if the BIR provides written notice to the IRS on August 31, 2009, that it is exercising its rights under this termination clause, then the BIR will be relieved of its responsibilities under this Working Arrangement with respect to taxable years ending on or after December 31, 2010.

**X. Limitations**

The terms of this Working Arrangement are not intended to alter, amend, or rescind any provisions of U.S. federal law. Any provision of this Working Arrangement that conflicts with U.S. federal law will be null and void. Nor are the terms of this Working Arrangement intended to alter, amend, or rescind any provisions of the Implementation Agreement now in effect. In any situation where a conflict arises between the provisions of this Working Arrangement and the Implementation Agreement, the provisions of the latter will govern.

**XI. Approvals**

For the Virgin Islands Bureau of Internal Revenue:

\_\_\_\_\_  
By: Gizette L. Thomas  
Acting Director  
U.S. Virgin Islands Bureau of Internal Revenue  
Signed at \_\_\_\_\_, this \_\_\_\_ day of \_\_\_\_\_, 2007.

For the Internal Revenue Service:

\_\_\_\_\_  
By: Frank Y. Ng  
Deputy Commissioner (International), LMSB  
Internal Revenue Service  
Signed at Washington, DC this \_\_\_\_ day of \_\_\_\_\_, 2007.

\_\_\_\_\_

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.  
(Also: Part I, § 911, 1.911-1.)

## Rev. Proc. 2007-28

### SECTION 1. PURPOSE

.01 This revenue procedure provides information to any individual who failed to meet the eligibility requirements of § 911(d)(1) of the Internal Revenue Code because adverse conditions in a foreign country precluded the individual from meeting those requirements for taxable year 2006.

.02 This revenue procedure lists the countries for which the eligibility requirements of § 911(d)(1) are waived for taxable year 2006.

### SECTION 2. BACKGROUND

.01 Section 911(a) of the Code allows a “qualified individual,” as defined in

§ 911(d)(1), to exclude foreign earned income and housing cost amounts from gross income. Section 911(c)(4) of the Code allows a qualified individual to deduct housing cost amounts from gross income.

.02 Section 911(d)(1) of the Code defines the term “qualified individual” as an individual whose tax home is in a foreign country and who is (A) a citizen of the United States and establishes to the satisfaction of the Secretary of the Treasury that the individual has been a *bona fide* resident of a foreign country or countries for an uninterrupted period that includes an entire taxable year, or (B) a citizen or resident of the United States who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days.

.03 Section 911(d)(4) of the Code provides an exception to the eligibility requirements of § 911(d)(1). An individual will be treated as a qualified individual with respect to a period in which the individual was a *bona fide* resident of, or

was present in, a foreign country, if the individual left the country during a period for which the Secretary of the Treasury, after consultation with the Secretary of State, determines that individuals were required to leave because of war, civil unrest, or similar adverse conditions that precluded the normal conduct of business. An individual must establish that but for those conditions the individual could reasonably have been expected to meet the eligibility requirements.

.04 For 2006, the Secretary of the Treasury, in consultation with the Secretary of State, has determined that war, civil unrest, or similar adverse conditions precluded the normal conduct of business in the following countries beginning on the specified date:

	<i>Date of Departure</i>	
<i>Country</i>	<i>On or after</i>	
East Timor	May 23, 2006	
Lebanon	July 27, 2006	
Nepal	April 26, 2006	

.05 Accordingly, for purposes of § 911 of the Code, an individual who left one of the foregoing countries on or after the specified departure date shall be treated as a qualified individual with respect to the period during which that individual was present in, or was a *bona fide* resident of, such foreign country, if the individual establishes a reasonable expectation of meeting the requirements of § 911(d) but for those conditions.

.06 To qualify for relief under § 911(d)(4) of the Code, an individual must have established residency, or have been physically present, in the foreign country on or prior to the date that the Secretary of the Treasury determines that

individuals were required to leave the foreign country. Individuals who establish residency, or are first physically present, in the foreign country after the date that the Secretary prescribes shall not be treated as qualified individuals under § 911(d)(4) of the Code. For example, individuals who are first physically present or establish residency in East Timor after May 23, 2006, are not eligible to qualify for the exception provided in § 911(d)(4) of the Code for taxable year 2006.

### SECTION 3. INQUIRIES

A taxpayer who needs assistance on how to claim this exclusion, or on how to

file an amended return, should contact a local IRS Office or, for a taxpayer residing or traveling outside the United States, the nearest overseas IRS office.

### SECTION 4. DRAFTING INFORMATION

The principal author of this revenue procedure is Kate Y. Hwa of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Ms. Hwa at (202) 622-3840 (not a toll-free call).

# Part IV. Items of General Interest

## Proposed Regulations and Notice of Public Hearing

### Effect of Election on Corporation

#### REG-158677-05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Proposed regulations and notice of public hearing.

SUMMARY: These proposed regulations clarify that if a bank is an S corporation within the meaning of section 1361(a)(1), its status as an S corporation does not affect the applicability of the special rules for banks under the Internal Revenue Code.

DATES: Written or electronic comments and requests for a public hearing must be received by November 22, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-158677-05), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at <http://www.irs.gov/regs> or via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS-REG-158677-05). If a public hearing is requested, the public hearing will be held in the Auditorium, New Carrollton Federal Building, 5000 Ellin Road, Lanham, MD.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Laura Fields at (202) 622-3050; concerning submissions and requests for a hearing, [Richard.A.Hurst@irscounsel.treas.gov](mailto:Richard.A.Hurst@irscounsel.treas.gov), (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

#### Background

Section 1361(b)(2) describes corporations that are ineligible to be S corporations (ineligible corporations). Until 1996, section 1361(b)(2)(A) treated as ineligible

corporations financial institutions to which section 585 applied (without regard to section 585(c)), which included primarily all banks within the meaning of section 581 (section 581 banks). In 1996, Congress revised section 1361(b)(2)(A) to allow certain banks to be S corporations. Under current section 1361(b)(2)(A), a section 581 bank is eligible to be an S corporation only if it does not use the reserve method of accounting for bad debts described in section 585, which is otherwise available to certain banks.

The proposed regulations address issues regarding the application, to S corporation banks, of the special rules applicable to banks under the Internal Revenue Code (Code) (the special bank rules).

First, questions have arisen regarding whether certain language in section 1363(b), enacted in 1982, may prevent S corporation banks from being subject to the special bank rules. Subject to certain exceptions, the general rule of section 1363(b) requires that “[t]he taxable income of an S corporation shall be computed in the same manner as in the case of an individual \* \* \*.” The special bank rules, however, apply only to corporations, because section 581 banks must be corporations for Federal tax purposes.

Second, questions have also arisen regarding the impact of section 1363(b)(4), which also pre-dates the 1996 legislation allowing banks to be S corporations. Section 1363(b)(4) applies section 291 to certain S corporations even if they would not otherwise be subject to it. Specifically, section 1363(b)(4) provides, “Section 291 shall apply if the S corporation (or any predecessor) was a C corporation for any of the 3 immediately preceding taxable years.” Section 291(a)(3) and (e)(1)(B) is a special bank rule that reduces by 20 percent the amount allowable as a deduction with respect to the portion of a bank’s interest expense that is allocable to qualified tax-exempt obligations as defined in section 265(b)(3)(B). This portion of a bank’s interest expense is the amount that bears the same ratio to the taxpayer’s interest expense as the taxpayer’s average adjusted bases of those tax-exempt obligations bears to the taxpayer’s average adjusted bases of all its assets.

#### Explanation of Provisions

The proposed regulations clarify that neither the general rule of section 1363(b), nor paragraph (4) of that section, prevents the special bank rules from applying to banks that are S corporations. When Congress allowed banks to become S corporations, it did not intend to deny them the benefits, or shield them from the burdens, ordinarily applicable to banks. This is reflected in the existing regulations under section 1361. See Sec. 1.1361-4(a)(3) (“If an S corporation is a bank, or if an S corporation makes a valid QSub election for a subsidiary that is a bank, any special rules applicable to banks under the Internal Revenue Code continue to apply separately to the bank parent or bank subsidiary \* \* \* (except as other published guidance may apply section 265(b) and section 291(a)(3) and (e)(1)(B) not only to the bank parent or bank subsidiary but also to any QSub \* \* \*).”).

The only special bank rule that Congress made inapplicable to S corporation banks was the section 585 reserve method for bad debts. The restriction in section 1361(b)(2)(A) regarding use of that method would be superfluous if the special bank rules were rendered inapplicable by section 1363(b). The section 585 reserve method is available only to banks, and those banks must be corporations. In amending section 1361(b)(2)(A), therefore, Congress did not expect the pre-existing general rule of section 1363(b) to prevent the special bank rules from applying to S corporation banks. The section 585 reserve method is a special bank rule, and it would have been unnecessary for Congress to make that rule inapplicable to S corporation banks if the special bank rules did not apply to them generally because of section 1363(b).

Section 1363(b)(4) historically subjected certain nonbank S corporations to section 291 if the S corporation (or any predecessor) was a C corporation for any of the 3 immediately preceding taxable years, even if section 291 would not otherwise apply. Section 1363(b)(4) does not provide that section 291 shall not apply in any other circumstance. When Congress enacted section 1363(b)(4) in 1984, banks could not yet be S corporations, and thus

section 1363(b)(4) had no applicability to section 291(a)(3) and (e)(1)(B) (which applies only to banks). After the 1996 amendments to subchapter S, the general rule of section 1363(b) does not prevent the special bank rules from applying to S corporations. Thus, if section 291(a)(3) and (e)(1)(B) applies to an S corporation bank in the absence of section 1363(b)(4), section 1363(b)(4) does not affect the continuing application to that bank of section 291(a)(3) and (e)(1)(B).

### Effective Date

These regulations are proposed to apply to taxable years of corporations beginning on or after August 24, 2006. No inference should be drawn from this effective date regarding prior taxable years.

### 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 regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will 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 public hearing will be published in the Federal Register.

### Drafting Information

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

\* \* \* \* \*

### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

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

Par. 2. Paragraph (b) of Sec. 1.1363-1 is amended as follows:

1. Paragraph (b) is revised.

2. Paragraph (d) is amended by removing the language “This section applies” and adding the language “This section (except for paragraph (b)(2) of this section) applies” in its place.

3. The paragraph heading for (d) is revised.

4. A sentence is added at the end of paragraph (d).

The revision and additions read as follows:

*§1.1363-1 Effect of election on corporation.*

\* \* \* \* \*

(b) *Computation of corporate taxable income—(1) In general.* The taxable income of an S corporation is computed as described in section 1363(b).

(2) *Treatment of banks.* Section 1363(b) (concerning computation of an S corporation’s taxable income) does not affect an S corporation’s status as a bank within the meaning of section 581, and it does not prevent the application to such an S corporation bank of any special rule applicable to banks under the Internal Revenue Code, such as sections 582(c) and 291(a)(3) and (e)(1)(B). See

Sec. 1.1361-4(a)(3) regarding application under subchapter S of the special rules applicable to banks. Further, section 1363(b)(4) causes section 291 to apply to an S corporation if the S corporation (or any predecessor) was a C corporation for any of the three immediately preceding taxable years, but section 1363(b)(4) does not prevent section 291 from applying to an S corporation to which section 291 otherwise applies.

(3) *Example.* The following example illustrates the application of this paragraph (b)(2):

*Example.* (i) *Facts.* X is described in section 581 and is an S corporation. Neither X nor any of X’s predecessors was a C corporation for any of the three immediately preceding taxable years. During the current taxable year, X sold debt instrument DI at a loss. At the time of the sale, X’s holding period in DI was more than one year and, but for section 582(c), the loss on the sale of DI would be capital. During the same taxable year, X held debt instrument QD, which it acquired after August 7, 1986. QD is a qualified tax-exempt obligation within the meaning of section 265(b)(3)(B).

(ii) X is described in section 581, and section 1363(b) does not affect X’s status under section 581. Accordingly, X qualifies as a bank within the meaning of section 581. Also, section 1363(b) does not prevent any special rule applicable to banks under the Internal Revenue Code from applying to X. Thus, section 582(c), which is a special rule applicable to banks, imposes ordinary character on the loss that X recognized from the sale of debt instrument DI.

(iii) Because QD is a qualified tax-exempt obligation that was acquired after August 7, 1986, section 265(b)(3)(A) causes QD to be treated for purposes of section 291(e)(1)(B) as having been acquired on that date. For that reason, if section 291(e)(1)(B) applies to X, a portion of the interest expense that X incurs during the taxable year is interest on indebtedness incurred or continued to purchase or carry qualified tax-exempt obligations and thus is a financial institution preference item. Section 291(a)(3) and (e)(1)(B) is a special rule applicable to banks, and thus section 1363(b) does not prevent section 291(a)(3) and (e)(1)(B) from applying to X unless some other authority prevents that result.

(iv) Section 1363(b)(4) does not prevent section 291 from applying in situations in which section 291 otherwise applies. Therefore, section 1363(b)(4) does not prevent section 291(a)(3) and (e)(1)(B) from applying to X. It is irrelevant that neither X nor any predecessor of X was a C corporation for any of the three immediately preceding taxable years. X’s status as a bank under section 581 causes section 291(a)(3) and (e)(1)(B) to apply.

\* \* \* \* \*

(d) *Effective dates.* \* \* \* Paragraph (b)(2) of this section applies to taxable years of corporations beginning on or after August 24, 2006.

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

(Filed by the Office of the Federal Register on August 23, 2006, 8:45 a.m., and published in the issue of the Federal Register for August 24, 2006, 71 F.R. 50007)

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

### Corporate Reorganizations; Guidance on the Measurement of Continuity of Interest

#### REG-146247-06

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9316) that provide guidance regarding the satisfaction of the continuity of interest requirement for corporate reorganizations. The text of those regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by June 18, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-146247-06), room 5203, Internal Revenue Service, PO Box 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-146247-06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov/> (IRS and REG-146247-06).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed

regulations, Lisa S. Dobson at (202) 622-7790; concerning submissions of comments and requests for a public hearing, Kelly Banks at (202) 622-0392 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to section 368, which provides for general non-recognition treatment for reorganizations. In addition to complying with the statutory and certain other requirements, to qualify as a reorganization, a transaction generally must satisfy the continuity of interest (COI) requirement. COI requires that, in substance, a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

##### 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 regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

##### Comments and Requests for Public Hearing

Before the proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies)

or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. All comments will be available for public inspection and copying. A public hearing will 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 public hearing will be published in the **Federal Register**.

##### Drafting Information

The principal author of these regulations is Lisa S. Dobson of the Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

##### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

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

Par. 2. Section 1.368-1 is amended by:

1. Revising paragraph (e)(2).
2. Revising and redesignating the text of paragraph (e)(8) as paragraph (e)(8)(i).
3. Adding paragraph (e)(8)(ii).

The revisions and addition read as follows:

*§1.368-1 Purpose and scope of exception of reorganization exchanges.*

[The text of the proposed amendment to §1.368-1(e)(2) and (e)(8) is the same as the text of §1.368-1T(e)(2) and (e)(8) published elsewhere in this issue of the Bulletin].

Kevin M. Brown,  
*Deputy Commissioner for  
Services and Enforcement.*

(Filed by the Office of the Federal Register on March 19, 2007, 8:45 a.m., and published in the issue of the Federal Register for March 20, 2007, 72 F.R. 13058)



**Corporate Reorganizations;  
Additional Guidance on  
Distributions Under Sections  
368(a)(1)(D) and 354(b)(1)(B);  
Correction**

**Announcement 2007-40**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to temporary regulations (T.D. 9313, 2007-13 I.R.B. 805) that were published in the **Federal Register** on Thursday, March 1, 2007 (72 FR 9262) providing guidance regarding the qualification of certain transactions as reorganizations described in section 368(a)(1)(D) where no stock and/or securities of the acquiring corporation are issued and distributed in the transaction.

DATES: This correcting amendment is effective March 29, 2007.

FOR FURTHER INFORMATION CONTACT: Bruce A. Decker at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

The temporary regulations that are the subjects of this correction are under section 368 of the Internal Revenue Code.

**Need for Correction**

As published, temporary regulations (T.D. 9313) contain an error that may prove to be misleading and is in need of clarification.

\* \* \* \* \*

**Correction of Publication**

Accordingly, 26 CFR part 1 is corrected by making the following amendments:

**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 1.368-2T is amended by revising paragraph (1)(2)(iv) to read as follows:

*§1.368-2T Definition of terms (temporary).*

\* \* \* \* \*  
(1) \* \* \*  
(2) \* \* \*

(iv) *Exception.* This paragraph (1)(2) of this section does not apply to a transaction otherwise described in §1.358-6(b)(2) or section 368(a)(1)(G) by reason of section 368(a)(2)(D).

\* \* \* \* \*

LaNita Van Dyke,  
*Chief, Publications and  
Regulations Branch,  
Legal Processing Division,  
Associate Chief Counsel  
(Procedure and Administration).*

(Filed by the Office of the Federal Register on March 28, 2007, 8:45 a.m., and published in the issue of the Federal Register for March 29, 2007, 72 F.R. 14678)

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

**Announcement 2007-41**

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another

person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin

their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

# Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the 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
Hankinson, Eugene M.	Somerset, PA	CPA	Indefinite from November 15, 2006
Canzano, Richard M.	Winchester, MA	Attorney	Indefinite from November 20, 2006
Sims, Jr., Lionel	Houston, TX	CPA	Indefinite from November 20, 2006
Wendekier, Raymond J.	Patton, PA	Attorney	Indefinite from November 21, 2006
Golden, Larry	Hinesville, GA	CPA	Indefinite from November 28, 2006
Lane, David B.	Hanover, MA	Attorney	Indefinite from November 28, 2006
Brown, Arthur I.	Miami, FL	CPA	Indefinite from December 1, 2006
Frisk, Daniel J.	Fargo, ND	Attorney	Indefinite from December 1, 2006
Small, Kenneth A.	McMurray, PA	CPA	Indefinite from December 1, 2006
Vazquez, Sonya M.	Port Orchard, WA	CPA	Indefinite from December 1, 2006
Swistak, Anthony	Adams, MA	Enrolled Agent	Indefinite from December 6, 2006
Lenahan, Jr., Robert J.	Elizabeth, NJ	Attorney	Indefinite from December 11, 2006

Name	Address	Designation	Date of Suspension
Hayes, Richard A.	Havervill, MA	Attorney	Indefinite from December 14, 2006
Scheller, Stephen M.	Coppell, TX	CPA	Indefinite from December 15, 2006
Wilson, James M.	Berlin, NJ	CPA	Indefinite from December 15, 2006
Franzese, Joseph P.	Winthrop, MA	Attorney	Indefinite from December 18, 2006
Black, Charles C.	Marietta, GA	Attorney	Indefinite from January 1, 2007
Enright, III, Robert A.	Naples, FL	Attorney	Indefinite from January 1, 2007
Fromovitz, Norman M.	Brooklyn, NY	CPA	Indefinite from January 1, 2007
Saylor, Mary A.	Iowa City, IA	Enrolled Agent	Indefinite from January 1, 2007
Seeherman, Alan	Wynnewood, PA	CPA	Indefinite from January 1, 2007
Beistel, Theodore L.	Canton, OH	CPA	Indefinite from January 3, 2007
Myers, Robert J.	Fairport Harbor, OH	CPA	Indefinite from January 9, 2007
Burrus, Robert V.	Valparaiso, IN	CPA	Indefinite from January 22, 2007
Patterson, Douglas W.	Newburgh, IN	Attorney	Indefinite from January 31, 2007
Lang, Jeffrey H.	Fishers, IN	CPA	Indefinite from January 22, 2007
Chickering, David	Vermillion, SD	CPA	February 5, 2007 to November 4, 2007

Name	Address	Designation	Date of Suspension
Moss, Steve E.	Henderson, NC	CPA	Indefinite from February 5, 2007
Hazlip, Kevin	Orange Park, FL	Enrolled Agent	Indefinite from February 10, 2007
Adelson, Robert A.	Newton, MA	Attorney	Indefinite from February 15, 2007
Boyer, Daniel D.	North Judson, IN	CPA	Indefinite from February 15, 2007
LaRusso, Anthony J.	North Caldwell, NJ	Attorney	Indefinite from February 15, 2007
Martin, Spencer R.	Lancaster, PA	CPA	Indefinite from February 15, 2007
Hursh, Stephanie S.	Brush Prairie, WA	Enrolled Agent	Indefinite from February 20, 2007
Guidera, George C.	Weston, CT	Attorney	Indefinite from February 26, 2007
Ruth, Christopher A.	Cypress, CA	CPA	Indefinite from February 27, 2007
Elias, Lenard S.	El Cajon, CA	Enrolled Agent	Indefinite from March 1, 2007
Ikeji, Chuck	Orlando, FL	CPA	Indefinite from March 1, 2007
Lewis, Craig S.	Savannah, GA	CPA	Indefinite from March 1, 2007
Sloan, Eric R.	Brighton, MI	CPA	Indefinite from March 1, 2007
Gostomski, Michael	Stamford, CT	CPA	Indefinite from March 5, 2007
Hafer, Charles J.	Hamburg, PA	Enrolled Agent	Indefinite from March 5, 2007
Jones, Phillip G.	Andalusia, AL	Enrolled Agent	Indefinite from March 7, 2007

Name	Address	Designation	Date of Suspension
Agashiwala, Mahesh J.	New York, NY	CPA	Indefinite from March 22, 2007
Berndgen, Michael	Plantation, FL	CPA	Indefinite from April 1, 2007
Grahn, Charles R.	Indianapolis, IN	Attorney	Indefinite from April 1, 2007
Shaw, G. Joyce	Hebron, KY	Enrolled Agent	Indefinite from April 1, 2007
Pikaart, Jr., Edward H.	N. Branford, CT	CPA	Indefinite from April 10, 2007
Kelley, Richard S.	Beverly, MA	Attorney	Indefinite from May 1, 2007
Crabtree, Michael L.	San Dimas, CA	Enrolled Agent	Indefinite from May 15, 2007
Hausmann, Mark D.	Troy, NY	Attorney	Indefinite from May 15, 2007

## 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
Hatchett, William M.	Pontiac, MI	Attorney	Indefinite from November 13, 2006
Jacobs, Mark L.	Jackson Heights, NY	Attorney	Indefinite from November 21, 2006
Sylver, Peter T.	E. Longmeadow, MA	Attorney	Indefinite from November 21, 2006

Name	Address	Designation	Date of Suspension
Portlock, David R.	Pensacola, FL	Enrolled Agent	Indefinite from November 27, 2006
Ascher, Michael P.	North Port, FL	Attorney	Indefinite from November 28, 2006
Barrett, Norman W.	Dover, DE	CPA	Indefinite from November 28, 2006
Burd, Gene	Houston, TX	Attorney	Indefinite from November 28, 2006
Caceres, Carlos H.	Silver Spring, MD	Attorney	Indefinite from November 28, 2006
Carrabotta, Peter S.	Niles, IL	Attorney	Indefinite from November 28, 2006
Davis, Carleton W.	St. Louis, MO	Attorney	Indefinite from November 28, 2006
Frasier, Roland B.	Rancho Santa Fe, CA	Attorney	Indefinite from November 28, 2006
Hubbard, Edward	Chicago, IL	Attorney	Indefinite from November 28, 2006
Hynes, Richard W.	Brookline, MA	Attorney	Indefinite from November 28, 2006
Johnson, Barbara C.	Andover, MA	Attorney	Indefinite from November 28, 2006
Konas, Theodore V.	Lancaster, PA	CPA	Indefinite from November 28, 2006
Korson, Daniel M.	Muskegon, MI	CPA	Indefinite from November 28, 2006
Lee, III, Norman J.	Collegeville, PA	Attorney	Indefinite from November 28, 2006
Loiben, Alan A.	Skokie, IL	Attorney	Indefinite from November 28, 2006

Name	Address	Designation	Date of Suspension
McGarry, Thomas H.	Denver, CO	Attorney	Indefinite from November 28, 2006
Roberts, Quinton D.	Elkridge, MD	Attorney	Indefinite from November 28, 2006
Schofield, Peter L.	Spencer, MA	Attorney	Indefinite from November 28, 2006
Shultz, Ryan K.	Mitchell, NE	Attorney	Indefinite from November 28, 2006
Stenger, Jeanne P.	Temecula, CA	Attorney	Indefinite from November 28, 2006
Wood, Gary K.	Edina, MN	Attorney	Indefinite from November 28, 2006
Bakare, Adigun S.	Laurel, MD	Attorney	Indefinite from December 6, 2006
Biagini, Marc J.	Downers Grove, IL	Attorney	Indefinite from December 6, 2006
Birchall, Richard G.	Brewster, MA	Attorney	Indefinite from December 6, 2006
Brown, Edward E.	Indianapolis, IN	Attorney	Indefinite from December 6, 2006
Cunningham, Jr., Shirley A.	Ft. Lauderdale, FL	Attorney	Indefinite from December 6, 2006
Docherty, Scott R.	Branson West, MO	Attorney	Indefinite from December 6, 2006
Dressler, Peter P.	West Chicago, IL	Attorney	Indefinite from December 6, 2006
Henry, William J.	Irvington, NJ	Attorney	Indefinite from December 6, 2006
Hubbard, Cynthia A.	Geneva, IL	Attorney	Indefinite from December 6, 2006
Jackson, Jr., Donald H.	Hanover, MA	Attorney	Indefinite from December 6, 2006

Name	Address	Designation	Date of Suspension
Katz, Norman H.	Owings Mills, MD	Attorney	Indefinite from December 6, 2006
Lakin, Leonard S.	Wellesley Hills, MA	Attorney	Indefinite from December 6, 2006
McGreevy, Jacqueline K.	Carbondale, CO	Attorney	Indefinite from December 6, 2006
Zepp, Dale D.	Ferguson, MO	Attorney	Indefinite from December 6, 2006
Triplett, Austin H.	Homewood, IL	Attorney	Indefinite from December 11, 2006
Murphy, Patrick W.	Honolulu, HI	Attorney	Indefinite from December 11, 2006
Cronin, Jr., Edward M.	Cambridge, MA	Attorney	Indefinite from December 11, 2006
Christof, Kevin F.	Santa Monica, CA	Attorney	Indefinite from December 21, 2006
Heath, Kenneth J.	Canaan, VT	CPA	Indefinite from December 21, 2006
Madigan, Brian C.	Binghamton, NY	Attorney	Indefinite from December 21, 2006
Malloy, Terry P.	Tulsa, OK	Attorney	Indefinite from December 21, 2006
Baynes, Robert M.	Indianapolis, IN	CPA	Indefinite from December 27, 2006
Ceresa, Richard A.	Woodbridge, CA	CPA	Indefinite from December 27, 2006
Crews, Richard A.	Henderson, CO	Attorney	Indefinite from December 27, 2006
Menkveld, Paul G.	Tucson, AZ	Attorney	Indefinite from December 27, 2006
Worischek, Joseph H.	Tempe, AZ	Attorney	Indefinite from December 27, 2006



Name	Address	Designation	Date of Suspension
Brown, Kirk P.	Pueblo, CO	Attorney	Indefinite from December 28, 2006
Dowling, Stanley W.	Scotts Valley, CA	CPA	Indefinite from December 28, 2006
Simmons, Henry L.	Greensboro, NC	CPA	Indefinite from December 28, 2006
Steele, Regina D.	San Diego, CA	Attorney	Indefinite from December 29, 2006
Craig, III, William A.	Austin, TX	Attorney	Indefinite from January 1, 2007
Acker, Thomas R.	Hollis Center, ME	Attorney	Indefinite from January 8, 2007
Baxter, Laura M.	Monee, IL	CPA	Indefinite from January 8, 2007
Herald, Sally J.	Cold Spring, KY	Attorney	Indefinite from January 8, 2007
Klapheke, II, William T.	Bowling Green, KY	Attorney	Indefinite from January 8, 2007
McCarthy, Charles C.	Encino, CA	Attorney	Indefinite from January 8, 2007
Bolling, Darius C.	Chicago, IL	CPA	Indefinite from January 10, 2007
Breitlauch, Linda	Saylorsburg, PA	Attorney	Indefinite from January 10, 2007
Coddington, Paul F.	Concord, NH	Attorney	Indefinite from January 10, 2007
Davis, Jr., William E.	Pinehurst, TX	CPA	Indefinite from January 10, 2007
Esola, Louis A.	Greensburg, PA	CPA	Indefinite from January 10, 2007
Finch, Judith A.	Walnut Creek, CA	Attorney	Indefinite from January 10, 2007

Name	Address	Designation	Date of Suspension
Jeing, Thomas C.	San Francisco, CA	Attorney	Indefinite from January 10, 2007
Ledbetter, Dean D.	Pelham, AL	CPA	Indefinite from January 10, 2007
McDiarmid, Katherine B.	Greensboro, NC	Attorney	Indefinite from January 10, 2007
Mills, George P.	Oceanside, CA	Attorney	Indefinite from January 10, 2007
Rather, James L.	Irvine, CA	Attorney	Indefinite from January 10, 2007
Rivera, Eduardo M.	Torrance, CA	Attorney	Indefinite from January 10, 2007
Stepovich, Michael A.	Fairbanks, AK	Attorney	Indefinite from January 10, 2007
Ulbrich, David L.	Woodland Hills, CA	CPA	Indefinite from January 10, 2007
Swanson, Todd-Ellis	Greenville, SC	CPA	Indefinite from January 20, 2007
Rubin, Deborah L.	Delray Beach, FL	Attorney	Indefinite from January 26, 2007
Wood, Brent E.	Cary, NC	Attorney	Indefinite from January 26, 2007
Currin, Samuel T.	Raleigh, NC	Attorney	Indefinite from February 7, 2007
Lupo, Robert N.	Weston, MA	Attorney	Indefinite from February 20, 2007
Taggart, Lawrence W.	El Cajon, CA	Attorney	Indefinite from March 7, 2007
Fife, III, James H.	Schererville, IN	Attorney	Indefinite from March 8, 2007
Katsis, Kevin G.	Riverside, IL	Attorney	Indefinite from March 8, 2007

Name	Address	Designation	Date of Suspension
O'Driscoll, Dennis M.	Quincy, MA	Attorney	Indefinite from March 8, 2007
Siever, Beth F.	Austin, TX	Attorney	Indefinite from March 8, 2007
Wheatley-Clark, Sheila R.	Houston, TX	CPA	Indefinite from March 8, 2007

## Suspensions 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 ad-

ministrative law judge, the following individuals have been placed under suspension

from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Redmond, Debra	Gifford, PA	Enrolled Agent	Indefinite from March 5, 2007

## 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 oppor-

tunity for a proceeding before an administrative law judge, the following individu-

als have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Brookstein, Gary	Huntingdon Valley, PA	CPA	December 15, 2006
James T. Jubb	Baltimore, MD	CPA	December 15, 2006

## Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent,

or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Zucker, Robert W.	Boca Raton, FL	CPA	November 14, 2006
Montgomery, David E.	Pleasanton, CA	Enrolled Agent	November 15, 2006

Name	Address	Designation	Date of Censure
Higgins, James M.	S. Boston, MA	Attorney	December 1, 2006
Pennington, Debra L.	Lees Summit, MO	Enrolled Agent	January 29, 2007
Goodwin, Steven C.	Concord, MA	Attorney	February 2, 2007
Francis, Andrew W.E.	Houston, TX	CPA	February 21, 2007
Griffin, Richard M.	Duluth, GA	CPA	February 28, 2007

## 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 Resignation
Filipski, Kenneth M.	Bakersfield, CA	April 16, 2007

# 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.

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