Internal Revenue
bulletin

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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 8960, page 176.
Temporary regulations under section 355(e) of the Code generally require corporations to recognize gain on certain distributions of stock or securities of a subsidiary corporation if the distribution is part of a plan that also involves one or more persons acquiring a 50-percent or greater interest in the distributing corporation or any controlled corporation.

Rev. Proc. 2001–43, page 191.
Partnership profits interests. This procedure clarifies Rev. Proc. 93–27 (1993–2 C.B. 343) by providing guidance on the treatment of the grant of a partnership profits interest that is substantially nonvested for the provision of services to or for the benefit of the partnership. Rev. Proc. 93–27 clarified.

EMPLOYMENT TAX

T.D. 8959, page 185.
Final regulations under section 6205 of the Code provide guidance on interest-free adjustments of certain underpayments of employment taxes.

ESTATE TAX

Notice 2001–50, page 189.
This notice provides guidance regarding requests for an extension of time to make an allocation of generation-skipping transfer (GST) exemption under sections 2642(b)(1) and (2) of the Code. It also provides guidance regarding requests for an extension of time to make GST elections under sections 2632(b)(3) and 2632(c)(5).

GIFT TAX

Notice 2001–50, page 189.
This notice provides guidance regarding requests for an extension of time to make an allocation of generation-skipping transfer (GST) exemption under sections 2642(b)(1) and (2) of the Code. It also provides guidance regarding requests for an extension of time to make GST elections under sections 2632(b)(3) and 2632(c)(5).

ADMINISTRATIVE

T.D. 8958, page 183.
Final regulations under section 6103 of the Code authorize the Service to disclose return information to the Department of Agriculture to structure, prepare, and conduct the Census of Agriculture.

Notice 2001–49, page 188.
This notice proposes a revenue procedure that sets forth a safe harbor under which an issue of tax or revenue anticipation bonds will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of the bonds under section 1.148–10(a)(4) of the regulations. The proposed procedure will apply to bonds sold after the date the procedure is published in the Internal Revenue Bulletin in final form. However, issuers may rely on the proposed procedure with respect to any issue of tax or revenue anticipation bonds that is sold before the effective

(Continued on the next page)

Actions Relating to Court Decisions is on the page following the Introduction.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

date of the proposed revenue procedure and on or after August 3, 2001.

Notice 2001–51, page 190.
Listed transactions. This notice updates a listing of certain transactions that the Service has determined are tax avoidance transactions and identifies them as "listed transactions" for purposes of sections 1.6011–4T(b)(2) and 301.6111–2T(b)(2) of the temporary regulations. Notice 2000–15 supplemented and superseded.

The IRS Mission

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

Introduction

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

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

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

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

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

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

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

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. "Nonacquiescence" signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a "nonacquiescence" indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletin are consolidated semiannually and appear in the first Bulletin for July and the Cumulative Bulletin for the first half of the year. A semiannual consolidation also appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner does NOT ACQUIESCE in the following decision:

Mesa Oil, Inc. v. United States,[1]
86 A.F.T.R.2d (RIA) 7312
(D. Colo. 2000)

[1] Nonacquiescence relating to whether a verbatim recording of a Collection Due Process (CDP) hearing is required under I.R.C. sections 6320 and 6330 to create a judicially reviewable administrative record.

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355–7T: Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

T.D. 8960

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Guidance Under Section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities in Connection With an Acquisition

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. Changes to the applicable law were made by the Taxpayer Relief Act of 1997. These temporary regulations affect corporations and are necessary to provide them with guidance needed to comply with these changes.

EFFECTIVE DATES: These temporary regulations are effective August 3, 2001.

FOR FURTHER INFORMATION CONTACT: Megan R. Fitzsimmons of the Office of Associate Chief Counsel (Corporate), (202) 622-7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On January 2, 2001, the IRS and Treasury published in the **Federal Register** (66 FR 66) a notice of proposed rulemaking (REG–107566–00, 2001–3 I.R.B. 346) (the Proposed Regulations) under section 355(e) of the Internal Revenue Code of 1986. Section 355(e) provides that the stock of a controlled corporation will not be qualified property under section 355(c)(2) or 361(c)(2) if the stock is distributed as "part of a plan (or series of related transactions) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation."

The Proposed Regulations provide guidance concerning the interpretation of the phrase "plan (or series of related transactions)." The Proposed Regulations generally provide that whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances. They also set forth six safe harbors, the satisfaction of which would confirm that a distribution and an acquisition are not part of a plan.

A public hearing regarding the Proposed Regulations was held on May 15, 2001. In addition, written comments were received. A number of commentators have indicated that the lack of guidance under section 355(e) is hindering the ability to undertake acquisitions and divestitures. These commentators have requested that the IRS and Treasury provide immediate guidance pending the finalization of those regulations. In response to these requests, the IRS and Treasury are promulgating the Proposed Regulations as temporary regulations in this Treasury Decision. The temporary regulations are identical to the Proposed Regulations, except that the temporary regulations reserve section 1.355–7(e)(6) (suspending the running of any time period prescribed in the Proposed Regulations during which there is a substantial diminution of risk of loss under the principles of section 355(d)(6)(B)) and Example 7 of the Proposed Regulations (interpreting the term "similar acquisition" in the context of a situation involving multiple acquisitions).

The IRS and Treasury continue to study all of the comments received regarding the Proposed Regulations. The IRS and Treasury will continue to devote significant resources to analyzing the comments and, in the near future, expect to issue additional guidance regarding the interpretation of the phrase "plan (or series of related transactions)."

Special Analyses

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

Drafting Information

The principal author of these temporary regulations is Brendan P. O'Hara, Office of the Associate Chief Counsel (Corporate). However, other personnel from the Department of the Treasury and the IRS participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.355–7T also issued under 26 U.S.C. 355(e)(5). * * *

Par. 2. Section 1.355–0 is amended by revising the section heading and the introductory text and adding an entry for §1.355–7T to read in part as follows:

§1.355–0 Outline of sections.

In order to facilitate the use of §§1.355–1 through 1.355–7T, this section lists the major paragraphs in those sections as follows:

* * * * *

§1.355–7T Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

(a) In general.
(b) Plan.
(c) Multiple acquisitions.
(d) Facts and circumstances.
(e) Operating rules.
(1) Reasonable certainty evidence of business purpose to facilitate an acquisition.
(2) Internal discussion evidence of business purpose.
(3) Hostile takeover defense.
(4) Effect of distribution on trading in stock.
(5) Consequences of section 355(e) disregarded for certain purposes.
(6) Substantial diminution of risk. [Reserved]
(f) Safe harbors.
(1) Safe Harbor I.
(2) Safe Harbor II.
(3) Safe Harbor III.
(4) Safe Harbor IV.
(5) Safe Harbor V.
(i) In general.
(ii) Special rules.
(6) Safe Harbor VI.
(g) Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests.
(1) Treatment of options.
(i) General rule.
(ii) Agreement, understanding, arrangement, or substantial negotiations to write an option.
(2) Instruments treated as options.
(3) Instruments generally not treated as options.
(i) Escrow, pledge, or other security agreements.
(ii) Compensatory options.
(iii) Options exercisable only upon death, disability, mental incompetency, or separation from service.
(iv) Rights of first refusal.
(v) Other enumerated instruments.
(h) Multiple controlled corporations.
(i) [Reserved]
(j) Valuation.
(k) Definitions.
(1) Agreement, understanding, arrangement, or substantial negotiations.
(2) Controlled corporation.
(3) Controlling shareholder.
(4) Established market.
(5) Five-percent shareholder.
(l) [Reserved]
(m) Examples.
(n) Effective date.

Par. 3. Section 1.355–7T is added to read as follows:

§1.355–7T Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

(a) *In general*. Except as provided in section 355(e) and in this section, section 355(e) applies to any distribution—

(1) To which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) That is part of a plan (or series of related transactions) (referred to elsewhere in this section as "plan") pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation (Distributing) or any controlled corporation (Controlled).

(b) *Plan*. (1) Whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances. In general, in the case of an acquisition after a distribution, the distribution and the acquisition are considered part of a plan if Distributing, Controlled, or any of their respective controlling shareholders intended, on the date of the distribution, that the acquisition or a similar acquisition occur in connection with the distribution. In general, in the case of an acquisition before a distribution, the acquisition and the distribution are considered part of a plan if Distributing, Controlled, or any of their respective controlling shareholders intended, on the date of the acquisition, that a distribution occur in connection with the acquisition.

(2) For purposes of paragraph (b)(1) of this section, the actual acquisition and the intended acquisition may be similar even though the identity of the person acquiring stock of Distributing or Controlled (acquirer), the timing of the acquisition or the terms of the actual acquisition are different from the intended acquisition. For example, in the case of a public offering or auction, the actual acquisition and the intended acquisition may be similar even though there are changes in the terms of the stock, the class of stock being offered, the size of the offering, the timing of the offering, the price of the stock, or the participants in the public offering or auction.

(c) *Multiple acquisitions*. All acquisitions of stock of Distributing or Controlled that are considered to be part of a plan with a distribution pursuant to paragraph (b) of this section will be aggregated for purposes of the 50-percent test of paragraph (a)(2) of this section.

(d) *Facts and circumstances*. (1) The facts and circumstances to be considered in demonstrating whether a distribution and an acquisition are part of a plan include, but are not limited to, the facts and circumstances specified in paragraphs (d)(2) and (3) of this section. The weight to be given each of the facts and circumstances depends on the particular case. Therefore, whether a distribution and an acquisition are part of a plan does not depend on the relative number of facts and circumstances present under paragraph (d)(2) of this section as compared to paragraph (d)(3) of this section.

(2) Among the facts and circumstances tending to show that a distribution and an acquisition are part of a plan are the following:

(i) In the case of an acquisition (other than involving a public offering or auction) after a distribution, Distributing or Controlled and the acquirer (or any of their respective controlling shareholders) discussed the acquisition or a similar acquisition by the acquirer before the distribution. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions. The existence of an agreement, understanding, arrangement or substantial negotiations at the time of the distribution is given substantial weight.

(ii) In the case of an acquisition (other than involving a public offering or auction) after a distribution, Distributing or Controlled and a potential acquirer (or any of their respective controlling shareholders) discussed an acquisition before the distribution and a similar acquisition by a different person occurred after the distribution. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions and the similarity of the acquisition actually occurring to the acquisition discussed before the distribution.

(iii) In the case of an acquisition involving a public offering or auction after a distribution, Distributing or Controlled (or any of their respective controlling shareholders) discussed the acquisition with an investment banker or other outside adviser before the distribution. The

weight to be accorded the discussions depends on the nature, extent, and timing of the discussions.

(iv) In the case of an acquisition before a distribution, Distributing or Controlled and the acquirer (or any of their respective controlling shareholders) discussed a distribution before the acquisition. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions.

(v) In the case of an acquisition before a distribution, Distributing or Controlled and a potential acquirer (or any of their respective controlling shareholders) discussed a distribution before the acquisition and a similar acquisition by a different person occurred before the distribution. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions and the similarity of the acquisition actually occurring to the potential acquisition that was discussed.

(vi) In the case of an acquisition involving a public offering or auction before a distribution, Distributing or Controlled (or any of their respective controlling shareholders) discussed a distribution with an investment banker or other outside adviser before the acquisition. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions.

(vii) In the case of an acquisition either before or after a distribution, the distribution was motivated by a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled.

(viii) In the case of an acquisition either before or after a distribution, the acquisition and the distribution occurred within 6 months of each other or there was an agreement, understanding, arrangement, or substantial negotiations regarding the second transaction within 6 months after the first transaction. Also, in the case of an acquisition occurring after a distribution, there was an agreement, understanding, arrangement, or substantial negotiations regarding a similar acquisition at the time of the distribution or within 6 months thereafter.

(ix) In the case of an acquisition either before or after a distribution, the debt allocation between Distributing and Controlled made an acquisition of Distributing or Controlled likely in order to service the debt.

(3) Among the facts and circumstances tending to show that a distribution and an acquisition are not part of a plan are the following:

(i) In the case of an acquisition (other than involving a public offering or auction) after a distribution, neither Distributing nor Controlled and the acquirer or any potential acquirer (nor any of their respective controlling shareholders) discussed the acquisition or a similar acquisition before the distribution.

(ii) In the case of an acquisition involving a public offering or auction after a distribution, neither Distributing nor Controlled (nor any of their respective controlling shareholders) discussed the acquisition with an investment banker or other outside adviser before the distribution.

(iii) In the case of an acquisition after a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the distribution that resulted in the acquisition that was otherwise unexpected at the time of the distribution.

(iv) In the case of an acquisition (other than involving a public offering or auction) before a distribution, neither Distributing nor Controlled and the acquirer (nor any of their respective controlling shareholders) discussed a distribution before the acquisition. This paragraph (d)(3)(iv) does not apply if the acquisition occurred after the date of the public announcement of the planned distribution.

(v) In the case of an acquisition before a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the acquisition that resulted in a distribution that was otherwise unexpected.

(vi) In the case of an acquisition either before or after a distribution, the distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled. The presence of a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled is relevant in determining the extent to which the distribution was motivated by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled.

(vii) In the case of an acquisition either before or after a distribution, the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition (including a previously proposed similar acquisition that did not occur).

(e) *Operating rules*. The operating rules contained in this paragraph (e) apply for all purposes of this section.

(1) *Reasonable certainty evidence of business purpose to facilitate an acquisition*. (i) In the case of an acquisition after a distribution, if, at the time of the distribution, it was reasonably certain that before a date that is 6 months after the distribution an acquisition would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding an acquisition of Distributing or Controlled, the reasonable certainty is evidence of a business purpose to facilitate an acquisition of Distributing or Controlled.

(ii) In the case of an acquisition before a distribution, if the acquisition occurred after the date of the public announcement of the planned distribution, or if, at the time of the acquisition, it was reasonably certain that before a date that is 6 months after the acquisition the distribution would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding the distribution, the public announcement or reasonable certainty is evidence of a business purpose to facilitate an acquisition of Distributing or Controlled.

(2) *Internal discussions evidence of business purpose.* The fact that internal discussions regarding an acquisition occurred may be indicative of the business purpose that motivated the distribution.

(3) *Hostile takeover defense.* If Distributing distributes Controlled stock intending, in whole or substantial part, to decrease the likelihood of the acquisition of Distributing or Controlled by separating it from another corporation that is likely to be acquired, Distributing will be treated as having a business purpose to facilitate the acquisition of the corporation that was likely to be acquired.

(4) *Effect of distribution on trading in stock.* The fact that the distribution made all or a part of the stock of Controlled available for trading or made Distributing or Controlled's stock trade more actively is not taken into account in determining whether the distribution and an acquisition of Distributing or Controlled stock were part of a plan.

(5) *Consequences of section 355(e) disregarded for certain purposes.* For purposes of determining the intentions of the relevant parties under this section, the consequences of the application of section 355(e), and the existence of any contractual indemnity by Controlled for tax resulting from the application of section 355(e) caused by an acquisition of Controlled, are disregarded.

(6) *Substantial diminution of risk.* [Reserved]

(f) *Safe harbors*—(1) *Safe Harbor I.* (i) A distribution and an acquisition occurring after the distribution will not be considered part of a plan if—

(A) The acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition before a date that is 6 months after the distribution; and

(B) The distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate an acquisition of Distributing or Controlled.

(ii) For purposes of paragraph (f)(1)(i)(B) of this section, the presence of a business purpose to facilitate an acquisition of Distributing or Controlled is relevant in determining the extent to which the distribution was motivated by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate an acquisition of Distributing or Controlled.

(2) *Safe Harbor II.* A distribution and an acquisition occurring after the distribution will not be considered part of a plan if—

(i) The acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition before a date that is 6 months after the distribution; and

(ii) The distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of §1.355–2(b)) to facilitate an acquisition or acquisitions of no more than 33 percent of the stock of Distributing or Controlled, and no more than 20 percent of the stock of the corporation (whose stock was acquired in the acquisition or acquisitions that motivated the distribution) was either acquired or the subject of an agreement, understanding, arrangement, or substantial negotiations before a date that is 6 months after the distribution.

(3) *Safe Harbor III.* If an acquisition occurs more than 2 years after a distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition at the time of the distribution or within 6 months thereafter, the acquisition and the distribution are not part of a plan.

(4) *Safe Harbor IV.* If an acquisition occurs more than 2 years before a distribution, and there was no agreement, understanding, arrangement, or substantial negotiations concerning the distribution at the time of the acquisition or within 6 months thereafter, the acquisition and the distribution are not part of a plan.

(5) *Safe Harbor V*—(i) *In general.* An acquisition of Distributing or Controlled stock that is listed on an established market is not part of a plan if the acquisition is pursuant to a transfer between shareholders of Distributing or Controlled, neither of whom is a 5-percent shareholder. For purposes of the preceding sentence, the term 5-percent shareholder is defined in paragraph (k)(5) of this section, except that the corporation can rely on Schedules 13D and 13G (or any similar schedules) filed with the Securities and Exchange Commission to identify its 5-percent shareholders.

(ii) *Special rules.* (A) This paragraph (f)(5) does not apply to public offerings or redemptions.

(B) This paragraph (f)(5) does not apply to a transfer of stock by or to a person who, pursuant to a formal or informal understanding with other persons (the coordinating group), has joined in coordinated transfers of stock if, at any time during the period the understanding exists, the coordinating group owns, in the aggregate, 5 percent or more of the stock of the corporation whose stock is transferred (determined by vote or value) immediately before or after each transfer or at the time of the distribution. A principal element in determining if such an understanding exists is whether the investment decision of each person is based on the investment decision of 1 or more other existing or prospective shareholders.

(C) This paragraph (f)(5) does not apply to a transfer of stock by or to a person if the corporation the stock of which is being transferred knows, or has reason to know, that the person (or a coordinating group, treating it as a single person) intends to become a 5-percent shareholder at any time during the 4-year period beginning 2 years before the distribution.

(6) *Safe Harbor VI.* If stock of Distributing or Controlled is acquired by an employee or director of Distributing, Controlled, or a person related to Distributing or Controlled under section 355(d)(7)(A), in connection with the performance of services as an employee or director for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed) in a transaction to which section 83 applies, the acquisition is not an acquisition that is part of a plan as described in paragraph (b)(1) of this section.

(g) *Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests*—(1) *Treatment of options*—(i) *General rule.* For purposes of this section, if stock of Distributing or Controlled is acquired pursuant to an option, the option will be treated as an agreement to acquire the stock on the date the option is written unless Distributing establishes that on the later of the date of the stock distribution or the writing of the option, the option was not more likely than not to be exercised. The determination of whether an option was more likely than not to be exercised is based on all the facts and circumstances, taking control premiums and minority and blockage discounts into account in determining the fair market value of stock underlying an option.

(ii) *Agreement, understanding, arrangement, or substantial negotiations to write an option.* If there is an agreement, understanding, or arrangement to write an option, the option will be treated as written on the date of the agreement, understanding, or arrangement. If an agreement, understanding, or arrange-

ment to write an option is reached, or an option is written, more than 6 months but not more than 2 years after the distribution, and there were substantial negotiations regarding the writing of the option or the acquisition of the stock underlying the option before the end of the 6-month period beginning on the date of the distribution, the option will be treated as written within 6 months after the distribution.

(2) *Instruments treated as options*. For purposes of this paragraph (g), except to the extent provided in paragraph (g)(3) of this section, call options, warrants, convertible obligations, the conversion feature of convertible stock, put options, redemption agreements (including rights to cause the redemption of stock), any other instruments that provide for the right or possibility to issue, redeem, or transfer stock (including an option on an option), or any other similar interests are treated as options.

(3) *Instruments generally not treated as options*. For purposes of this paragraph (g), the following are not treated as options unless (in the case of paragraphs (g)(3)(i), (iii), and (iv) of this section) written, transferred (directly or indirectly), or listed with a principal purpose of avoiding the application of section 355(e) or this section.

(i) *Escrow, pledge, or other security agreements*. An option that is part of a security arrangement in a typical lending transaction (including a purchase money loan), if the arrangement is subject to customary commercial conditions. For this purpose, a security arrangement includes, for example, an agreement for holding stock in escrow or under a pledge or other security agreement, or an option to acquire stock contingent upon a default under a loan.

(ii) *Compensatory options*. An option to acquire stock in Distributing or Controlled with customary terms and conditions provided to an employee or director of Distributing, Controlled, or a person related to Distributing or Controlled under section 355(d)(7)(A), in connection with the performance of services as an employee or director for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed) and that immediately after the distribution and within 6 months thereafter—

(A) Is nontransferable within the meaning of §1.83–3(d); and

(B) Does not have a readily ascertainable fair market value as defined in §1.83–7(b).

(iii) *Options exercisable only upon death, disability, mental incompetency, or separation from service*. Any option entered into between shareholders of a corporation (or a shareholder and the corporation) that is exercisable only upon the death, disability, or mental incompetency of the shareholder, or, in the case of stock acquired in connection with the performance of services for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed), the shareholder's separation from service.

(iv) *Rights of first refusal*. A *bona fide* right of first refusal regarding the corporation's stock with customary terms, entered into between shareholders of a corporation (or between the corporation and a shareholder).

(v) *Other enumerated instruments*. Any other instrument the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(h) *Multiple controlled corporations*. Only the stock or securities of a controlled corporation in which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest as part of a plan involving the distribution of that corporation will be treated as not qualified property under section 355(e)(1) if—

(1) The stock or securities of more than 1 controlled corporation are distributed in distributions to which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) One or more persons do not acquire, directly or indirectly, stock representing a 50-percent or greater interest in Distributing pursuant to a plan involving any of those distributions.

(i) [Reserved]

(j) *Valuation.* Except as provided in paragraph (g)(1)(i) of this section, for purposes of section 355(e) and this section, all shares of stock within a single class are considered to have the same value. Thus, control premiums and minority and blockage discounts within a single class are not taken into account.

(k) *Definitions*—(1) *Agreement, understanding, arrangement, or substantial negotiations*. Whether an agreement, understanding, or arrangement exists depends on the facts and circumstances. The parties do not necessarily have to have entered into a binding contract or have reached agreement on all terms to have an agreement, understanding, or arrangement. However, an agreement, understanding, or arrangement clearly exists if enforceable rights to acquire stock exist. In public offerings or auctions by Distributing or Controlled of Distributing or Controlled's stock, an agreement, understanding, arrangement, or substantial negotiations can exist even if the acquirer has not been specifically identified. The existence of such an agreement, understanding, arrangement, or substantial negotiations will be based on discussions with an investment banker or other outside adviser.

(2) *Controlled corporation*. For purposes of this section, a controlled corporation is a corporation the stock of which is distributed in a distribution to which section 355 (or so much of section 356 as relates to section 355) applies.

(3) *Controlling shareholder*. (i) A controlling shareholder of a corporation the stock of which is not listed on an established market is any person who, directly or indirectly, or together with related persons (as described in sections 267(b) and 707(b)), possesses voting power in Distributing or Controlled representing a meaningful voice in the governance of the corporation.

(ii) A controlling shareholder of a corporation the stock of which is listed on an established market is a 5-percent shareholder who actively participates in the management or operation of the corporation.

(iii) For purposes of this section, a person is a controlling shareholder if that person meets the definition of controlling shareholder in this paragraph (k)(3) immediately before or immediately after the acquisition being tested.

(iv) If a distribution precedes an acquisition, Controlled's controlling shareholders immediately after the distribution are considered Controlled's controlling shareholders at the time of the distribution.

(4) *Established market*. An established market is—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f);

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Act of 1934 (15 U.S.C. 78o–3); or

(iii) Any additional market that the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(5) *Five-percent shareholder*. A person will be considered a 5-percent shareholder of a corporation the stock of which is listed on an established market if the person owns, directly or indirectly, or together with related persons (as described in sections 267(b) and 707(b)) 5 percent or more of any class of stock of the corporation whose stock is transferred. A person is a 5-percent shareholder if the person meets the requirements of the preceding sentence immediately before or after each transfer. All options are treated as exercised for the purpose of determining whether the shareholder is a 5-percent shareholder.

(l) [Reserved]

(m) *Examples*. The following examples illustrate paragraphs (a) through (k) of this section. Throughout these examples, assume that Distributing (D) owns all of the stock of Controlled (C). Assume further that D distributes the stock of C in a distribution to which section 355 applies and to which section 355(d) does not apply. Unless otherwise stated, assume the corporations do not have controlling shareholders. No inference should be drawn from any example concerning whether any requirements of section 355 other than those of section 355(e) are satisfied. The examples are as follows:

Example 1. Unwanted assets. (i) D is in business 1. C is in business 2. D is relatively small in its industry. D wants to combine with X, a larger corporation also engaged in business 1. X and D begin negotiating for X to acquire D, but X does not want to acquire C. To facilitate the acquisition of D by X, D agrees to distribute all the stock of C *pro rata* before the acquisition. D and X enter into a binding contract for D to merge into X subject to several conditions. D distributes C and D merges into X one month later. As a result of the merger, D's former shareholders own less than 50 percent of the stock of X.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the distribution of C and the merger of D into X are part of a plan. To determine whether the distribution of C and the merger of D into X are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) The following tends to show that the distribution of C and the merger of D into X are part of a plan: X and D discussed the acquisition before the distribution (paragraph (d)(2)(i) of this section), D was motivated by a business purpose to facilitate the merger (paragraph (d)(2)(vii) of this section), and the distribution and the merger occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). Because the merger was not only discussed, but was agreed to, before the distribution, the fact described in paragraph (d)(2)(i) of this section is given substantial weight.

(v) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(vi) The distribution of C and the merger of D into X are part of a plan under paragraph (b)(1) of this section.

Example 2. Substituted acquirer. (i) The facts are the same as in *Example 1*, except that after D distributes C, X is unable to fulfill one of the conditions of the merger agreement and the merger of D into X does not occur. Y, one of X's competitors, perceives this as an opportunity and begins discussing with D a merger into Y. Five months after D distributes C, D merges into Y. As a result of the merger, the D shareholders own less than 50 percent of the outstanding Y stock.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the distribution of C and the merger of D into Y are part of a plan. To determine whether the distribution of C and the merger of D into Y are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) The following tends to show that the distribution of C and the merger of D into Y are part of a plan: X, a potential acquirer, and D discussed an acquisition before the distribution and a similar acquisition by Y occurred (paragraph (d)(2)(ii) of this section), D was motivated by a business purpose to facilitate an acquisition similar to the merger with Y (paragraph (d)(2)(vii) of this section), and the distribution and the merger occurred within 6 months of each other (paragraph (d)(2)(viii) of this section).

(v) As in *Example 1*, none of the facts and circumstances listed in paragraph (d)(3) of this section exist in this case. Although a substituted acquirer acquired D, the merger of D into Y was similar to the negotiated merger of D into X.

(vi) The distribution of C and the merger of D into Y are part of a plan under paragraph (b)(1) of this section.

Example 3. Public offering. (i) D's managers, directors, and investment banker discuss the possibility of offering D stock to the public. They decide a public offering of 50 percent of D's stock with D as a stand alone corporation would be in D's best interest. To facilitate a stock offering by D of 50 percent of its stock, D distributes all the stock of C *pro rata* to D's shareholders. D issues new shares amounting to 50 percent of its stock to the public in a public offering 7 months after the distribution.

(ii) No Safe Harbor applies to this acquisition. Safe Harbor V, relating to public trading, does not apply to public offerings (paragraph (f)(5)(ii)(A) of this section).

(iii) The issue is whether the distribution of C and the public offering by D are part of a plan. To determine whether the distribution of C and the public offering by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) The following tends to show that the distribution of C and the public offering by D are part of a plan: D discussed the public offering with its investment banker before the distribution (paragraph (d)(2)(iii) of this section), D was motivated by a business purpose to facilitate the public offering (paragraph (d)(2)(vii) of this section), and there were substantial negotiations regarding the public offering within 6 months after the distribution (paragraph (d)(2)(viii) of this section).

(v) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(vi) The distribution of C and the public offering by D are part of a plan under paragraph (b)(1) of this section.

Example 4. Public offering followed by unexpected opportunity. (i) *Facts*. D's managers, directors, and investment banker discuss the possibility of offering C stock to the public. D decides to distribute C *pro rata* to D's shareholders solely to facilitate a 20 percent stock offering by C. To take advantage of favorable market conditions, C issues new shares amounting to 20 percent of its stock in a public offering 1 month before D distributes its remaining 80 percent of the C stock. The public offering documents disclose the intended distribution of C, which is expected to occur shortly after the public offering. At the time of the distribution, it is not reasonably certain that an acquisition will occur, an agreement, understanding, or arrangement concerning an acquisition will exist, or substantial negotiations concerning an acquisition will occur within 6 months. Two months after the distribution, C is approached unexpectedly regarding an opportunity to acquire X. Five months after the distribution, C acquires X in exchange for 40 percent of the C stock.

(ii) *Public offering*. (A) No Safe Harbor applies to the public offering. Safe Harbor V, related to public trading, does not apply to public offerings (paragraph (f)(5)(ii)(A) of this section).

(B) The issue is whether the 20 percent public offering by C and the distribution by D of the remaining C stock are part of a plan. To determine whether the distribution and the public offering are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(C) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and the public offering are part of a plan: D discussed the distribution with its investment banker before the public offering (paragraph (d)(2)(vi) of this section), D was motivated by a business purpose to facilitate the public offering (paragraph (d)(2)(vii) of this section), and the public offering and the distribution occurred within 6 months of each other (paragraph (d)(2)(viii) of this section).

(D) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(E) The public offering of C and the distribution of C are part of a plan under paragraph (b)(1) of this section.

(iii) *X acquisition*. (A) No Safe Harbor applies to the X acquisition.

(B) The issue is whether the distribution of C and the acquisition by C of X are part of a plan. To determine whether the distribution of C and the acquisition by C of X are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(C) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and acquisition by C of X are part of a plan: The distribution and the acquisition occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). The fact described in paragraph (d)(2)(vii) of this section does not exist in this case because D's business purpose was to facilitate the public offering and C's acquisition of X is not similar to that acquisition.

(D) Under paragraph (d)(3) of this section, the following tends to show that the distribution of C and the acquisition by C of X are not part of a plan: Neither D, C, nor their respective controlling shareholders discussed the acquisition of X or a similar acquisition with potential acquirers before the distribution (paragraph (d)(3)(i) of this section), D had a substantial business purpose for the distribution other than a business purpose to facilitate the acquisition of X or a similar acquisition (paragraph (d)(3)(vi) of this section), and the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition of X (paragraph (d)(3)(vii) of this section). The distribution was announced and accomplished to facilitate the 20 percent public offering by C. D and C were unaware of the opportunity to acquire X at the time of the distribution.

(E) Weighing the facts and circumstances, the acquisition by C of X and the distribution of C by D are not part of a plan under paragraph (b)(1) of this section.

(F) If C's acquisition of X had occurred more than 6 months after the distribution and had not been the subject of an agreement, understanding, arrangement, or substantial negotiations before the date that is 6 months after the distribution, Safe Harbor II would have applied to C's acquisition of X.

Example 5. Hot market. (i) D is a widely held corporation the stock of which is listed on an established market. D announces a distribution of C and distributes C *pro rata* to D's shareholders. By contract, C agrees to indemnify D for any imposition of tax under section 355(e) caused by the acts of C. The distribution is motivated by a desire to improve D's access to financing at preferred customer interest rates, which will be more readily available if D separates from C. At the time of the distribution, although D has not been approached by any potential acquirer of C, it is reasonably certain that within 6 months after the distribution either an acquisition of C will occur or there will be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C. Corporation Y acquires C in a merger described in section 368(a)(2)(E) within 6 months after the distribution. The C shareholders receive less than 50 percent of the stock of Y in the exchange.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the distribution of C and the acquisition of C by Y are part of a plan. To determine whether the distribution of C and the acquisition of C by Y are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and the acquisition of C by Y are part of a plan: The acquisition and the distribution occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). In addition, the distribution may be motivated by a business purpose to facilitate the acquisition or a similar acquisition because there is evidence of a business purpose to facilitate an acquisition by reason of the fact that at the time of the distribution it was reasonably certain that an acquisition of C would occur or there would be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C within 6 months after the distribution (paragraphs (d)(2)(vii) and (e)(1)(i) of this section).

(v) Under paragraph (d)(3) of this section, the following tends to show that the distribution of C and the acquisition of C by Y are not part of a plan: Neither D, C, nor their respective controlling shareholders discussed the acquisition or a similar acquisition with Y or any other potential acquirers before the distribution (paragraph (d)(3)(i) of this section). Furthermore, D may be able to demonstrate that the distribution was motivated in whole or substantial part by a corporate business purpose other than a business purpose to facilitate the acquisition or a similar acquisition (paragraph (d)(3)(vi) of this section). D's stated purpose for the distribution (facilitating D's access to favorable financing) must be evaluated in light of the evidence of a business purpose to facilitate an acquisition. D also may be able to demonstrate that the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition (paragraph (d)(3)(vii) of this section).

(vi) Under paragraph (e)(5) of this section, the existence of the indemnity is irrelevant in analyzing whether the distribution and acquisition of C are part of a plan.

(vii) In determining whether the distribution of C and the acquisition of C by Y are part of a plan, one should consider the importance of D's stated business purpose for the distribution in light of the reasonable certainty that C would be acquired or there would be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C within 6 months after the distribution. If D's stated business purpose for the distribution is substantial even though the reasonable certainty that C would be acquired is evidence of a business purpose to facilitate an acquisition, and if D would have distributed C regardless of Y's acquisition of C, Y's acquisition of C and D's distribution of C are not part of a plan.

Example 6. Unexpected opportunity. (i) D, the stock of which is listed on an established market, announces that it will distribute all the stock of C *pro rata* to D's shareholders. At the time of the announcement, the distribution is motivated wholly by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate an acquisition. After the announcement but before the distribution, widely held X becomes available as an acquisition target. There were no discussions between D and X before the announcement. D negotiates with and acquires X before the distribution. After the acquisition, X's former shareholders own 55 percent of D's stock. D distributes the stock of C *pro rata* within 6 months after the acquisition of X.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the acquisition of X by D and the distribution of C are part of a plan. To determine whether the distribution of C and the acquisition of X by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) Under paragraph (d)(2) of this section, the following tends to show that the acquisition of X by D and the distribution of C are part of a plan: The acquisition and the distribution occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). Also, the distribution may be motivated by a business purpose to facilitate the acquisition or a similar acquisition because there is evidence of a business purpose to facilitate an acquisition by reason of the fact that the acquisition occurred after the public announcement of the planned distribution (paragraphs (d)(2)(vii) and (e)(1)(ii) of this section).

(v) Under paragraph (d)(3) of this section, D would assert that the following tends to show that the distribution of C and the acquisition of X by D are not part of a plan: The distribution was motivated by a corporate business purpose other than a business purpose to facilitate the acquisition or a similar acquisition (paragraph (d)(3)(vi) of this section), and the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition (paragraph (d)(3)(vii) of this section). That D decided to distribute C and announced that decision before it became aware of the opportunity to acquire X suggests that the distribution would have occurred at approximately the same time and in similar form regardless of D's acquisition of X. X's lack of participation in the decision also helps establish that fact.

(vi) In determining whether the distribution of C and acquisition of X by D are part of a plan, one should consider the importance of D's business purpose for the distribution in light of D's opportunity to acquire X. If D can establish that the distribution continued to be motivated by the stated business purpose, and if D would have distributed C regardless of D's acquisition of X, then D's acquisition of X and D's distribution of C are not part of a plan.

Example 7. Multiple acquisitions. [Reserved]

(n) *Effective date*. This section applies to distributions occurring after August 3, 2001.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved July 26, 2001.

Mark A. Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 2, 2001, 8:45 a.m., and published in the issue of the Federal Register for August 3, 2001, 66 F.R. 40590)

Section 2632.—Special Rules for Allocation of GST Exemption

26 CFR 26.2632–1: Allocation of GST exemption.

If a taxpayer does not elect on a timely filed gift tax return under section 2632(b) to have the automatic allocation of GST exemption rules not apply to direct skips, what procedure must the taxpayer follow to request an extension of time to make an election that the automatic allocation rules not apply? See Notice 2001–50, page 189.

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26 CFR 26.2632–1: Allocation of GST exemption.

If a taxpayer does not elect on a timely filed gift tax return under section 2632(c) to have the automatic allocation of GST exemption rules not apply to indirect skips made after December 31, 2000, what procedure must the taxpayer follow to request an extension of time to make an election that the automatic allocation rules not apply? If a taxpayer does not elect on a timely filed gift tax return under section 2632(c)(5)(A)(ii) to treat a trust as a GST trust described in section 2632(c)(3)(B), what procedure must the taxpayer follow to request an extension of time to treat the trust as a GST trust? See Notice 2001–50, page 189.

Section 2642.—Inclusion Ratio

26 CFR 26.2642–2: Valuation.

If a taxpayer does not allocate generation-skipping transfer exemption on a timely filed gift tax return with respect to a lifetime transfer under § 2642(b)(1) or on a timely filed estate tax return with respect to transfers at death under § 2642(b)(2), what procedure must the taxpayer follow to request an extension of time to make an allocation of the generation-skipping transfer exemption? See Notice 2001–50, page 189.

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

26 CFR 301.6103(j)(5)–1: Disclosures of return information to officers and employees of the Department of Agriculture for certain statistical purposes and related activities.

T.D. 8958

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Disclosures of Return Information to Officers and Employees of the Department of Agriculture for Certain Statistical Purposes and Related Activities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document provides a final regulation relating to the disclosure of return information to officers and employees of the Department of Agriculture for certain statistical purposes and related activities. This regulation permits the IRS to disclose return information to the Department of Agriculture to structure, prepare, and conduct the Census of Agriculture.

DATES: *Effective Date*: This regulation is effective July 31, 2001.

Applicability Date: For dates of applicability of this regulation, see §301.6103 (j)(5)–1(d).

FOR FURTHER INFORMATION CONTACT: Stuart Murray, (202) 622-4580 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On January 4, 2000, a temporary regulation (T.D. 8854, 2000–3 I.R.B. 306) relating to disclosure of return information to the Department of Agriculture was published in the **Federal Register** (65 FR 215). A notice of proposed rulemaking (REG–116704–99, 2000–3 I.R.B. 325) cross-referencing the temporary regulation was published in the **Federal Register** for the same day (65 FR 215). No public hearing was requested or held. No written or electronic comments responding to the notice of proposed rulemaking were received. Accordingly, the regulation proposed by REG–116704–99 is adopted by this Treasury decision without revision, and the corresponding temporary regulation is removed.

Explanation of Provisions

This regulation allows the IRS to disclose return information to the Department of Agriculture for purposes of the Census of Agriculture.

The disclosure of the specific items of return information identified in this regulation is necessary in order for the Department of Agriculture to accurately identify, locate, and classify, as well as properly process, information from agricultural businesses to be surveyed for the statutorily mandated Census of Agriculture.

Special Analyses

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

It is hereby certified that this regulation will not have a significant impact on a substantial number of small entities. This certification is based upon the fact that this regulation concerns the disclosure of return information by the IRS to the Department of Agriculture for purposes of the Census of Agriculture and does not require any action by or otherwise affect small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Code, the temporary regulation and the notice of proposed rulemaking preceding this regulation were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of this regulation is Jennifer S. McGinty, formerly of the Office of the Associate Chief Counsel (Procedure & Administration), Disclosure & Privacy Law Division, IRS. However, other personnel from the IRS and Treasury Department participated in its development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by removing the

entry for 301.6103(j)(5)–1T and adding an entry in numerical order to read in part as follows:

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

Section 301.6103(j)(5)–1 also issued under 26 U.S.C. 6103(j)(5);* * *

Par. 2. Section 301.6103(j)(5)–1 is added to read as follows:

§301.6103(j)(5)–1 Disclosures of return information to officers and employees of the Department of Agriculture for certain statistical purposes and related activities.

(a) *General rule.* Pursuant to the provisions of section 6103(j)(5) of the Internal Revenue Code and subject to the requirements of paragraph (c) of this section, officers or employees of the Internal Revenue Service (IRS) will disclose return information to officers and employees of the Department of Agriculture to the extent, and for such purposes as may be, provided by paragraph (b) of this section.

(b) *Disclosure of return information to officers and employees of the Department of Agriculture.* (1) Officers or employees of the IRS will disclose the following return information for individuals, partnerships, and corporations with agricultural activity, as determined generally by industry code classification or the filing of returns for such activity, to officers and employees of the Department of Agriculture for purposes of, but only to the extent necessary in, structuring, preparing, and conducting, as authorized by chapter 55 of title 7, United States Code, the Census of Agriculture.

(2) From Form 1040/Schedule F—
(i) Taxpayer Identity Information (as defined in section 6103(b)(6) of the Internal Revenue Code);
(ii) Spouse's SSN;
(iii) Annual Accounting Period;
(iv) Principal Business Activity (PBA) Code;
(v) Sales of livestock and produce raised;
(vi) Taxable cooperative distributions;
(vii) Income from custom hire and machine work;
(viii) Gross income;
(ix) Master File Tax (MFT) Code;
(x) Document Locator Number (DLN);
(xi) Cycle Posted;
(xii) Final return indicator; and
(xiii) Part year return indicator.

(3) From Form 943—
(i) Taxpayer Identity Information;
(ii) Annual Accounting Period;
(iii) Total wages subject to Medicare taxes;
(iv) Master File Tax (MFT) Code;
(v) Document Locator Number (DLN);
(vi) Cycle Posted;
(vii) Final return indicator; and
(viii) Part year return indicator.

(4) From Form 1120 series—
(i) Taxpayer Identity Information;
(ii) Annual Accounting Period;
(iii) Gross receipts less returns and allowances;
(iv) PBA Code;
(v) Parent corporation Employer Identification Number, and related Name and PBA Code for entities with agricultural activity;
(vi) Master File Tax (MFT) Code;
(vii) Document Locator Number (DLN);
(viii) Cycle posted;
(ix) Final return indicator;
(x) Part year return indicator; and
(xi) Consolidated return indicator.

(5) From Form 851—
(i) Subsidiary Taxpayer Identity Information;
(ii) Annual Accounting Period;
(iii) Subsidiary PBA Code;
(iv) Parent Taxpayer Identity Information;
(v) Parent PBA Code;
(vi) Master File Tax (MFT) Code;
(vii) Document Locator Number (DLN); and
(viii) Cycle Posted.

(6) From Form 1065 series—
(i) Taxpayer Identity Information;
(ii) Annual Accounting Period;
(iii) PBA Code;
(iv) Gross receipts less returns and allowances;
(v) Net farm profit (loss);
(vi) Master File Tax (MFT) Code;
(vii) Document Locator Number (DLN);
(viii) Cycle Posted;
(ix) Final return indicator; and
(x) Part year return indicator.

(c) *Procedures and restrictions.* (1) Disclosure of return information by officers or employees of the IRS as provided by paragraph (b) of this section shall be made only upon written request designating, by name and title, the officers and employees of the Department of Agriculture to whom such disclosure is authorized, to the Commissioner of Internal Revenue by the Secretary of the Department of Agriculture and describing—
(i) The particular return information to be disclosed;
(ii) The taxable period or date to which such return information relates; and
(iii) The particular purpose for which the return information is to be used.

(2) No such officer or employee to whom return information is disclosed pursuant to the provisions of paragraph (b) of this section shall disclose such return information to any person, other than the taxpayer to whom such return information relates or other officers or employees of the Department of Agriculture whose duties or responsibilities require such disclosure for a purpose described in paragraph (b) of this section, except in a form that cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. If the IRS determines that the Department of Agriculture, or any officer or employee thereof, has failed to, or does not, satisfy the requirements of section 6103(p)(4) of the Internal Revenue Code or regulations or published procedures thereunder, the IRS may take such actions as are deemed necessary to ensure that such requirements are or shall be satisfied, including suspension of disclosures of return information otherwise authorized by section 6103(j)(5) and paragraph (b) of this section, until the IRS determines that such requirements have been or will be satisfied.

(d) *Effective date.* This section is applicable on July 31, 2001.

§301.6103(j)(5)–1T [Removed]

Par. 3. Section 301.6103(j)(5)–1T is removed.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved July 20, 2001.

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

(Filed by the Office of the Federal Register on July 30, 2001, 8:45 a.m., and published in the issue of the Federal Register for July 31, 2001, 66 F.R. 39437)

Section 6112.—Organizers and Sellers of Potentially Abusive Tax Shelters Must Keep Lists of Investors

26 CFR 301.6112–1T: Requirements to maintain list of investors in potentially abusive tax shelters.

Which transactions have been determined by the Internal Revenue Service to be tax avoidance transactions for purposes of § 6111(d)(1)(A) and are transactions for which promoters must maintain lists of investors pursuant to § 301.6112–1T? See Notice 2001–51, page 190.

Section 6205.—Special Rules Applicable to Certain Employment Taxes

26 CFR 31.6205–1: Adjustments of underpayments.

T.D. 8959

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 31

Interest-Free Adjustments With Respect to Underpayments of Employment Taxes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to interest-free adjustments with respect to underpayments of employment taxes. These final regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. The final regulations affect employers that are the subject of IRS examinations involving determinations by the IRS that workers are employees for purposes of subtitle C or that the employers are not entitled to relief from employment taxes under section 530 of the Revenue Act of 1978.

DATES: *Effective Date*: These regulations are effective August 1, 2001.

Applicability Date: These regulations are applicable with respect to notices of determination issued on or after March 19, 2001. Interest will be computed under the rule in this regulation on any claims for refund of interest pending on January 17, 2001. No inference is intended that the rule set forth in these final regulations is not current law.

FOR FURTHER INFORMATION CONTACT: Lynne Camillo (202) 622-6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains an amendment to the Employment Tax Regulations (26 CFR part 31) under section 6205. On January 17, 2001, the IRS published in the **Federal Register** (66 FR 3956) a notice of proposed rulemaking (REG–110374–00, 2001–12 I.R.B. 915) under section 6205 of the Internal Revenue Code relating to interest-free adjustments of employment tax underpayments. The notice proposed to amend §31.6205–1 of the employment tax regulations.

No written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. Accordingly, the proposed regulations are adopted as final regulations.

Section 6205 allows employers that have paid less than the correct amount of employment taxes to make adjustments without interest, provided the error is reported and the taxes are paid by the last day for filing the return for the quarter in which the error was ascertained. However, no interest-free adjustments are permitted pursuant to section 6205 after receipt of notice and demand for payment thereof based upon an assessment. §31.6205–1(a)(6).

The Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788), effective August 5, 1997, created new section 7436 of the Internal Revenue Code (Code), which provides the Tax Court with jurisdiction to review determinations by the IRS that workers are employees for purposes of subtitle C, or that the employer is not entitled to relief from employment taxes under section 530. Section 7436 resulted in a change in the way employment tax examinations involving worker classification and section 530 issues are conducted insofar as notice and demand for payment of an employment tax underpayment based upon an assessment cannot be made until after the taxpayer under examination receives notice of the IRS's determination and has been given an opportunity to file a petition in the Tax Court contesting such determination.

Explanation of Provisions

This document contains an amendment to the regulations under section 6205. The amendment clarifies the period for adjustments of employment tax underpayments without interest under section 6205 following the expansion of Tax Court review to certain employment tax determinations.

As a general rule, under section 6601, all taxpayers who fail to pay the full amount of a tax due under the Code must pay interest at the applicable rate on the unpaid amount from the last date prescribed for payment of the tax until the date the tax is paid. However, section 6205 allows employers that have paid less than the correct amount of certain employment taxes[1] with respect to any payment of wages or compensation to make adjustments to returns without interest pursuant to the regulations. The employment tax regulations under section 6205 generally allow employers to make adjustments to returns without interest until the last day for filing the return for the quarter in which the error was ascertained. An error is ascertained when the employer has sufficient knowledge of the error to be able to correct it. §31.6205–1(a)(4). Section 31.6205–1(a)(6) provides that no interest-free adjustments can be made after receipt of a statement of notice and demand for payment based upon an assessment.

In Revenue Ruling 75–464 (1975–2 C.B. 474), the IRS further clarified the time for adjustments under section 6205. The ruling clarifies that employers can still make interest-free adjustments where the underpayment is discovered during an audit or examination (*i.e.*, where the employer has not independently ascertained

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[1] Section 6205 applies to underpayments of taxes under the Federal Insurance Contributions Act (FICA), the Railroad Retirement Tax Act (RRTA), and income tax withholding. Section 6205 does not apply to underpayments of taxes under the Federal Unemployment Tax Act (FUTA), as such underpayments are not subject to interest under section 6601(i).

the underpayment). The ruling sets forth situations illustrating when an error is ascertained with respect to returns under audit by the IRS. Under the facts in the revenue ruling, an error is ascertained when the employer signs an *"Agreement to Adjustment and Collection of Additional Tax"*, Form 2504, either at the examination level or the appeals level, when the taxpayer pays the full amount due so as to file a refund claim (if paid prior to notice and demand), or at the conclusion of internal IRS appeal rights if no agreement is reached. Under the factual situations in Revenue Ruling 75–464, the employment taxes can be paid free of interest at the time the employer signs Agreement Form 2504 or at the time it pays the tax preparatory to filing a claim to contest the liability in court, after having exhausted all appeal rights within the IRS, provided the payment is made before the taxpayer receives notice and demand for payment.

The Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788), created new section 7436 of the Code which provides the Tax Court with jurisdiction to review determinations by the IRS that workers are employees for purposes of subtitle C of the Code, or that the organization for which services are performed is not entitled to relief from employment taxes under section 530. Section 7436(a) requires that the determination involve an actual controversy and that it be made as part of an examination. Subsequent to enactment of section 7436 of the Code, the IRS created a standard notice, the "Notice of Determination Concerning Worker Classification Under Section 7436" (notice of determination) to serve as the "determination" that is a prerequisite to invoking the Tax Court's jurisdiction under section 7436. Notice 98–43 (1998–2 C.B. 211).

Section 7436(d)(1) provides that the suspension of the limitations period for assessment in section 6503(a) applies in the same manner as if a notice of deficiency had been issued. Thus, pursuant to section 6503(a), the mailing of the notice of determination by certified or registered mail will suspend the statute of limitations for assessment of taxes attributable to the worker classification and section 530 issues. Generally, the statute of limitations for assessment of taxes attributable to the worker classification and section 530 issues is suspended for the 90-day period during which the taxpayer can begin a suit in Tax Court, plus an additional 60 days thereafter. Moreover, if the taxpayer does file a timely petition in the Tax Court, the statute of limitations for assessment of taxes attributable to the worker classification and section 530 issues is suspended under section 6503(a) during the Tax Court proceedings, and for sixty days after the Tax Court decision becomes final.

Current IRS guidance provides for interest-free adjustments under section 6205 prior to assessment and notice and demand. Because of the prohibition on assessment for cases pending in the Tax Court, this creates a potential for inconsistent application of interest depending upon whether an employer files a claim in the Tax Court or in another court of Federal jurisdiction. The legislative history of section 7436 shows no intent to create an advantage for taxpayers who choose to litigate their cases in Tax Court as opposed to another court of Federal jurisdiction. H.R. No. 105–148, 105th Cong., 1st Sess., at 639–640 (1997). Taxpayers who choose to petition the Tax Court under section 7436 still have the benefit of all of the inherent advantages of litigating in the Tax Court, including the ability to obtain judicial review without prior payment of the additional tax the IRS has determined to be due.

Judicial and administrative precedents provide that an error is ascertained for purposes of section 6205 (ending the period for interest-free adjustments) when the taxpayer has exhausted all internal appeal rights with the IRS. *Eastern Investment Corp. v. United States*, 49 F.3d 651 (10th Cir. 1995); Rev. Rul. 75–464 (1975–2 C.B. 474). In the context of refund litigation, where a taxpayer whose erroneous underpayment of employment taxes is discovered during an examination pays only the required divisible portion of employment tax prior to filing a claim for refund in order to satisfy the jurisdictional requirements for filing suit in district court, interest continues to accrue on the unpaid portion of employment tax from the date upon which the tax is assessed after the taxpayer has exhausted all appeal rights within the IRS until the date such tax is paid. See *Eastern Investment Corp., supra* (rejecting taxpayer's argument that the error could not have been "ascertained" until a decision was made by the court and the liability was no longer being contested). Moreover, in Tax Court deficiency proceedings that do not involve employment taxes, unless the taxpayer makes a deposit to stop the running of interest, interest continues to accrue on the deficiency during the course of the Tax Court proceeding. Rev. Rul. 56–501 (1956–2 C.B. 954).

In employment tax examinations that do not involve worker classification or section 530 issues, the taxpayer has exhausted all internal appeal rights by the time a notice and demand for payment thereof based upon an assessment is received. Similarly, in employment tax examinations involving worker classification or section 530 issues, the taxpayer has already had the benefit of all of the same internal appeal rights by the time a notice of determination is received.

These final regulations provide that, in employment tax examinations involving worker classification or section 530 issues, as in other types of employment tax examinations, the error is ascertained for purposes of section 6205 when the employer has exhausted all internal appeals within the IRS. The fact that notice and demand for payment based upon an assessment cannot be made in cases involving worker classification and section 530 issues until the suspension of the statute of limitations is lifted, following issuance of a notice of determination, does not result in an extension of the period during which interest-free adjustments can be made under section 6205. Accordingly, in order to clarify that the error is ascertained for purposes of section 6205 once a taxpayer has exhausted all internal appeal rights with the IRS, the existing regulations are hereby modified by prohibiting interest-free adjustments after receipt of the notice of determination.

However, if, prior to receipt of a notice of determination, a taxpayer makes a remittance which is equal to the amount of the proposed liability, the IRS considers the remittance a payment and assesses it. Rev. Proc. 84–58 (1984–2 C.B. 501). In such a situation, no notice of determination would be sent to the taxpayer. If a taxpayer wants to stop the running of interest and contest the adjustment in the Tax Court, the taxpayer may make a re-

mittance, designating it in writing as a deposit in the nature of a cash bond. If the taxpayer makes such a deposit, the IRS does not consider the remittance a payment. Id. at §4.02. The deposit stops the running of interest and, if the taxpayer does not waive the restrictions on assessment, the IRS will send the taxpayer a notice of determination, thus permitting the taxpayer the option of Tax Court review.

In order to provide a mechanism for taxpayers to make a remittance to stop the accrual of interest, yet still receive a notice of determination and retain the right to petition the Tax Court, these final regulations further modify the existing regulations to provide that, prior to receipt of a notice of determination, the taxpayer may, in lieu of making a payment, make a cash bond deposit which would have the effect of stopping the accrual of any interest, but would not deprive the taxpayer of its right to receive a notice of determination and to petition the Tax Court under section 7436.

Special Analyses

It has been determined that this final regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the 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 author of this final regulation is Lynne Camillo, Office of the Assistant Chief Counsel (Exempt Organizations/Employment Tax/Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

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

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

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

Par. 2. In §31.6205–1, paragraph (a)(6) is revised to read as follows:

§31.6205–1 Adjustments of underpayments.

(a) * * *

(6) No underpayment shall be reported pursuant to this section after the earlier of the following—

(i) Receipt from the Director of notice and demand for payment thereof based upon an assessment; or

(ii) Receipt from the Director of a Notice of Determination Concerning Worker Classification Under Section 7436 (Notice of Determination). (Prior to receipt of a Notice of Determination, the taxpayer may, in lieu of making a payment, make a cash bond deposit which would have the effect of stopping the accrual of any interest, but would not deprive the taxpayer of its right to receive a Notice of Determination and to petition the Tax Court under section 7436).

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved July 20, 2001.

Mark A. Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 31, 2001, 8:45 a.m., and published in the issue of the Federal Register for August 1, 2001, 66 F.R. 39638)

Safe Harbor Under Which an Issue of Tax or Revenue Anticipation Bonds Will Not Be Treated as Outstanding Longer Than Is Reasonably Necessary to Accomplish the Governmental Purposes of the Bonds for Purposes of § 1.148–10(a)(4) of the Income Tax Regulations

Notice 2001–49

Recent Internal Revenue Service examinations have identified a lack of clarity in regulations concerning when tax or revenue anticipation bonds will be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of the bonds for purposes of § 1.148–10(a)(4) of the Income Tax Regulations. Because of this lack of clarity in the regulations, the Internal Revenue Service announces that the issue of whether a tax or revenue anticipation bond is outstanding longer than necessary for purposes of § 1.148–10(a)(4) will be closed in any current examination, and will not be raised in any future examination, with respect to any issue of tax or revenue anticipation bonds that has a term of 2 years or less and was sold prior to August 3, 2001. This announcement has no effect on any other issue that may be identified in any current or future examination.

In addition, the Internal Revenue Service has determined that it is appropriate to provide a prospective safe harbor regarding the term of tax or revenue anticipation bonds. Therefore, attached is a proposed revenue procedure that sets forth a safe harbor under which an issue of tax or revenue anticipation bonds will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of the bonds for purposes of § 1.148–10(a)(4).

Section 3 of the proposed revenue procedure provides that the safe harbor applies to an issue of tax or revenue anticipation bonds the proceeds of which qualify for a temporary period for restricted working capital expenditures under § 1.148–2(e)(3). Section 4 of the proposed revenue procedure provides that, for purposes of § 1.148–10(a)(4), an issue of tax or revenue anticipation bonds will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of those bonds if the final maturity date of the issue is not later than the end of the applicable temporary period under § 1.148–2(e)(3)(i) or § 1.148–2(e)(3)(ii) for which proceeds of the issue qualify.

The proposed revenue procedure will apply to bonds sold after the date the revenue procedure is published in the Internal Revenue Bulletin in final form. However, issuers may rely on the proposed revenue procedure with respect to any issue of tax or revenue anticipation bonds that is sold before the effective date of the proposed revenue procedure and on or after August 3, 2001.

Comments are requested on the proposed revenue procedure. Comments may be submitted on or before November 18, 2001, to Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224, Attn: CC:ITA:RU (Notice 2001–49), Room 5226. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:ITA:RU (Notice 2001–49), Room 5226. Submissions may also be sent electronically via the Internet to the following e-mail address: notice.comments@m1.irscounsel.treas.gov.

The principal authors of this notice are Rose M. Weber and Timothy L. Jones of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in the development of this notice. For further information regarding this notice, contact either Rose M. Weber or Timothy L. Jones at (202) 622-3980 (not a toll-free call).

26 CFR 1.148–10: Anti-abuse rules and Authority of Commissioner.
(Also Part I, §§ 103, 148, 1.148–1, 148–2, 148–6)

Rev. Proc. 2001–XX

SECTION 1. PURPOSE

This revenue procedure sets forth a safe harbor under which an issue of tax or revenue anticipation bonds will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of the bonds for purposes of § 1.148–10(a)(4) of the Income Tax Regulations.

SECTION 2. BACKGROUND

01. Section 103(a) of the Internal Revenue Code of 1986 provides that, except as provided in section 103(b), gross income does not include interest on any state or local bond.

02. Section 103(b) provides that the exclusion described in section 103(a) does not apply to any arbitrage bond.

03. Section 148(a) provides that an arbitrage bond is any bond issued as part of an issue any portion of the proceeds of which are to be used directly or indirectly–

(1) to acquire higher yielding investments, or

(2) to replace funds which were used directly or indirectly to acquire higher yielding investments.

04. Section 148(c)(1) provides that a bond will not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which such bond is a part may be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which such issue was issued.

05. Section 1.148–2(e)(3)(i) of the Income Tax Regulations provides that the proceeds of an issue that are reasonably expected to be allocated to restricted working capital expenditures within 13 months after the issue date qualify for a temporary period of 13 months beginning on the issue date.

06. Section 1.148–2(e)(3)(ii) provides that if an issuer reasonably expects to use tax revenues arising from tax levies for a single fiscal year to redeem or retire an issue, and the issue matures by the earlier of 2 years after the issue date or 60 days after the last date for payment of those taxes without interest or penalty, the temporary period under § 1.148–2(e)(3)(i) is extended until the maturity date of the issue.

07. Section 1.148–1(b) provides that restricted working capital expenditures

are working capital expenditures that are subject to the proceeds-spent-last rule in § 1.148–6(d)(3)(i) and are ineligible for any exception to that rule.

08. Section 1.148–10(a)(1) provides that bonds of an issue are arbitrage bonds if an abusive arbitrage device under § 1.148–10(a)(2) is used in connection with the issue.

09. Section 1.148–10(a)(2) provides that any action is an abusive arbitrage device if the action has the effect of (i) enabling the issuer to exploit the difference between tax-exempt and taxable interest rates to obtain a material financial advantage and (ii) overburdening the tax-exempt bond market.

10. Section 1.148–10(a)(4) provides that an action overburdens the tax-exempt bond market if it results in issuing more bonds, issuing bonds earlier, or allowing bonds to remain outstanding longer than is otherwise reasonably necessary to accomplish the governmental purposes of the bonds, based on all the facts and circumstances.

11. Under § 1.148–10(a)(4), one factor evidencing that bonds may remain outstanding longer than necessary is a term that exceeds the safe harbors against the creation of replacement proceeds under § 1.148–1(c)(4)(i)(B). This factor may be outweighed by other factors, however, such as long-term financial distress.

12. Section 1.148–1(c)(4)(i)(A) provides that certain replacement proceeds arise to the extent that the issuer reasonably expects as of the issue date that the term of the issue will be longer than is reasonably necessary for the governmental purposes of the issue and that there will be available amounts during the period that the issue remains outstanding longer than necessary. Whether an issue is outstanding longer than necessary is determined under § 1.148–10.

13. Section 1.148–1(c)(4)(i)(B)(1) provides a safe harbor against the creation of replacement proceeds under § 1.148–1(c)(4)(i)(A) for the portion of an issue that finances restricted working capital expenditures. This safe harbor is met if that portion is not outstanding longer than 2 years.

14. Section 1.148–1(c)(4)(i)(B)(2) provides a safe harbor against the creation of replacement proceeds under § 1.148–1(c)(4)(i)(A) for the portion of an issue (including a refunding issue) that finances or refinances capital projects. This safe harbor is met if that portion has a weighted average maturity that does not exceed 120 percent of the average reasonably expected economic life of the financed capital projects.

15. Section 1.148–10(d) contains examples illustrating the application of the anti-abuse rules of § 1.148–10. Example 2(i) describes a particular transaction in which an issue is deemed to have a longer weighted average maturity than necessary, notwithstanding that the issue satisfies the safe harbor against the creation of replacement proceeds in § 1.148–1(c)(4)(i)(B)(2).

SECTION 3. SCOPE

This revenue procedure applies to an issue of tax or revenue anticipation bonds the proceeds of which qualify for a temporary period for restricted working capital expenditures under § 1.148–2(e)(3).

SECTION 4. SAFE HARBOR

For purposes of § 1.148–10(a)(4), an issue of tax or revenue anticipation bonds within the scope of this revenue procedure will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of those bonds if the final maturity date of the issue is not later than the end of the applicable temporary period under § 1.148–2(e)(3)(i) or § 1.148–2(e)(3)(ii) for which proceeds of the issue qualify. This revenue procedure does not apply to determine whether an issue of tax or revenue anticipation bonds meets the other requirements of section 148.

SECTION 5. ADVANCE RULINGS

The Service will consider requests for rulings on proposed issues of tax or revenue anticipation bonds that do not satisfy the safe harbor provided in section 4.

SECTION 6. EFFECTIVE DATE

This revenue procedure applies to tax or revenue anticipation bonds sold after August 20, 2001.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Rose M. Weber and Timothy L. Jones of Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in the development of this revenue procedure. For further information regarding this revenue procedure, contact Rose M. Weber or Timothy L. Jones at (202) 622-3980 (not a toll-free call).

Relief From Late Allocation of GST Exemption

Notice 2001–50

PURPOSE

This notice provides guidance regarding requests for an extension of time to make an allocation of generation-skipping transfer (GST) exemption under § 2642(b)(1) and (2) of the Internal Revenue Code in view of the enactment of § 2642(g) by The Economic Growth and Tax Relief Reconciliation Act of 2001 (the Act). Pub. L. 107–16, § 564, 115 Stat. 91. This notice also provides guidance regarding requests for an extension of time to make elections under § 2632(b)(3) and § 2632(c)(5) as added by § 561(a) of the Act.

BACKGROUND

Section 2601 imposes a tax on every GST. Each individual is allowed a GST exemption that may be allocated to transfers that would be subject to the GST tax. In general, an individual's GST exemption may be allocated to transfers at any time on or before the due date for filing the federal estate tax return for the individual's estate under § 2632(a)(1).

For lifetime transfers, available GST exemption is automatically allocated to a direct skip under § 2632(b), and to indirect skips made after December 31, 2000, under § 2632(c), unless the individual elects out of the automatic allocation under § 2632(b)(3) and § 2632(c)(5), respectively. Under § 2632(c)(3)(A), an indirect skip is a transfer of property, subject to gift tax, to a GST trust as defined in § 2632(c)(3)(B). An individual may elect to treat any trust as a GST trust under § 2632(c)(5)(A)(ii).

Under § 26.2632–1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the election out of the automatic allocation for direct skips must be made on a timely filed federal gift tax return. The Treasury Department and the Internal Revenue Service will issue regulations providing that the election out of the automatic allocation for indirect skips and the election to treat any trust as a GST trust must also be made on a timely filed federal gift tax return.

Under § 2642(b)(1) and § 26.2642–2(a)(1), with respect to lifetime transfers, the value of the property to which the GST exemption is allocated is its value at the date of the transfer if the GST exemption is automatically allocated or is allocated on a timely filed federal gift tax return. Under § 2642(b)(3), if the allocation is not made on a timely filed gift tax return, the value of the property to which the exemption is allocated is its value on the effective date of the allocation as described in § 26.2642–2(a)(2).

Section 2642(b)(2) describes allocations with respect to transfers at death and provides that the value of property to which the GST exemption is allocated is its value as determined for estate tax purposes. The allocation of the GST exemption to transfers at death may be made by the executor at any time prior to the due date of the federal estate tax return under § 26.2632–1(a). Unused GST exemption that has not been allocated by the executor is automatically allocated to transfers at death and lifetime transfers for which no allocation had previously been made as prescribed in § 2632(e)(1).

Section 2642(g)(1)(A), added by § 564(a) of the Act, authorizes the Treasury Department to issue regulations prescribing the circumstances and procedures under which extensions of time will be granted to make an allocation of the GST exemption described in § 2642(b)(1) and (2) or to make an election under § 2632(b)(3) and (c)(5). Section 2642(g)(1)(B) provides that in determining whether to grant relief, the time for making the allocation or election is to be treated as if not expressly prescribed by statute. If an extension of time is granted to make the allocation, then the gift or estate tax value of the transfer to the trust is used to determine the allocation of the GST exemption. H.R. Conf. Rep. No. 84, 107th Cong., 1st Sess. 202 (2001). Under § 564(b) of the Act, the provisions of § 2642(g)(1) apply to requests for relief pending on, or filed after, December 31, 2000.

REQUESTS FOR RELIEF UNDER § 2642(g)(1)

Section 301.9100–3 of the Procedure and Administration Regulations provides the standards used to determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation (and not expressly provided by statute). Under § 301.9100–1(b), a regulatory election includes an election whose due date is prescribed by a notice published in the Internal Revenue Bulletin. In accordance with § 2642(g)(1)(B), the time for allocating the GST exemption to lifetime transfers and transfers at death, the time for electing out of the automatic allocation rules, and the time for electing to treat any trust as a GST trust are to be treated as if not expressly prescribed by statute. Therefore, taxpayers may seek an extension of time to make an allocation described in § 2642(b)(1) or (b)(2) or an election described in § 2632(b)(3) or (c)(5) under the provisions of § 301.9100–3.

In general, under § 301.9100–3, relief will be granted if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith and that the grant of relief will not prejudice the interests of the government. Taxpayers requesting relief should follow the procedures for requesting a private letter ruling under § 301.9100 contained in section 5.02 of Rev. Proc. 2001–1 (or its successor), 2001–1 I.R.B. 1, 13.

EFFECTIVE DATE

This notice is effective with respect to requests for relief pending on, or filed after, December 31, 2000.

DRAFTING INFORMATION

The principal author of this notice is William L. Blodgett of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Blodgett at (202) 622-3090 (not a toll-free call).

Listed Transactions Update

Notice 2001–51

On February 28, 2000, the Internal Revenue Service issued Notice 2000–15, 2000–12 I.R.B. 826, identifying certain transactions as "listed transactions" for purposes of § 1.6011–4T(b)(2) of the temporary Income Tax Regulations and § 301.6111–2T(b)(2) of the temporary Procedure and Administration Regulations. This notice restates the list of transactions identified in Notice 2000–15 as "listed transactions" effective February 28, 2000, and updates the list by adding transactions identified in notices released subsequent to February 28, 2000.

Transactions that are the same as or substantially similar to transactions described in the list below have been determined by the Service to be tax avoidance transactions and are identified as "listed transactions" for purposes of § 1.6011–4T(b)(2) and § 301.6111–2T(b)(2). As a result, corporate taxpayers may need to disclose their participation in these listed transactions as prescribed in § 1.6011–4T, and promoters (or other persons responsible for registering tax shelter transactions) may need to register these transactions under § 301.6111–2T. In addition, promoters must maintain lists of investors and other information with respect to these listed transactions pursuant to § 301.6112–1T.

(1) Rev. Rul. 90–105, 1990–2 C.B. 69 (transactions in which taxpayers claim deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by plan participants after the end of the taxable year (identified as "listed transactions" on February 28, 2000));

(2) Notice 95–34, 1995–1 C.B. 309 (certain trust arrangements purported to qualify as multiple employer welfare benefit funds exempt from the limits of §§ 419 and 419A of the Internal Revenue Code (identified as "listed transactions" on February 28, 2000));

(3) Notice 95–53, 1995–2 C.B. 334 (certain multiple-party transactions intended to allow one party to realize rental or other income from property or service contracts and to allow another party to report deductions related to that income

(often referred to as "lease strips") (identified as "listed transactions" on February 28, 2000));

(4) Transactions described in Part II of Notice 98–5, 1998–1 C.B. 334 (transactions in which the reasonably expected economic profit is insubstantial in comparison to the value of the expected foreign tax credits (identified as "listed transactions" on February 28, 2000));

(5) Transactions substantially similar to those at issue in *ASA Investerings Partnership v. Commissioner*, 201 F.3d 505 (D.C. Cir. 2000), and *ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998) (transactions involving contingent installment sales of securities by partnerships in order to accelerate and allocate income to a tax-indifferent partner, such as a tax-exempt entity or foreign person, and to allocate later losses to another partner (identified as "listed transactions" on February 28, 2000));

(6) Treas. Reg. § 1.643(a)–8 (transactions involving distributions described in § 1.643(a)–8 from charitable remainder trusts (identified as "listed transactions" on February 28, 2000));

(7) Rev. Rul. 99–14, 1999–1 C.B. 835 (transactions in which a taxpayer purports to lease property and then purports to immediately sublease it back to the lessor (that is, lease-in/lease-out or LILO transactions) (identified as "listed transactions" on February 28, 2000));

(8) Notice 99–59, 1999–2 C.B. 761 (transactions involving the distribution of encumbered property in which taxpayers claim tax losses for capital outlays that they have in fact recovered (identified as "listed transactions" on February 28, 2000));

(9) Treas. Reg. § 1.7701(l)–3, (transactions involving fast-pay arrangements as defined in § 1.7701(l)–3(b) (identified as "listed transactions" on February 28, 2000));

(10) Rev. Rul. 2000–12, 2000–11 I.R.B. 744 (certain transactions involving the acquisition of two debt instruments the values of which are expected to change significantly at about the same time in opposite directions (identified as "listed transactions" on February 28, 2000));

(11) Notice 2000–44, 2000–36 I.R.B. 255 (transactions generating losses resulting from artificially inflating the basis of partnership interests (identified as "listed transactions" on August 11, 2000));

(12) Notice 2000–60, 2000–49 I.R.B. 568 (transactions involving the purchase of a parent corporation's stock by a subsidiary, a subsequent transfer of the purchased parent stock from the subsidiary to the parent's employees, and the eventual liquidation or sale of the subsidiary (identified as "listed transactions" on November 16, 2000));

(13) Notice 2000–61, 2000–49 I.R.B. 569 (transactions purporting to apply § 935 to Guamanian trusts (identified as "listed transactions" on November 21, 2000));

(14) Notice 2001–16, 2001–9 I.R.B. 730 (transactions involving the use of an intermediary to sell the assets of a corporation (identified as "listed transactions" on January 18, 2001));

(15) Notice 2001–17, 2001–9 I.R.B. 730 (transactions involving a loss on the sale of stock acquired in a purported § 351 transfer of a high basis asset to a corporation and the corporation's assumption of a liability that the transferor has not yet taken into account for federal income tax purposes (identified as "listed transactions" on January 18, 2001)); and

(16) Notice 2001–45, 2001–33 I.R.B. 129 (certain redemptions of stock in transactions not subject to U.S. tax in which the basis of the redeemed stock is purported to shift to a U.S. taxpayer (identified as "listed transactions" on July 26, 2001)).

Notice 2000–15 is supplemented and superseded.

The principal author of this notice is David A. Shulman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Shulman at (202) 622-3080 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, §§ 61, 83, 721; 1.721–1.)

Rev. Proc 2001–43

SECTION 1. PURPOSE

This revenue procedure clarifies Rev. Proc. 93–27 (1993–2 C.B. 343) by providing guidance on the treatment of the grant of a partnership profits interest that is substantially nonvested for the provision of services to or for the benefit of the partnership.

SECTION 2. BACKGROUND

Rev. Proc. 93–27 provides that (except as otherwise provided in section 4.02 of the revenue procedure), if a person receives a profits interest for the provision of services to or for the benefit of a partnership in a partner capacity or in anticipation of being a partner, the Internal Revenue Service will not treat the receipt of the interest as a taxable event for the partner or the partnership. For this purpose, section 2.02 of Rev. Proc. 93–27 defines a profits interest as a partnership interest other than a capital interest. Section 2.01 of Rev. Proc. 93–27 defines a capital interest as an interest that would give the holder a share of the proceeds if the partnership's assets were sold at fair market value and then the proceeds were distributed in a complete liquidation of the partnership. Section 2.01 of Rev. Proc. 93–27 provides that the determination as to whether an interest is a capital interest generally is made at the time of receipt of the partnership interest.

SECTION 3. SCOPE

This revenue procedure clarifies Rev. Proc. 93–27 by providing that the determination under Rev. Proc. 93–27 of whether an interest granted to a service provider is a profits interest is, under the circumstances described below, tested at the time the interest is granted, even if, at that time, the interest is substantially nonvested (within the meaning of § 1.83–3(b) of the Income Tax Regulations). Accordingly, where a partnership grants a profits interest to a service provider in a transaction meeting the requirements of this revenue procedure and Rev. Proc. 93–27, the Internal Revenue Service will not treat the grant of the interest or the event that causes the interest to become substantially vested (within the meaning of § 1.83–3(b) of the Income Tax Regulations) as a taxable event for the partner or the partnership. Taxpayers to which this revenue procedure applies need not file an election under section 83(b) of the Code.

SECTION 4. APPLICATION

This revenue procedure clarifies that, for purposes of Rev. Proc. 93–27, where a partnership grants an interest in the partnership that is substantially nonvested to a service provider, the service provider will be treated as receiving the interest on the date of its grant, provided that:

.01 The partnership and the service provider treat the service provider as the owner of the partnership interest from the date of its grant and the service provider takes into account the distributive share of partnership income, gain, loss, deduction, and credit associated with that interest in computing the service provider's income tax liability for the entire period during which the service provider has the interest;

.02 Upon the grant of the interest or at the time that the interest becomes substantially vested, neither the partnership nor any of the partners deducts any amount (as wages, compensation, or otherwise) for the fair market value of the interest; and

.03 All other conditions of Rev. Proc. 93–27 are satisfied.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 93–27 is clarified.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Craig Gerson of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure contact Craig Gerson at (202) 622-3050 (not a toll-free call).

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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