Internal Revenue
bulletin

Bulletin No. 2001–9
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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

Rev. Rul. 2001–1, page 726.

E & P adjustments on exercise of option. The earnings and profits of a corporate employer are reduced to reflect the deduction the corporation takes when an employee receives stock upon exercise of a nonstatutory stock option.

Rev. Rul. 2001–8, page 726.

Inventories; floor stocks payments. Payments made or received with respect to floor stocks must be accounted for as adjustments to the invoice price or production cost of the goods physically held on the floor stocks date to which the payments relate, rather than as an adjustment to the tax basis (carrying value) of those goods. This ruling provides, for costing purposes, an optional simplifying assumption for LIFO taxpayers regarding identification of the goods physically held on the floor stocks date to which the floor stocks payments relate. Rev. Ruls. 85–30 and 88–95 clarified. Rev. Proc. 99–49 modified and amplified.

EXEMPT ORGANIZATIONS

Rev. Proc. 2001–20, page 738.

This procedure describes the Voluntary Compliance on Alien Withholding Program (VCAP), which is available to certain public and other not-for-profit colleges and universities and their charitable affiliates to resolve issues arising from the payment, withholding, and reporting of certain taxes due on payments made to alien individuals.

ADMINISTRATIVE

T.D. 8936, page 720.

Final regulations under section 118(c) of the Code relate to the exclusion from gross income for a contribution in aid of construction (CIAC) from any person (whether or not a shareholder) to a regulated public utility that provides water or sewerage disposal services. The regulations define what property constitutes a CIAC for purposes of the exclusion from gross income and provide rules for adjusting the basis of water or sewerage disposal facilities acquired as, or acquired or constructed with any money received as, a CIAC. The regulations also provide the time and manner for taxpayers to notify the Secretary of amounts treated as a contribution to capital under this provision.

Notice 2001–16, page 730.

Intermediary transactions tax shelter. The Service may challenge certain transactions in which the assets of a corporation are sold following the purported sale of the corporation's stock to an intermediary. Such transactions are designated as "listed transactions" for purposes of sections 1.6011–4T(b)(2) and 301.6111–2T of the regulations.

Notice 2001–17, page 730.

Contingent liability tax shelter. The Service may challenge certain transactions in which a taxpayer transfers assets to a corporation and the transferee assumes a liability that the transferor has not yet taken into account for federal income tax purposes. Such transactions are designated as "listed transactions" for purposes of sections 1.6011–4T(b)(2) and 301.6111–2T of the regulations.

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Actions Relating to Court Decisions is on the page following the Introduction.
Finding Lists begin on page ii.
Announcements of Disbarments and Suspensions begin on page 752.

Department of the Treasury
Internal Revenue Service

Notice 2001–18, page 731.

This notice provides an exception from the registration requirements under section 6111(d) of the Code and the list maintenance requirements under section 6112 for certain leasing transactions, except as may be provided in subsequent guidance.

Rev. Proc. 2001–19, page 732.

Automobile owners and lessees. This procedure provides owners and lessees of passenger automobiles (including electric automobiles) with tables detailing the limitations on depreciation deductions for automobiles first placed in service during calendar year 2001 and the amounts to be included in income for automobiles first leased during calendar year 2001. In addition, this procedure provides the maximum allowable value of employer-provided automobiles first made available to employees for personal use in calendar year 2001 for which the vehicle cents-per-mile valuation rule provided under section 1.61–21(e) of the regulations may be applicable.

Rev. Proc. 2001–21, page 742.

Election to treat certain debt substitutions as realization events. The procedure provides for an election that allows taxpayers to treat a debt substitution, in certain circumstances, as a realization event even though it does not result in a significant modification under section 1.1001–3 of the regulations. Rev. Proc. 99–18 modified and superseded.

Rev. Proc. 2001–22, page 745.

Pre-filing agreement program. This procedure permits a taxpayer subject to the jurisdiction of the Large and Mid-Size Business Division (LMSB) of the Service to request the examination of specific issues relating to a tax return before the return is timely filed. If the taxpayer and the Service are able to resolve the examined issues prior to the filing of the return, this procedure authorizes the taxpayer and the Service to finalize their resolution by executing an LMSB Pre-Filing Agreement.

Announcement 2001–13, page 752.

New Schedule N (Form 1120), *Foreign Operations of U.S. Corporations*, is now available. This form is used by corporations that have assets in, or operate a business in, a foreign country or U.S. possession.

Announcement 2001–21, page 752.

This announcement advises trustees and custodians of medical savings accounts of the extension of the requirement to file Form 8851, *Summary of Archer MSAs*, and changes for magnetic and electronic filing.

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 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.

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

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:

Arnold W. Vinick v. United States,[1]
205 F.3d 1 (1st Cir. 2000)

[1] Nonacquiescence as to whether actual, exercised authority over a company's financial matters, including the duty and power to determine which creditors to pay, is necessary for a finding that a taxpayer is a responsible person under I.R.C. section 6672.

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

Section 56.—Adjustments in Computing Alternative Minimum Taxable Income

This Rev. Rul. announces that the earnings and profits of a corporate employer are reduced to reflect the deduction the corporation takes when an employee receives stock upon exercise of a nonstatutory stock option. Because this item reduces earnings and profits, § 56(g)(4)(C)(i) does not disallow the deduction of the item in computing adjusted current earnings for purposes of alternative minimum tax. See Rev. Rul. 2001–1, page 726.

Section 61.—Gross Income Defined

26 CFR 1.61–1: Gross income.

Must payments made or received with respect to floor stocks be accounted for as adjustments to the invoice price or production cost of the goods physically held on the floor stocks date to which the payments relate, rather than as an adjustment to the tax basis (carrying value) of those goods. See Rev. Rul. 2001–8, page 726.

26 CFR 1.61–21: Taxation of fringe benefits.

This procedure provides the maximum value of employer-provided automobiles first made available to employees for personal use in calendar year 2001 for which the vehicle cents-per-mile valuation rule provided under § 1.61–21(e) of the Income Tax Regulations may be applicable. See Rev. Proc. 2001–19, page 732.

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

26 CFR 1.83–6: Deduction by employer.

This Rev. Rul. announces that the earnings and profits of a corporate employer are reduced to reflect the deduction the corporation takes when an employee receives stock upon exercise of a nonstatutory stock option. See Rev. Rul. 2001–1, page 726.

Section 111.—Recovery of Tax Benefit Items

26 CFR 1.111–1: Recovery of certain items previously deducted or credited.

Must payments made or received with respect to floor stocks be accounted for as adjustments to the invoice price or production cost of the goods physically held on the floor stocks date to which the payments relate, rather than as an adjustment to the tax basis (carrying value) of those goods. See Rev. Rul. 2001–8, page 726.

Section 118.—Contributions to the Capital of a Corporation

26 CFR 1.118–2: Contribution in aid of construction.

T.D. 8936

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

Definition of Contribution in Aid of Construction Under Section 118(c)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning an exclusion from gross income for a contribution in aid of construction under section 118(c) that is treated as a contribution to capital under section 118(a). The final regulations affect a regulated public utility that provides water or sewerage services because a qualifying contribution in aid of construction is treated as a contribution to the capital of the utility and excluded from gross income. The final regulations provide guidance on the definition of a contribution in aid of construction, the adjusted basis of any property acquired with a contribution in aid of construction, the information relating to a contribution in aid of construction required to be furnished by the utility, and the time and manner for providing that information to the IRS.

DATES: *Effective Date*: These regulations are effective January 11, 2001.

Date of Applicability: For date of applicability of §1.118–2, see §1.118–2(f).

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

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545–1639. Responses to these collections of information are mandatory.

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

The estimated annual burden per respondent varies from .5 hour to 5 hours, depending on individual circumstances, with an estimated average of 1 hour.

Comments concerning the accuracy of these burden estimates and suggestions for reducing these burdens should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S:O, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

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

Background

On December 20, 1999, the IRS published proposed regulations (REG–106012–98, 2000–2 I.R.B. 290) in the **Federal Register** (64 F.R. 71082) inviting comments under section 118(c). A public hearing was held April 27, 2000. Numerous comments have been received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

Summary of Comments

Under section 118(a), gross income does not include any contribution to the capital of the taxpayer. Section 118(c)(1) provides that a contribution to the capital of a taxpayer includes any amount of money or other property received from any person (whether or not a shareholder) by a regulated public utility that provides water or sewerage disposal services if the amount is a contribution in aid of construction, satisfies the expenditure rule, and is not included in rate base for ratemaking purposes. Pursuant to the authority granted to the Secretary under section 118(c)(3)(A), the proposed regulations define a *contribution in aid of construction* as any amount of money or other property contributed to a regulated public utility that provides water or sewerage disposal services to the extent that the purpose of the contribution is to provide for the expansion, improvement, or replacement of the utility's water or sewerage disposal facilities.

Customer Connection Fees

The proposed regulations define nontaxable contributions in aid of construction to exclude customer connection fees. Customer connection fees are defined in the proposed regulations to include amounts paid for the cost of installing a connection or service line (including the cost of meters and piping) from the utility's main lines to the lines owned by the customer, unless the connection or service line serves, or is designed to serve, more than one customer. Customer connection fees also are defined in the proposed regulations to include any amounts paid as service charges for starting or stopping services.

Several commentators contend that connection and service lines should not be treated as taxable customer connection fees for a number of reasons. For example, these commentators argue that the omission from the current law of the language included in former section 118(b)(3)(A) that directed the Secretary to define a contribution in aid of construction to exclude amounts paid to connect the customer's line to a main water or sewer line signals congressional intent to include connection and service lines in the definition of a nontaxable contribution in aid of construction. In addition, some of these commentators believe that the inclusion of connection and service lines as taxable customer connection fees is inconsistent with the judicial interpretation of a contribution in aid of construction, which arguably would treat contributions for main lines and connection and service lines as taxable prerequisites for services under the Supreme Court's decision in *United States v. Chicago, Burlington & Quincy R.R.*, 412 U.S. 401 (1973) (1973–2 C.B. 428). Some of these commentators also contend that the exclusion of connection and service lines from the definition of a nontaxable contribution in aid of construction is inconsistent with regulatory accounting treatment, which does not distinguish between main lines and connection and service lines for purposes of classifying property or for purposes of ratemaking. Finally, a few of these commentators point out that the inclusion of connection and service lines as taxable customer connection fees will result in customers being required to gross-up their contributions of connection and service lines for taxes, increasing the cost of housing and development and creating a competitive disadvantage for investor-owned utilities.

The IRS and Treasury Department do not agree with the commentators' position with respect to connection and service lines. As explained in the preamble to the proposed regulations, the inclusion of connection and service lines in the definition of taxable customer connection fees is consistent with the legislative history explanation that section 118(c) was intended to restore the contribution in aid of construction provision of former section 118(b) that was repealed by The Tax Reform Act of 1986 for regulated public utilities that provide water or sewerage disposal services. H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 316 (1996) (1996–3 C.B. 741, 1056). While the language regarding the definition of a contribution in aid of construction did change from the language in former section 118(b), Congress did not explicitly include connection and service lines in the definition of a contribution in aid of construction but instead directed the Secretary to define a contribution in aid of construction, presumably aware of the IRS' and Treasury Department's position that connection and service lines are taxable customer connection fees based on Rev. Rul. 75–557 (1975–2 C.B. 33), and the proposed regulations under former section 118(b) (43 F.R. 22997 (May 30, 1978)). Moreover, the IRS and Treasury Department continue to believe that the exclusion of connection and service lines from a nontaxable contribution in aid of construction is more consistent with the judicial and regulatory interpretation of a contribution in aid of construction and with the Supreme Court's directive that exclusions be narrowly construed. See, for example, *Edwards v. Cuba R.R.*, 268 U.S. 628 (1925) (IV-2 C.B. 122); *Detroit Edison Co. v. Commissioner*, 319 U.S. 98 (1943) (1943 C.B. 1019); *Chicago, Burlington & Quincy R.R.*, 412 U.S. at 401; *Florida Progress Corp. v. United States*, No. 93–246–CIV–T–25A (M.D. Fla. July 2, 1998), *appeal docketed*, No. 99–15389–FF (11th Cir. Dec. 29, 1999); *Commissioner v. Schleier*, 515 U.S. 323, 328 (1995); and Rev. Rul. 75–557. As explained by the court in *Teco Energy, Inc. v. Unites States*, No. 98–430–Civ–J–TJC (M.D. Fla. Oct. 21, 1999), "former [section] 118(b) codifies the principles of *Edwards* that payments made by a government or other group to a utility to encourage the extension of facilities into new areas benefitting a large number of people are given tax free status, while also affirming the reasoning of *Detroit Edison* and Revenue Ruling 75-557, that payments made by an individual or business entity to a utility as a prerequisite to receiving water or sewage services would be treated as taxable income to the utility." Further, the IRS and Treasury Department believe that the definition of a contribution in aid of construction used for regulatory accounting purposes should not control for tax purposes. See, for example, *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 541–45 (1979) (1979–1 C.B. 167). Accordingly, the final regulations retain the exclusion of connection and service lines from the definition of a nontaxable contribution in aid of construction.

Some commentators state that, before the proposed regulations were published, some utilities took the position that payments for connection and service lines were not taxable and did not charge their contributors a sufficient amount to cover their tax liabilities. The IRS and Treasury Department understand that there was uncertainty before the proposed regulations were published and that some utilities may have reasonably interpreted section 118(c)(3)(A) to mean that connection and service lines should not be treated as taxable. It is clear that these final regulations apply to money and other property received on or after January 11, 2001, and do not apply to transactions entered into prior to that date. In addition, the IRS will take into account all the facts and circumstances in applying section 118(c) to such transactions.

Commentators suggest that customer connection fees relating to services provided to public authorities, such as schools, hospitals, public libraries, and governmental entities, should be included in the definition of nontaxable contributions in aid of construction because these services provide a broad public benefit. In addition, commentators recommend that customer connection fees relating to fire protection services should qualify as nontaxable contributions in aid of construction because a utility receives no revenue for public fire protection services and only a nominal standby fee for private fire protection services. The IRS and Treasury Department believe that, regardless of whether the activities of public authorities provide a public benefit, connection and service lines that serve these customers should be treated in the same manner as connection or service lines to any paying customer — as a prerequisite for services. Consequently, the final regulations continue to treat amounts paid for connection and service lines with respect to public authorities as customer connection fees. However, the IRS and the Treasury Department agree with commentators that amounts paid with respect to fire protection services should not be considered customer connection fees.

Several commentators suggest that connection and service lines that serve more than one user, such as lines for apartment houses, condominium projects, shopping malls, and office buildings, should be considered to serve more than one customer and, thus, be excluded from taxable customer connection fees, regardless of whether the utility treats the facility as one customer or many. The final regulations do not adopt this suggestion because whether connection or service lines are designed to serve more than one customer does not depend on the number of users but upon the number of customers. Thus, for example, if a water or sewerage disposal utility treats an apartment or office building as one utility customer, then the cost of connecting the utility's main lines to the connection or service lines serving that single customer is a taxable customer connection fee.

Binding Agreement Rule

The proposed regulations provide that if a water or sewerage disposal facility is placed in service by the utility before an amount is contributed to the utility, the contribution is not a nontaxable contribution in aid of construction unless, at the time the facility is placed in service by the utility, there is an agreement, binding under local law between the prospective contributor and the utility, that the utility is to receive the amount as reimbursement for the cost of acquiring or constructing the facility.

Commentators suggest that the binding agreement rule should be expanded to include enforceable public utility commission orders and tariffs. The final regulations adopt this suggestion by treating an order or a tariff, issued or approved by the applicable public utility commission, that requires a current or prospective customer to reimburse the utility for the cost of acquiring or constructing the facility as a binding agreement. Because public utility commission orders or tariffs may be issued or approved before or after the facility is placed in service, the final regulations also extend the time for entering into a binding agreement or the issuance or approval of an order or a tariff to no later than 82 months after the close of the taxable year (the usual due date with extensions for a taxpayer's return) in which the facility is placed in service.

One commentator suggests adding an example demonstrating that payments made pursuant to a binding agreement qualify as a contribution in aid of construction under section 118(c). The final regulations adopt this suggestion.

Basis Rules

The proposed regulations provide that the basis of a water or sewerage facility acquired or constructed with a contribution under a binding agreement must be reduced by the amount of the contribution at the time the facility is placed in service. Several commentators suggest that if the receipt of all of the expected contributions under the agreement occurs more than one or two years after a facility is placed in service, the utility should be permitted to claim the full cost of the facility as basis for depreciation purposes, subject to adjustment as the contributions are received. The final regulations do not adopt this comment because section 118(c)(4) disallows any depreciation deductions for a water or sewerage disposal facility that is fully paid with a nontaxable contribution in aid of construction under section under section 118(c). This result is consistent with similar rules that either exclude expected contributions from basis or deny a deduction to the extent the taxpayer has a right to, or reasonable prospect of, reimbursement. See, for example, §1.110–1(b)(4)(ii)(B); §1.165–1(d)(2)(i); and Rev. Rul. 79–263 (1979–2 C.B. 82).

The proposed regulations provide that, if a contribution in aid of construction treated as a contribution to the capital of the taxpayer is repaid to the contributor, either in whole or in part, then the repayment amount is a capital expenditure in the taxable year in which it is paid or incurred, resulting in an increase in the property's adjusted basis in such year. A couple of commentators suggest that the repayment should be depreciated over the remaining life of the property. The final regulations adopt this suggestion.

Reporting Requirement

The proposed regulations provide that a taxpayer treating a contribution in aid of construction as a contribution to capital must file a statement with its tax returns to report the amount of the contribution in aid of construction the taxpayer: (1) expended during the taxable year for property described in section 118(c)(2)(A) (qualified property); (2) does not intend to expend for qualified property; and (3) failed to expend for qualified property. Several commentators express concern that the reporting requirement in the proposed regulations exceeds the intent of the statute because section 118(c)(2)(C) only requires the maintenance of adequate records. However, section 118(d)(1) provides that if the taxpayer for any taxable year treats an amount as a contribution to the capital of the taxpayer described in section 118(c), then the statutory period for the assessment of any deficiency attributable to any part of the amount does not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may prescribe) of the amount of the expenditure referred to in section 118(c)(2)(A), of the taxpayer's intention not to make the expenditures referred to in section 118(c)(2)(A), or of a failure to make the expenditure within the period described in section 118(c)(2)(B). Thus, the regulations do not impose an additional reporting requirement but merely provide the time and manner in which taxpayers must notify the Secretary under section 118(d)(1) of amounts treated as contributions in aid of construction.

Collection of Information under Paperwork Reduction Act

Two comments were sent to OMB on the collection of information contained in the proposed regulations, with copies of the comments sent to the IRS Reports Clearance Officer. The commentators estimate that complying with the recordkeeping requirements of section 118(c)(2)(C) involves more hours and that the number of respondents is greater than estimated. The collection of information burden under the proposed regulations is based only upon the time for notifying the IRS of the required information under section 118(d)(1) and is not required to include the time for maintaining accurate books and records. Thus, the individual time to comply with the collection of information burden was not increased to reflect these commentators concerns. However, the estimated number of annual respondents has been increased to 300 and the estimated total annual reporting burden has been increased to 300 hours.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that any burden on taxpayers is minimal. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

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

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Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.118–2 also issued under 26 U.S.C. 118(c)(3)(A); * * *

Par. 2. Section 1.118–2 is added to read as follows:

§1.118–2 Contribution in aid of construction.

(a) *Special rule for water and sewerage disposal utilities*—(1) *In general*. For purposes of section 118, the term *contribution to the capital of the taxpayer* includes any amount of money or other property received from any person (whether or not a shareholder) by a regulated public utility that provides water or sewerage disposal services if—

(i) The amount is a contribution in aid of construction under paragraph (b) of this section;

(ii) In the case of a contribution of property other than water or sewerage disposal facilities, the amount satisfies the expenditure rule under paragraph (c) of this section; and

(iii) The amount (or any property acquired or constructed with the amount) is not included in the taxpayer's rate base for ratemaking purposes.

(2) *Definitions*—(i) *Regulated public utility* has the meaning given such term by section 7701(a)(33), except that such term does not include any utility which is not required to provide water or sewerage disposal services to members of the general public in its service area.

(ii) *Water or sewerage disposal facility* is defined as tangible property described in section 1231(b) that is used predominately (80% or more) in the trade or business of furnishing water or sewerage disposal services.

(b) *Contribution in aid of construction*—(1) *In general*. For purposes of section 118(c) and this section, the term *contribution in aid of construction* means any amount of money or other property contributed to a regulated public utility that provides water or sewerage disposal services to the extent that the purpose of the contribution is to provide for the expansion, improvement, or replacement of the utility's water or sewerage disposal facilities.

(2) *Advances*. A contribution in aid of construction may include an amount of money or other property contributed to a regulated public utility for a water or sewerage disposal facility subject to a contingent obligation to repay the amount, in whole or in part, to the contributor (commonly referred to as an advance). For example, an amount received by a utility from a developer to construct a water facility pursuant to an agreement under which the utility will pay the developer a

percentage of the receipts from the facility over a fixed period may constitute a contribution in aid of construction. Whether an advance is a contribution or a loan is determined under general principles of federal tax law based on all the facts and circumstances. For the treatment of any amount of a contribution in aid of construction that is repaid by the utility to the contributor, see paragraphs (c)(2)(ii) and (d)(2) of this section.

(3) *Customer connection fee*—(i) *In general*. Except as provided in paragraph (b)(3)(ii) of this section, a customer connection fee is not a contribution in aid of construction under this paragraph (b) and generally is includible in income. The term *customer connection fee* includes any amount of money or other property transferred to the utility representing the cost of installing a connection or service line (including the cost of meters and piping) from the utility's main water or sewer lines to the line owned by the customer or potential customer. A customer connection fee also includes any amount paid as a service charge for starting or stopping service.

(ii) *Exceptions*—(A) *Multiple customers*. Money or other property contributed for a connection or service line from the utility's main line to the custome's or the potential customer's line is not a customer connection fee if the connection or service line serves, or is designed to serve, more than one customer. For example, a contribution for a split service line that is designed to serve two customers is not a customer connection fee. On the other hand, if a water or sewerage disposal utility treats an apartment or office building as one utility customer, then the cost of installing a connection or service line from the utility's main water or sewer lines serving that single customer is a customer connection fee.

(B) *Fire protection services*. Money or other property contributed for public and private fire protection services is not a customer connection fee.

(4) *Reimbursement for a facility previously placed in service*—(i) *In general*. If a water or sewerage disposal facility is placed in service by the utility before an amount is contributed to the utility, the contribution is not a contribution in aid of construction under this paragraph (b) with respect to the cost of the facility unless, no later than 82 months after the close of the taxable year in which the facility was placed in service, there is an agreement, binding under local law, that the utility is to receive the amount as reimbursement for the cost of acquiring or constructing the facility. An order or tariff, binding under local law, that is issued or approved by the applicable public utility commission requiring current or prospective utility customers to reimburse the utility for the cost of acquiring or constructing the facility, is a binding agreement for purposes of the preceding sentence. If an agreement exists, the basis of the facility must be reduced by the amount of the expected contributions. Appropriate adjustments must be made if actual contributions differ from expected contributions.

(ii) *Example*. The application of paragraph (b)(4)(i) of this section is illustrated by the following example:

Example. M, a calendar year regulated public utility that provides water services, spent $1,000,000 for the construction of a water facility that can serve 200 customers. M placed the facility in service in 2000. In June 2001, the public utility commission that regulates M approves a tariff requiring new customers to reimburse M for the cost of constructing the facility by paying a service availability charge of $5,000 per lot. Pursuant to the tariff, M expects to receive reimbursements for the cost of the facility of $100,000 per year for the years 2001 through 2010. The reimbursements are contributions in aid of construction under paragraph (b) of this section because no later than 82 months after the close of the taxable year in which the facility was placed in service there was a tariff, binding under local law, approved by the public utility commission requiring new customers to reimburse the utility for the cost of constructing the facility. The basis of the $1,000,000 facility is zero because the expected contributions equal the cost of the facility.

(5) *Classification by ratemaking authority*. The fact that the applicable ratemaking authority classifies any money or other property received by a utility as a contribution in aid of construction is not conclusive as to its treatment under this paragraph (b).

(c) *Expenditure rule*—(1) *In general*. An amount satisfies the expenditure rule of section 118(c)(2) if the amount is expended for the acquisition or construction of property described in section 118(c)(2)(A), the amount is paid or incurred before the end of the second taxable year after the taxable year in which the amount was received as required by section 118(c)(2)(B), and accurate records are kept of contributions and expenditures as provided in section 118(c)(2)(C).

(2) *Excess amount*—(i) *Includible in the utility's income*. An amount received by a utility as a contribution in aid of construction that is not expended for the acquisition or construction of water or sewerage disposal facilities as required by paragraph (c)(1) of this section (the excess amount) is not a contribution to the capital of the taxpayer under paragraph (a) of this section. Except as provided in paragraph (c)(2)(ii) of this section, such excess amount is includible in the utility's income in the taxable year in which the amount was received.

(ii) *Repayment of excess amount*. If the excess amount described in paragraph (c)(2)(i) of this section is repaid, in whole or in part, either—

(A) Before the end of the time period described in paragraph (c)(1) of this section, the repayment amount is not includible in the utility's income; or

(B) After the end of the time period described in paragraph (c)(1) of this section, the repayment amount may be deducted by the utility in the taxable year in which it is paid or incurred to the extent such amount was included in income.

(3) *Example*. The application of this paragraph (c) is illustrated by the following example:

Example. M, a calendar year regulated public utility that provides water services, received a $1,000,000 contribution in aid of construction in 2000 for the purpose of constructing a water facility. To the extent that the $1,000,000 exceeded the actual cost of the facility, the contribution was subject to being returned. In 2001, M built the facility at a cost of $700,000 and returned $200,000 to the contributor. As of the end of 2002, M had not returned the remaining $100,000. Assuming accurate records are kept, the requirement under section 118(c)(2) is satisfied for $700,000 of the contribution. Because $200,000 of the contribution was returned within the time period during which qualifying expenditures could be made, this amount is not includible in M's income. However, the remaining $100,000 is includible in M's income for its 2000 taxable year (the taxable year in which the amount was received) because the amount was neither spent nor repaid during the prescribed time period. To the extent M repays the remaining $100,000 after year 2002, M would be entitled to a deduction in the year such repayment is paid or incurred.

(d) *Adjusted basis*—(1) *Exclusion from basis*. Except for a repayment described in paragraph (d)(2) of this section, to the extent that a water or sewerage disposal facility is acquired or constructed with an amount received as a contribution to the capital of the taxpayer under paragraph (a) of this section, the basis of the facility is reduced by the amount of the contribution. To the extent the water or sewerage disposal facility is acquired as a contribution to the capital of the taxpayer under paragraph (a) of this section, the basis of the contributed facility is zero.

(2) *Repayment of contribution*. If a contribution to the capital of the taxpayer under paragraph (a) of this section is repaid to the contributor, either in whole or in part, then the repayment amount is a capital expenditure in the taxable year in which it is paid or incurred, resulting in an increase in the property's adjusted basis in such year. Capital expenditures allocated to depreciable property under paragraph (d)(3) of this section may be depreciated over the remaining recovery period for that property.

(3) *Allocation of contributions*. An amount treated as a capital expenditure under this paragraph (d) is to be allocated proportionately to the adjusted basis of each property acquired or constructed with the contribution based on the relative cost of such property.

(4) *Example*. The application of this paragraph (d) is illustrated by the following example:

Example. A, a calendar year regulated public utility that provides water services, received a $1,000,000 contribution in aid of construction in 2000 as an advance from B, a developer, for the purpose of constructing a water facility. To the extent that the $1,000,000 exceeds the actual cost of the facility, the contribution is subject to being returned. Under the terms of the advance, A agrees to pay to B a percentage of the receipts from the facility over a fixed period, but limited to the cost of the facility. In 2001, A builds the facility at a cost of $700,000 and returns $300,000 to B. In 2002, A pays $20,000 to B out of the receipts from the facility. Assuming accurate records are kept, the $700,000 advance is a contribution to the capital of A under paragraph (a) of this section and is excludable from A's income. The basis of the $700,000 facility constructed with this contribution to capital is zero. The $300,000 excess amount is not a contribution to the capital of A under paragraph (a) of this section because it does not meet the expenditure rule described in paragraph (c)(1) of this section. However, this excess amount is not includible in A's income pursuant to paragraph (c)(2)(ii) of this section since the amount is repaid to B within the required time period. The repayment of the $300,000 excess amount to B in 2001 is not treated as a capital expenditure by A. The $20,000 payment to B in 2002 is treated as a capital expenditure by A in 2002 resulting in an increase in the adjusted basis of the water facility from zero to $20,000.

(e) *Statute of limitations*—(1) *Extension of statute of limitations*. Under section 118(d)(1), the statutory period for assessment of any deficiency attributable to a contribution to capital under paragraph (a) of this section does not expire before the expiration of 3 years after the date the taxpayer notifies the Secretary in the time and manner prescribed in paragraph (e)(2) of this section.

(2) *Time and manner of notification*. Notification is made by attaching a statement to the taxpayer's federal income tax return for the taxable year in which any of the reportable items in paragraphs (e)(2)(i) through (iii) of this section occur. The statement must contain the taxpayer's name, address, employer identification number, taxable year, and the following information with respect to contributions of property other than water or sewerage disposal facilities that are subject to the expenditure rule described in paragraph (c) of this section—

(i) The amount of contributions in aid of construction expended during the taxable year for property described in section 118(c)(2)(A) (qualified property) as required under paragraph (c)(1) of this section, identified by taxable year in which the contributions were received;

(ii) The amount of contributions in aid of construction that the taxpayer does not intend to expend for qualified property as required under paragraph (c)(1) of this section, identified by taxable year in which the contributions were received; and

(iii) The amount of contributions in aid of construction that the taxpayer failed to expend for qualified property as required under paragraph (c)(1) of this section, identified by taxable year in which the contributions were received.

(f) *Effective date*. This section is applicable for any money or other property received by a regulated public utility that provides water or sewerage disposal services on or after January 11, 2001.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.118–2	1545–1639
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 20, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 10, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 11, 2001, 66 F.R. 2252)

Section 280F.—Limitation on Depreciation for Luxury Automobiles; Limitation Where Certain Property Used for Personal Purposes

26 CFR 1.280F–7: Property leased after December 31, 1986.

This procedure provides owners and lessees of passenger automobiles (including electric automobiles) with tables detailing the limitations on depreciation deductions for automobiles first placed in service during calendar year 2001 and the amounts to be included in income for automobiles first leased during calendar year 2001. See Rev. Proc. 2001–19, page 732.

Section 312.—Effect on Earnings and Profits

26 CFR 1.312–6: Earnings and profits.
(Also §§ 56, 83; § 1.83–6.)

E & P adjustments on exercise of option. This revenue ruling announces that the earnings and profits of a corporate employer are reduced to reflect the deduction the corporation takes when an employee receives stock upon exercise of a nonstatutory stock option.

Rev. Rul. 2001–1

If a corporation transfers stock upon exercise of an option that was granted in connection with the performance of services and to which § 421 of the Internal Revenue Code does not apply (a nonstatutory stock option), and the option did not have a readily ascertainable fair market value at the time of grant, the earnings and profits of the service recipient are reduced by the amount of the deduction allowed to the service recipient under §§ 83(h) and 162 by reason of such exercise. Because this item reduces earnings and profits, § 56(g)(4)(C)(i) does not disallow the deduction of the item in computing adjusted current earnings for purposes of alternative minimum tax.

The principal author of this revenue ruling is Russell P. Subin of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Mr. Subin at (202) 622-7790 (not a toll-free call).

Section 446.—General Rule for Methods of Accounting

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

What are the procedures for a taxpayer subject to the jurisdiction of the Large and Mid-Size Business Division (LMSB) of the Service to request the examination of specific issues relating to a tax return before the return is timely filed and to obtain an LMSB Pre-Filing Agreement with respect to that issue. See Rev. Proc. 2001–22, page 745.

Section 471.—General Rule for Inventories

26 CFR 1.471–3: Inventories at cost.
(Also §§ 61, 111, 472; 1.472–2.)

Rev. Rul. 2001–8

ISSUE

What is the proper method of accounting for payments made or received with respect to "floor stocks"?

BACKGROUND

A floor stocks provision, which applies to a designated type of goods held in inventory (floor stocks) on a particular date (the "floor stocks date"), is sometimes enacted in conjunction with a tax, change in tax rate, or subsidy that is imposed upon similar goods purchased or produced on or after that date. The purpose of a floor stocks provision is to ensure that all goods sold on or after the floor stocks date are subjected to the same total amount of tax or subsidy, regardless of whether the items sold were goods held as floor stocks on the floor stocks date or goods purchased or produced after that date. This equal treatment is achieved by imposing with respect to goods held on the floor stocks date an amount, to be either paid or received, that will serve to eliminate any differential in total tax or subsidy that would otherwise exist relative to goods subsequently purchased or produced.

The Internal Revenue Service, in two previous revenue rulings, has addressed the proper tax treatment of payments received with respect to floor stocks. Rev. Rul. 88–95, 1988–2 C.B. 28, and Rev. Rul. 85–30, 1985–1 C.B. 20, generally provide that payments received with respect to floor stocks should be treated as either an item of gross income or a reduction in inventory, depending on whether the cost of the goods to which the payments relate remains in ending inventory under the taxpayer's cost flow assumption. However, questions continue to arise about how the "goods to which the payments relate" should be determined, particularly when the last-in, first-out (LIFO) inventory method is used.

The purpose of this revenue ruling is to clarify that payments made or received with respect to floor stocks must be accounted for as adjustments to the invoice price or production cost of the goods physically held on the floor stocks date to which the payments relate, rather than as an adjustment to the tax basis (carrying value) of those goods. This revenue ruling also provides, for costing purposes, an optional simplifying assumption for LIFO taxpayers regarding identification of the goods physically held on the floor stocks date to which the floor stocks payments relate.

LAW

Section 471(a) of the Internal Revenue Code provides that inventories must be taken on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting income.

Section 1.471–3 of the Income Tax Regulations provides rules for determining the cost of merchandise on hand at the beginning of the taxable year and the cost of merchandise purchased or produced since the beginning of the taxable year.

Section 472(a) provides that taxpayers may use the LIFO method of inventorying goods in accordance with such regulations as the Secretary may prescribe as necessary in order that the use of such method may clearly reflect income.

Section 472(b) and § 1.472–1 require taxpayers using the LIFO inventory method to treat goods remaining on hand at the close of the taxable year as being: first, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof; and second, those acquired during the taxable year. Section 472(b) and § 1.472–2 require taxpayers using the LIFO method to inventory their goods at cost.

Section 263A(a) provides, in the case of property that is inventory in the hands of the taxpayer, that the direct costs and an allocable share of the indirect costs (including taxes) of the property must be included in inventory costs.

Section 1.263A–1(e)(3)(i) provides that indirect costs are properly allocable to property produced or property acquired for resale when the costs directly benefit or are incurred by reason of the performance of production or resale activities.

Section 1.263A–2(a)(3)(iii) provides that producers must capitalize all indirect costs incurred subsequent to completion of production that are properly allocable to the property produced.

Section 61(a) provides generally that gross income means all income from whatever source derived.

Rev. Rul. 85–30 addresses the income tax treatment of payments received by a retail dealer of highway vehicle tires as a reimbursement of federal excise taxes previously paid with respect to floor stocks of certain tires held on the floor stocks date. Rev. Rul. 85–30 holds that the excise tax reimbursement should be treated as a reduction in ending inventory to the extent that it relates to tires the cost of which remains in ending inventory. Rev. Rul. 85–30 further holds that the excise tax reimbursement should be treated as an item of gross income to the extent that it relates to tires the cost of which does not remain in ending inventory and has been included in cost of goods sold.

Rev. Rul. 88–95 addresses the income tax treatment of two types of payments received by a textile manufacturer that were attributable to domestically produced raw cotton that was either held as of a specific date (*i.e.*, floor stocks) or purchased subsequent to that date. Rev. Rul. 88–95 holds that both types of payments should be treated as a reduction in the inventory cost of the cotton giving rise to the payments to the extent that the cost is deemed to remain in inventory at the date the payments are accrued under the taxpayer's method of accounting. Rev. Rul. 88–95 further holds that the payments should be treated as an item of gross income to the extent that the cost of the cotton giving rise to the payments is deemed to have been relieved from inventory and accounted for through cost of goods sold as of the date the payments are accrued under the taxpayer's method of accounting.

Mohawk Liqueur Corp. v. United States, 324 F.2d 241 (6th Cir. 1963), *cert. denied*, 377 U.S. 905 (1964), addressed the specific question of whether the taxpayer, a manufacturer of alcoholic beverages, could deduct floor stocks taxes on distilled spirits instead of including them in inventory in accordance with its previous practice. The court held that consistency in inventory practice is required. As a result, the taxpayer was not allowed to deviate from its prior practice of including floor stocks taxes in inventory.

Turtle Wax, Inc. v. Commissioner, 43 T.C. 460 (1965), held that refunds of federal excise taxes on watches were taxable income to the extent that the taxpayer had derived a tax benefit related to the payment of such taxes from deductions taken in prior years.

ANALYSIS

The inventory accounting rules generally require a taxpayer to first determine the cost of goods purchased or produced during a taxable year and then to allocate that cost between goods sold during that taxable year and goods that remain in ending inventory based on the taxpayer's inventory cost flow assumption. *See* §§ 1.471–3 and 1.263A–1(c)(1).

Payments made with respect to floor stocks (*e.g.*, taxes) represent an inventoriable cost of the goods to which the payments relate under §§ 471 and 263A. *See* § 263A(a). Similarly, payments received with respect to floor stocks (*e.g.*, tax refunds or subsidy payments) represent a reduction in the purchase price or production cost of the goods giving rise to the payments. *See* Rev. Rul. 85–30; Rev. Rul. 88–95.

Thus, consistent with the requirements of §§ 1.471–3 and 1.263A–1, payments made or received with respect to floor stocks must be accounted for as adjustments to the cost of the goods physically held on the floor stocks date to which the payments relate. "Cost" for this purpose means invoice price or production cost. The resultant effect on either gross income or inventory depends on the extent to which the cost of the goods physically held on the floor stocks date remains in ending inventory. Whether the cost of the goods physically held on the floor stocks date remains in ending inventory is determined by applying the taxpayer's inventory cost flow assumption (*e.g.*, LIFO, first-in, first-out (FIFO), or a specific-goods method) to identify the particular costs that are deemed to be contained in ending inventory. *See* Rev. Rul. 85–30; Rev. Rul. 88–95.

Therefore, to the extent that the cost of the goods associated with the floor stocks payments has been included in cost of goods sold under the taxpayer's inventory cost flow assumption, payments made (or received) with respect to floor stocks increase (or decrease) cost of goods sold. However, payments received that relate to goods the cost of which has been included in cost of goods sold in a previous year under the taxpayer's inventory cost flow assumption increase gross income, consistent with operation of the tax benefit rule as illustrated in *Turtle Wax*, 43 T.C. at 466. For taxpayers using a LIFO inventory method, this treatment ensures that payments made or received with respect to floor stocks do not affect historical LIFO cost increments that contain the cost of unrelated goods.

Similarly, to the extent that the cost of the goods associated with the floor stocks payments remains in ending inventory under the taxpayer's inventory cost flow assumption, payments made (or received) with respect to floor stocks increase (or decrease) ending inventory. For taxpayers using a LIFO inventory method, payments made or received with respect to floor stocks affect ending inventory only when one or more LIFO cost increments that remain in ending inventory, as computed under § 472(b) and § 1.472–1, include the cost of the goods physically held on the floor stocks date. For taxpayers using a FIFO inventory method, payments made or received with respect to floor stocks generally are included in cost of goods sold and not ending inventory because the goods physically held on the floor stocks date to which the payments relate usually do not remain in FIFO inventory at the end of the year.

Mohawk Liqueur was decided on grounds of consistency in inventory practice and did not address the issue considered in this revenue ruling, *i.e.*, the proper method of accounting for floor stocks taxes under a particular inventory cost flow assumption.

EXAMPLES

The following four examples illustrate the proper income tax accounting treatment of payments made and received with respect to floor stocks:

Example 1. *X* files returns on a calendar year basis using an accrual method of accounting and the double-extension, dollar-value LIFO method of inventorying goods. *X* has only one item, Product 1, in its dollar-value LIFO pool. The federal excise tax on Product 1 decreases on January 1, 2000, from 10¢ to 8¢ per unit. Simultaneously, a floor stocks provision is implemented that entitles merchants holding Product 1 in inventory on January 1, 2000, upon which an excise tax of 10¢ per unit had previously been paid, to a refund of 2¢ per unit. *X* held 10,000 units of Product 1 on January 1, 2000, and received an associated $200 excise tax refund in 2000. The 10,000 units of Product 1 that *X* physically held on January 1, 2000, were purchased in 1999. *X*'s December 31, 1999, LIFO inventory consists of a

1995 LIFO cost increment that includes the cost of 3,000 units of Product 1 and a 1999 LIFO cost increment that contains the cost associated with an additional 7,000 units. These 1995 and 1999 increments remain in *X*'s 2000 LIFO ending inventory.

X must account for the $200 excise tax refund in 2000 as follows: The $200 refund represents a reduction in the invoice price of the 10,000 units of Product 1 purchased in 1999 and held on January 1, 2000. Of these 10,000 units, only the cost of 7,000 units remains in *X*'s 2000 ending inventory under *X*'s LIFO inventory cost flow assumption as part of a 1999 increment; thus, $140 of the $200 refund (7,000/10,000 x $200 = $140) is allocated to these units, resulting in a $140 decrease in 2000 ending inventory. ($140 must be subtracted from the current-year cost of the 1999 LIFO cost increment and the index (*i.e.*, the ratio of total current-year cost to total base-year cost) for the 1999 increment would be recalculated). The cost of the remaining 3,000 of these 10,000 units was included in cost of goods sold in 1999 under *X*'s LIFO inventory cost flow assumption. Thus, $60 of the refund (3,000/10,000 x $200 = $60) must be included in gross income in 2000.

Example 2. *Y* files returns on a calendar year basis using an accrual method of accounting and the double-extension, dollar-value LIFO method of inventorying goods. A floor stocks provision is implemented on July 1, 2000, that entitles merchants holding Product 2 in inventory on that date to receive inventory protection (subsidy) payments of $1 per unit. *Y* held 50,000 units of Product 2 on July 1, 2000, and received an associated $50,000 inventory protection payment in 2000. The 50,000 units of Product 2 that *Y* physically held on July 1, 2000, were purchased in 2000. The cost of these units does not remain in *Y*'s 2000 LIFO ending inventory, which consists of 1996, 1997, and 1998 LIFO cost increments.

Y must include the entire $50,000 inventory protection payment as a decrease in 2000 cost of goods sold because the cost of the associated goods was included in 2000 cost of goods sold and thus does not remain in 2000 ending inventory under *Y*'s LIFO inventory cost flow assumption.

Example 3. *Z* files returns on a calendar year basis using an accrual method of accounting and the double-extension, dollar-value LIFO method of inventorying goods. *Z* has only one item, Product 3, in its dollar-value LIFO pool. The federal excise tax on Product 3 increases on January 1, 2000, from 6¢ to 10¢ per unit. Simultaneously, a floor stocks tax provision is implemented that requires producers holding Product 3 in inventory on January 1, 2000, upon which an excise tax of 6¢ per unit had previously been paid, to pay an additional excise tax of 4¢ per unit. *Z* has 100,000 units of Product 3 on hand on January 1, 2000, and pays the additional excise tax of $4,000 in 2000. The 100,000 units of Product 3 that *Z* physically held on January 1, 2000, were produced in 1999 and subjected to a 6¢ per unit excise tax in 1999. *Z*'s December 31, 1999, LIFO inventory consists of LIFO cost increments from 1990, 1993, and 1996. The cost of these 100,000 units does not remain in *Z*'s 2000 LIFO ending inventory because *Z* did not add a LIFO cost increment in 1999.

Z must include the entire $4,000 floor stocks tax in cost of goods sold in 2000 because the production cost of the associated goods was included in cost of goods sold in 1999 and thus does not remain in 2000 ending inventory under *Z*'s LIFO inventory cost flow assumption.

Example 4. The facts are the same as *Example 3*, except that the cost of 60,000 of the 100,000 units of Product 3 that *Z* produced in 1999 and physically held on January 1, 2000, is included in a 1999 LIFO cost increment. The cost of these 60,000 units remains in *Z*'s 2000 LIFO ending inventory because *Z* did not have an inventory decrement in 2000.

Z must account for the $4,000 floor stocks tax in 2000 as follows: $2,400 must be assigned as an increase in the production cost of the 60,000 units held on January 1, 2000, that were produced in 1999 the cost of which remains in 2000 ending inventory under *Z*'s LIFO inventory cost flow assumption as part of a 1999 LIFO cost increment (60,000/100,000 x $4,000 = $2,400). This adjustment results in an increase in 2000 ending inventory ($2,400 must be added to the current-year cost of the 1999 LIFO cost increment and the index (*i.e.*, the ratio of total current-year cost to total base-year cost) for the 1999 increment would be recalculated). The remaining $1,600 of the floor stocks tax must be included in cost of goods sold in 2000 because the production cost of the 40,000 units of Product 3 produced in 1999 with which it is associated was included in 1999 cost of goods sold and thus does not remain in 2000 ending inventory under *Z*'s LIFO inventory cost flow assumption.

HOLDING

Payments made or received with respect to floor stocks must be accounted for as adjustments to the invoice price or production cost of the goods physically held on the floor stocks date to which the payments relate. Payments made or received with respect to floor stocks affect inventory valuation only to the extent that the invoice price or production cost of the goods on hand that gave rise to the payments has not been included in cost of goods sold but remains in ending inventory under the taxpayer's inventory cost flow assumption. Payments made or received with respect to floor stocks affect gross income to the extent that the invoice price or production cost of the goods on hand that gave rise to the payments has been included in cost of goods sold and thus is not included in ending inventory under the taxpayer's inventory cost flow assumption.

SIMPLIFYING ASSUMPTION REGARDING GOODS ON HAND

Identification of the goods that were physically held on the floor stocks date may be unduly burdensome for some taxpayers, particularly LIFO taxpayers with large inventories of fungible goods. As a matter of administrative convenience, the Service will permit LIFO taxpayers to assume that the goods physically held on the floor stocks date are those most recently purchased or produced. This simplifying assumption for payments made or received with respect to floor stocks is a method of accounting that must be applied on a consistent basis and used only for the purpose of identifying the goods physically held on the floor stocks date for costing purposes.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in § 7805(b) of the Code, the conclusions in this revenue ruling will not be applied adversely to challenge a consistent treatment by taxpayers of payments made or received with respect to floor stocks on or before February 26, 2001.

CHANGE IN METHOD OF ACCOUNTING

A change to comply with this revenue ruling is a change in method of accounting to which the provisions of § 446 and the regulations thereunder apply. A taxpayer wanting to change its method of accounting to conform with the holding in this revenue ruling or to elect the simplifying assumption must follow the automatic change in accounting method provisions of Rev. Proc. 99–49, 1999–2 C.B. 725 (or its successor), provided the change is made for the first taxable year in which payments are made or received with respect to floor stocks subsequent to February 26, 2001, with the following modifications: (1) the scope limitations in section 4.02 of Rev. Proc. 99–49 do not apply (if the taxpayer is under examination, before an appeals office, or before a federal court with respect to any income tax issue, the taxpayer must provide a copy of the Form 3115, *Application for Change in Accounting Method*, to the examining agent, appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the Form 3115 with the national office); (2) in lieu of the label required by section 6.02(3) of Rev. Proc. 99–49, a taxpayer should write "Filed pursuant to Rev. Rul. 2001–8" at the top of its Form 3115; (3) the change in method of accounting to comply with the holding in this revenue ruling is to be made using a cut-off method relative to payments made or received with respect to floor stocks on or before February 26, 2001 (*see* section 2.06 of Rev. Proc. 99–49); (4) a taxpayer should clearly indicate on its Form 3115 or in an attachment thereto if it is electing to use the simplifying assumption to identify the goods physically held on the floor stocks date for costing purposes.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 85–30 is clarified to reflect that the reimbursement of excise taxes is treated as a reduction in the invoice price of the tires physically held on the floor stocks date.

Rev. Rul. 88–95 is clarified to reflect that the inventory protection payments are treated as a reduction in the invoice price of the cotton physically held on the floor stocks date.

Rev. Proc. 99–49 is modified and amplified to include this automatic change in section 9 of the APPENDIX.

DRAFTING INFORMATION

The principal author of this revenue ruling is Alan J. Tomsic of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic at (202) 622-4970 (not a toll-free call).

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–2: Requirements incident to adoption and use of LIFO inventory method.

Must payments made or received with respect to floor stocks be accounted for as adjustments to the invoice price or production cost of the goods physically held on the floor stocks date to which the payments relate, rather than as adjustment to the tax basis (carrying value) of those goods. See Rev. Rul. 2001–8, page 726.

Section 482.—Allocation of Income and Deductions Among Taxpayers

What are the procedures for a taxpayer subject to the jurisdiction of the Large and Mid-Size Business Division (LMSB) of the Service to request the examination of specific issues relating to a tax return before the return is timely filed and to obtain an LMSB Pre-Filing Agreement with respect to that issue. See Rev. Proc. 2001–22, page 745.

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001–3: Modification of debt instruments.

The revenue procedure, which modifies and supersedes Rev. Proc. 99–18, provides for an election that will allow taxpayers to treat a debt substitution, in certain circumstances, as a realization event even though it does not result in a significant modification under section 1.1001–3 of the Income Tax Regulations. See Rev. Proc. 2001–21, page 742.

Section 1275.—Other Definitions and Special Rules

26 CFR 1.1275–2: Special rules relating to debt instruments.

The revenue procedure, which modifies and supersedes Rev. Proc. 99–18, provides for an election that will allow taxpayers to treat a debt substitution, in certain circumstances, as a realization event even though it does not result in a significant modification under section 1.1001–3 of the Income Tax Regulations. See Rev. Proc. 2001–21, page 742.

Section 7121.—Closing Agreements

26 CFR 301.7121–1: Closing agreements.

What are the procedures for a taxpayer subject to the jurisdiction of the Large and Mid-Size Business Division (LMSB) of the Service to request the examination of specific issues relating to a tax return before the return is timely filed and to obtain an LMSB Pre-Filing Agreement with respect to that issue. See Rev. Proc. 2001–22, page 745.

Part III. Administrative, Procedural, and Miscellaneous

Intermediary Transactions Tax Shelter

Notice 2001–16

The Internal Revenue Service and the Treasury Department have become aware of certain types of transactions, described below, that are being marketed to taxpayers for the avoidance of federal income taxes. The Service and Treasury are issuing this notice to alert taxpayers and their representatives of certain responsibilities that may arise from participation in these transactions.

These transactions generally involve four parties: seller (X) who desires to sell stock of a corporation (T), an intermediary corporation (M), and buyer (Y) who desires to purchase the assets (and not the stock) of T. Pursuant to a plan, the parties undertake the following steps. X purports to sell the stock of T to M. T then purports to sell some or all of its assets to Y. Y claims a basis in the T assets equal to Y's purchase price. Under one version of this transaction, T is included as a member of the affiliated group that includes M, which files a consolidated return, and the group reports losses (or credits) to offset the gain (or tax) resulting from T's sale of assets. In another form of the transaction, M may be an entity that is not subject to tax, and M liquidates T (in a transaction that is not covered by § 337(b)(2) of the Internal Revenue Code or § 1.337(d)–4) of the Income Tax Regulations, resulting in no reported gain on M's sale of T's assets.

Depending on the facts of the particular case, the Service may challenge the purported tax results of these transactions on several grounds, including but not limited to one of the following: (1) M is an agent for X, and consequently for tax purposes T has sold assets while T is still owned by X, (2) M is an agent for Y, and consequently for tax purposes Y has purchased the stock of T from X, or (3) the transaction is otherwise properly recharacterized (*e.g.*, to treat X as having sold assets or to treat T as having sold assets while T is still owned by X). Alternatively, the Service may examine M's consolidated group to determine whether it may properly offset losses (or credits) against the gain (or tax) from the sale of assets.

The Service may impose penalties on participants in these transactions, or, as applicable, on persons who participate in the promotion or reporting of these transactions, including the accuracy-related penalty under § 6662, the return preparer penalty under § 6694, the promoter penalty under § 6700, and the aiding and abetting penalty under § 6701.

Transactions that are the same as or substantially similar to those described in the Notice 2001–16 are identified as "listed transactions" for the 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. See also § 301.6112–1T, A–4. It should be noted that, independent of their classification as "listed transactions" for purposes of §§ 1.6011–4T(b)(2) and 301.6111–2T(b)(2), such transactions may already be subject to the tax shelter registration and list maintenance requirements of §§ 6111 and 6112 under the regulations issued in February 2000 (§§ 301.6111–2T and 301.6112–1T, A–4). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under § 6707(a) and to the penalty under § 6708(a) if the requirements of § 6112 are not satisfied.

For further information regarding this notice, contact Theresa Abell, of the Office of Associate Chief Counsel (Corporate), at (202)622-7700 (not a toll-free call).

Contingent Liability Tax Shelter

Notice 2001–17

The Internal Revenue Service and the Treasury Department have become aware of certain types of transactions, described below, that are being marketed to taxpayers for the purpose of accelerating and, in some cases, duplicating tax deductions. This notice is intended to alert taxpayers and their representatives that the losses generated by such transactions are not properly allowable for federal income tax purposes. This notice also alerts taxpayers and their representatives of certain responsibilities that may arise from participation in such transactions.

FACTS

These transactions take several forms but, in all cases, involve the transfer of a high basis asset (*i.e.*, an asset with a basis that approximates its fair market value) to a corporation purportedly in exchange for stock of the transferee corporation, and the transferee corporation's assumption of a liability (such as a liability for deferred compensation or other deferred employee benefits or an obligation for environmental remediation) that the transferor has not yet taken into account for federal income tax purposes. The transferor typically remains liable on the underlying obligation. The basis and fair market value of the transferred asset, which may be a security of another member of the same affiliated group of corporations, are generally only marginally greater than the present value of the assumed liability. Therefore, the value of the stock of the transferee received by the transferor is minimal relative to the basis and fair market value of the asset transferred to the transferee corporation.

The transaction is purported to qualify as an exchange under § 351 of the Internal Revenue Code, with the intent that the basis of the stock that the transferor receives from the transferee corporation will be equal to the basis of the transferred asset, unreduced by the liability assumed by the transferee corporation. Under § 358(a), a transferor's basis in stock received in a § 351 exchange is equal to the transferor's basis in property exchanged for such stock, subject to certain adjustments, including a reduction for any money or other property received by the transferor. Under § 358(d)(1), liabilities assumed by the transferee corporation are treated as money received by the transferor. Under certain circumstances, however, liabilities assumed by a transferee corporation in a § 351 exchange are not treated as money received by the transferor and thus do not reduce the basis of the stock received in the exchange. *See* § 358(d)(2); § 357(c)(3).

The transferor typically sells the stock of the transferee corporation for its fair market value within a relatively short period of time after the purported § 351 exchange and claims a tax loss in an amount approximating the present value of the liability assumed by the transferee corporation. In the case of a transaction involving members of an affiliated group that has elected to file a consolidated return, the transaction is structured with the intention of avoiding the loss disallowance rule of § 1.1502–20 of the Income Tax Regulations. In addition to the transferor's purported loss on the sale of the stock of the transferee corporation, the transferee corporation may claim a § 162 deduction with respect to payments on the liability.

Taxpayers assert several business purposes for these transactions. However, the Service and the Treasury are not aware of any case in which a taxpayer has shown a legitimate non-tax business reason to carry out the combination of steps described above. Moreover, the Service and the Treasury believe that any business purposes taxpayers may assert for certain aspects of these transactions are far outweighed by the purpose to generate deductible losses for federal income tax purposes.

ANALYSIS

Depending on the facts of the particular case, the Service intends to disallow losses claimed by the transferor with respect to these transactions. For transfers after October 18, 1999, the Service will assert that such losses are disallowed because the transferor's basis in the stock received is reduced under § 358(h) (reducing stock basis by the amount of certain liabilities).

For transfers on or before October 18, 1999, as well as for transfers after October 18, 1999, that are not subject to § 358(h), the Service will disallow such losses for one or more reasons, including but not limited to the following: (1) that the purported § 351 exchange lacks sufficient business purpose to qualify as a § 351 exchange; (2) that the transfer of the asset to the transferee corporation is not, in substance, a transfer of property in exchange for stock within the meaning of § 351, but instead is either an agency arrangement for the transferor or simply a payment to the transferee for its assumption of a liability; (3) that the purported § 351 exchange constitutes an acquisition of control of the transferee corporation for the principal purpose of tax avoidance within the meaning of § 269(a) and thus the purported loss should be disallowed under § 269(a); (4) that the principal purpose of the transferee's assumption of the liability was a purpose to avoid federal income tax or was not a *bona fide* business purpose within the meaning of § 357(b)(1), and thus the assumption of the liability should be treated as money received by the transferor that reduces its basis in the transferee stock; (5) that the purported loss on the sale of the stock of the transferee corporation is disallowed or limited by the loss disallowance rules of § 1.1502–20, including the anti-avoidance rule in § 1.1502–20(e) and the duplicated loss rule in § 1.1502–20(c); (6) that the purported loss on the sale of the stock of the transferee corporation is not a *bona fide* loss actually sustained by the transferor, as required by § 1.165–1(b); and (7) that the overall transaction lacks sufficient economic substance to be respected for federal income tax purposes, *see ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998), *cert. denied*, 526 U.S. 1017 (1999).

In addition, any deduction claimed by a transferee corporation for payments on a liability assumed in a transaction similar to that described above may, depending on the facts of the particular case, be subject to disallowance on one or more of several possible grounds, including that the payments are not for ordinary and necessary business expenses of the transferee corporation. Rev. Rul. 95–74, 1995–2 C.B. 36, which addressed the treatment of certain environmental liabilities assumed by a transferee of a manufacturing business, does not apply to the deductibility by the transferee of liabilities assumed in a transaction of the type described in this notice because Rev. Rul. 95–74 dealt with liabilities assumed by a transferee corporation in connection with the transfer of substantially all the assets associated with the operation of a manufacturing business to the transferee corporation in a transaction that qualified as a § 351 exchange.

The Service may impose penalties on participants in these transactions, or, as applicable, on persons who participate in the promotion or reporting of these transactions, including the accuracy-related penalty under § 6662, the return preparer penalty under § 6694, the promoter penalty under § 6700, and the aiding and abetting penalty under § 6701.

Transactions that are the same as or substantially similar to those described in this Notice 2001–17 (including transactions utilizing partnerships) are identified as "listed transactions" for the 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. *See also* § 301.6112–1T, A–4. It should be noted that, independent of their classification as "listed transactions" for purposes of §§ 1.6011–4T(b)(2) and 301.6111–2T(b)(2), such transactions may already be subject to the tax shelter registration and list maintenance requirements of §§ 6111 and 6112 under the regulations issued in February 2000 (§§ 301.6111–2T and 301.6112–1T, A–4), as well as the regulations issued in 1984 and amended in 1986 (§§ 301.6111–1T and 301.6112–1T, A–3). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under § 6707(a) and to the penalty under § 6708(a) if the requirements of § 6112 are not satisfied.

The principal author of this notice is Theresa Abell, of the Office of Associate Chief Counsel (Corporate). For further information regarding this notice, contact Ms. Abell at (202) 622-7700 (not a toll-free call).

Lease Exception to the Tax Shelter Regulations

Notice 2001–18

This notice provides an exception from the registration requirements under § 6111(d) of the Internal Revenue Code and the list maintenance requirements under § 6112 for certain leasing transactions, except as may be provided in subsequent guidance.

BACKGROUND

Section 301.6111–2T of the temporary Procedure and Administration Regulations provides rules regarding the registration of confidential corporate tax shelters under § 6111(d). A confidential corporate tax shelter is any entity, plan, arrangement, or transaction that satisfies the following three requirements: (1) a significant purpose of the structure of the transaction is the avoidance or evasion of federal income tax for a direct or an indirect corporate participant; (2) the transaction is offered to any potential participant under conditions of confidentiality; and (3) the tax shelter promoters may receive fees in excess of $100,000 in the aggregate. Section 301.6111–2T(b) provides that the avoidance or evasion of federal income tax is considered a significant purpose of the structure of the transaction if the transaction is a listed transaction under § 301.6111–2T(b)(2), lacks economic substance under § 301.6111–2T (b)(3), or is otherwise a tax-structured transaction under § 301.6111–2 T(b)(4). However, a transaction described in § 301.6111–2T(b)(3) or (4) does not need to be registered if, under § 301.6111–2T (b)(5)(ii), the Internal Revenue Service makes a determination by published guidance that a transaction is not subject to the registration requirements under § 6111(d).

Section 301.6112–1T provides rules regarding the requirement to maintain lists of investors in potentially abusive tax shelters under § 6112. A potentially abusive tax shelter under § 6112 includes any investment that is required to be registered with the Internal Revenue Service as a tax shelter under § 6111, and any other entity, plan, or arrangement, if specified in regulations, that has a potential for tax avoidance or evasion. Section 301.6112–1T A–4 provides that for purposes of the list requirement, a tax shelter includes any transaction a significant purpose of the structure of which is the avoidance or evasion of federal income tax within the meaning of §§ 6111(d)(1)(A) and 301.6111–2T(b) (whether or not offered to any direct or indirect corporate participant). If a transaction is exempted from registration under § 301.6111–2T(b)(5), the transaction is also exempted from the list maintenance requirement under § 6112, unless the transaction is subject to registration under § 6111(c).

DISCUSSION

Since the issuance of §§ 301.6111–2T and 301.6112–1T, the U.S. Treasury Department and the Internal Revenue Service have received comments asking that certain customary leasing transactions involving tangible personal property be excepted from the registration requirement under § 6111(d) and the list maintenance requirement under § 6112. After consideration of those comments, Treasury and the Service have determined that exemptive relief for certain leasing transactions is consistent with the objectives of the registration requirements under § 6111(d) and the list maintenance requirements under § 6112.

Under § 301.6111–2T(b)(5)(ii), no person shall be required to register under § 6111(d) a transaction that satisfies the following requirements: (1) the transaction is a lease or sale leaseback between an owner-lessor of tangible personal property and a lessee who is the user of the property, (2) the terms of the lease (including any related agreements) are consistent with customary commercial practice for the leasing of similar items of property, (3) the transaction qualifies as a lease for federal income tax purposes under Rev. Proc. 75–21, 1975–1 C.B. 715 (or its successor), or under generally accepted case law principles, (4) the lessor and lessee agree to consistently report the transaction as a lease for federal income tax purposes, and (5) the transaction is not the same as or substantially similar to a listed transaction (or part of a listed transaction) under § 301.6111–2T (b)(2), including a "lease strip" described in Notice 95–53, 1995–2 C.B. 334, or a "LILO" (lease in / lease out) transaction described in Rev. Rul. 99–14, 1999–1 C.B. 835. Furthermore, no list needs to be maintained under § 6112 for transactions satisfying this leasing exception that are not otherwise subject to registration under § 6111(c).

EFFECTIVE DATE

This notice applies to leasing transactions entered into after February 28, 2000.

DRAFTING INFORMATION

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

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 61, 280F; 1.61–21, 1.280F–7.)

Rev. Proc. 2001–19

SECTION 1. PURPOSE

This revenue procedure provides: (1) limitations on depreciation deductions for owners of passenger automobiles first placed in service during calendar year 2001, including separate limitations on passenger automobiles designed to be propelled primarily by electricity and built by an original equipment manufacturer (electric automobiles); (2) the amounts to be included in income by lessees of passenger automobiles first leased during calendar year 2001, including separate inclusion amounts for electric automobiles; and (3) the maximum allowable value of employer-provided automobiles first made available to employees for personal use in calendar year 2001 for which the vehicle cents-per-mile valuation rule provided under § 1.61–21(e) of the Income Tax Regulations may be applicable. The tables detailing these depreciation limitations and lessee inclusion amounts reflect the automobile price inflation adjustments required by § 280F(d)(7) of the Internal Revenue Code. The maximum allowable automobile value for applying the vehicle cents-per-mile valuation rule reflects the automobile price inflation adjustment of § 280F(d)(7) as required by § 1.61–21(e) (1)(iii)(A).

SECTION 2. BACKGROUND

For owners of automobiles, § 280F(a) imposes dollar limitations on the depreciation deduction for the year that the automobile is placed in service and each succeeding year. In the case of electric automobiles placed in service after August 5, 1997, and before January 1, 2005, § 280F(a)(1)(C) requires tripling of these limitation amounts. Section 280F(d)(7) requires the amounts allowable as depreciation deductions to be increased by a price inflation adjustment amount for passenger automobiles placed in service after 1988.

For leased automobiles, § 280F(c) requires a reduction in the deduction allowed to the lessee of the automobile. The reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of automobiles. Under § 1.280F–7(a), this reduction requires the lessees to include in gross income an inclusion amount determined by applying a formula to the amount obtained from a table. There is a table for lessees of electric automobiles and a table for all other passenger automobiles. Each table shows inclusion amounts for a range of fair market values for each tax year after the automobile is first leased.

For automobiles first provided by employers to employees that meet the requirements of § 1.61–21(e)(1), the value to the employee of the use of the automobile may be determined under the vehicle cents-per-mile valuation rule of § 1.61–21(e). Section 1.61–21(e)(1)(iii)(A) provides that for an automobile first made available after 1988 to any employee of the employer for personal use, the value of the use of the automobile may not be determined under the vehicle cents-per-mile valuation rule for a calendar year if the fair market value of the automobile (determined pursuant to § 1.61–21(d)(5)(i) through (iv)) on the first date the automobile is made available to the employee exceeds $12,800 as adjusted by § 280F(d)(7).

SECTION 3. SCOPE AND OBJECTIVE

01. The limitations on depreciation deductions in section 4.02 of this revenue procedure apply to automobiles (other than leased automobiles) that are placed in service in calendar year 2001 and continue to apply for each tax year that the automobile remains in service.

02. The tables in section 4.03 of this revenue procedure apply to leased automobiles for which the lease term begins in calendar year 2001. Lessees of such automobiles must use these tables to determine the inclusion amount for each tax year during which the automobile is leased.

03. Rev. Proc. 96–25, 1996–1 C.B. 681, for information on determining inclusion amounts for automobiles first leased before January 1, 1997; Rev. Proc. 97–20, 1997–1 C.B. 647, for automobiles first leased during calendar year 1997, including electric automobiles first leased on or after January 1, 1997, and before August 6, 1997; Rev. Proc. 98–24, 1998–1 C.B. 663, for electric automobiles first leased after August 5, 1997, and before January 1, 1998; Rev. Proc. 98–30, 1998–1 C.B. 930, for all automobiles first leased in calendar year 1998; Rev. Proc. 99–14, 1999–1 C.B. 413, for all automobiles first leased in calendar year 1999; and Rev. Proc. 2000–18, 2000–9 I.R.B. 722, for all automobiles first leased in calendar year 2000.

04. The maximum fair market value figure in section 4.04(2) of this revenue procedure applies to employer-provided automobiles first made available to any employee for personal use in calendar year 2001. *See* Rev. Proc. 97–20, for the maximum fair market value figure for automobiles first made available in calendar year 1997; Rev. Proc. 98–30, for the maximum fair market value figure for automobiles first made available in calendar year 1998; Rev. Proc. 99–14, for the maximum fair market value figure for automobiles first made available in calendar year 1999; and Rev. Proc. 2000–18, for the maximum fair market value figure for automobiles first made available in calendar year 2000.

SECTION 4. APPLICATION

01. A taxpayer placing an automobile in service for the first time during calendar year 2001 is limited to the depreciation deduction shown in Table 1 of section 4.02(2) of this revenue procedure or, in the case of an electric automobile, Table 2 of this revenue procedure. A taxpayer first leasing an automobile in calendar year 2001 must determine the inclusion amount that is added to gross income using Table 3 of section 4.03 of this revenue procedure or, in the case of an electric automobile, Table 4 of this revenue procedure. In addition, the procedures of § 1.280F–7(a) must be followed. An employer providing an automobile for the first time in calendar year 2001 for the personal use of any employee may determine the value of the use of the automobile by using the cents-per-mile valuation rule in § 1.61–21(e) if the fair market value of the automobile does not exceed the amount specified in section 4.04(2) of this revenue procedure. If the fair market value of the automobile exceeds the amount specified in section 4.04(2) of this revenue procedure, the employer may determine the value of the use of the automobile under the general valuation rules of § 1.61–21(b) or under the special valuation rules of § 1.61–21(d) (Automobile lease valuation) or § 1.61–21(f) (Commuting valuation) if the applicable requirements are met.

02. *Limitations on Depreciation Deductions for Certain Automobiles*.

(1) *Amount of the Inflation Adjustment*. Under § 280F(d)(7)(B)(i), the automobile price inflation adjustment for any calendar year is the percentage (if any) by which the CPI automobile component for October of the preceding calendar year exceeds the CPI automobile component for October 1987. The term "CPI automobile component" is defined in § 280F(d)(7)(B)(ii) as the "automobile component" of the Consumer Price Index for all Urban Consumers published by the Department of Labor (the CPI). The new car component of the CPI was 115.2 for October 1987 and 138.6 for October 2000. The October 2000 index exceeded the October 1987 index by 23.4. The Internal Revenue Service has, therefore, determined that the automobile price inflation adjustment for 2001 is 20.31 percent (23.4/115.2 x 100%). This adjustment is applicable to all automobiles that are first placed in service in calendar year 2001. The dollar limitations in § 280F(a) must therefore be multiplied by a factor of 0.2031, and the resulting increases, after rounding to the nearest $100, are added to the 1988 limitations to give the depreciation limitations applicable to passenger automobiles (other than electric automobiles) for calendar year 2001. To determine the dollar limitations applicable to an electric automobile first placed in service during calendar year 2001, the dollar limitations in § 280F(a) are tripled in accordance with § 280F(a)(1)(C) and are then multiplied by a factor of 0.2031; the resulting increases, after rounding to the nearest $100, are added to the tripled 1988 limitations to give the depreciation limitations for calendar year 2001.

(2) *Amount of the Limitation*. For automobiles (other than electric automobiles) placed in service in calendar year 2001, Table 1 of this revenue procedure contains the dollar amount of the depreciation limitations for each tax year. For electric automobiles placed in service in calendar year 2001, Table 2 of this revenue procedure contains these amounts.

REV. PROC. 2001–19 TABLE 1

DEPRECIATION LIMITATIONS FOR AUTOMOBILES (OTHER THAN ELECTRIC AUTOMOBILES) FIRST PLACED IN SERVICE IN CALENDAR YEAR 2001

Tax Year	*Amount*
1st Tax Year	$3,060
2nd Tax Year	$4,900
3rd Tax Year	$2,950
Each Succeeding Year	$1,775

REV. PROC. 2001–19 TABLE 2

DEPRECIATION LIMITATIONS FOR ELECTRIC AUTOMOBILES FIRST PLACED IN SERVICE IN CALENDAR YEAR 2001

Tax Year	*Amount*
1st Tax Year	$9,280
2nd Tax Year	$14,800
3rd Tax Year	$8,850
Each Succeeding Year	$5,325

03. *Inclusions in Income of Lessees of Automobiles*.

The inclusion amounts for automobiles first leased in calendar year 2001 are calculated under the procedures described in § 1.280F–7(a). Lessees of automobiles other than electric automobiles should use Table 3 of this revenue procedure in applying these procedures, while lessees of electric automobiles should use Table 4 of this revenue procedure.

REV. PROC. 2001–19 TABLE 3

DOLLAR AMOUNTS FOR AUTOMOBILES (OTHER THAN ELECTRIC AUTOMOBILES) WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2001

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
15,500	15,800	3	6	9	10	11
15,800	16,100	5	12	16	20	22
16,100	16,400	8	17	24	30	33
16,400	16,700	10	22	33	39	44
16,700	17,000	13	27	41	48	56
17,000	17,500	16	35	51	61	70
17,500	18,000	20	44	64	77	89
18,000	18,500	24	53	78	92	107
18,500	19,000	28	62	91	109	125
19,000	19,500	32	71	104	125	143
19,500	20,000	36	80	117	141	162
20,000	20,500	40	89	131	156	181
20,500	21,000	45	97	144	173	199
21,000	21,500	49	106	158	188	217
21,500	22,000	53	115	171	204	236
22,000	23,000	59	129	190	229	263
23,000	24,000	67	147	217	260	300
24,000	25,000	75	165	243	292	337
25,000	26,000	83	183	270	324	373

REV. PROC. 2001–19 TABLE 3—Continued

DOLLAR AMOUNTS FOR AUTOMOBILES (OTHER THAN ELECTRIC AUTOMOBILES) WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2001

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
26,000	27,000	91	201	296	356	410
27,000	28,000	100	218	324	387	447
28,000	29,000	108	236	350	419	484
29,000	30,000	116	254	377	451	520
30,000	31,000	124	272	403	483	557
31,000	32,000	132	290	430	515	594
32,000	33,000	140	308	456	547	631
33,000	34,000	149	326	482	579	667
34,000	35,000	157	343	510	610	705
35,000	36,000	165	361	536	643	741
36,000	37,000	173	379	563	674	778
37,000	38,000	181	397	590	705	815
38,000	39,000	189	415	616	738	851
39,000	40,000	198	433	642	770	888
40,000	41,000	206	451	669	801	925
41,000	42,000	214	469	695	833	962
42,000	43,000	222	487	722	865	998
43,000	44,000	230	505	748	897	1,036
44,000	45,000	238	523	775	929	1,072
45,000	46,000	247	540	802	961	1,108
46,000	47,000	255	558	828	993	1,145
47,000	48,000	263	576	855	1,024	1,183
48,000	49,000	271	594	881	1,057	1,219
49,000	50,000	279	612	908	1,088	1,256
50,000	51,000	287	630	935	1,119	1,293
51,000	52,000	296	648	961	1,151	1,330
52,000	53,000	304	666	987	1,184	1,366
53,000	54,000	312	684	1,014	1,215	1,403
54,000	55,000	320	702	1,040	1,248	1,439
55,000	56,000	328	720	1,067	1,279	1,476
56,000	57,000	336	738	1,093	1,311	1,514
57,000	58,000	345	755	1,120	1,343	1,550
58,000	59,000	353	773	1,147	1,375	1,586
59,000	60,000	361	791	1,173	1,407	1,624
60,000	62,000	373	818	1,213	1,455	1,678
62,000	64,000	390	854	1,266	1,518	1,752
64,000	66,000	406	890	1,319	1,582	1,825
66,000	68,000	422	926	1,372	1,645	1,900
68,000	70,000	439	961	1,426	1,709	1,972
70,000	72,000	455	997	1,479	1,772	2,047
72,000	74,000	471	1,033	1,532	1,836	2,120
74,000	76,000	488	1,068	1,585	1,901	2,193
76,000	78,000	504	1,104	1,638	1,964	2,267
78,000	80,000	520	1,140	1,692	2,027	2,341
80,000	85,000	549	1,203	1,784	2,139	2,469
85,000	90,000	590	1,292	1,917	2,298	2,653
90,000	95,000	631	1,382	2,049	2,458	2,837
95,000	100,000	671	1,472	2,182	2,617	3,020
100,000	110,000	733	1,605	2,382	2,856	3,296

REV. PROC. 2001–19 TABLE 3—Continued

DOLLAR AMOUNTS FOR AUTOMOBILES (OTHER THAN ELECTRIC AUTOMOBILES) WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2001

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
110,000	120,000	814	1785	2,647	3,174	3,664
120,000	130,000	896	1,964	2,913	3,492	4,032
130,000	140,000	978	2,142	3,179	3,811	4,399
140,000	150,000	1,059	2,322	3,444	4,129	4,767
150,000	160,000	1,141	2,501	3,709	4,448	5,135
160,000	170,000	1,223	2,680	3,975	4,766	5,502
170,000	180,000	1,304	2,859	4,241	5,084	5,871
180,000	190,000	1,386	3,038	4,506	5,403	6,238
190,000	200,000	1,468	3,217	4,772	5,721	6,606
200,000	210,000	1,549	3,396	5,038	6,040	6,973
210,000	220,000	1,631	3,575	5,303	6,358	7,341
220,000	230,000	1,713	3,754	5,568	6,677	7,709
230,000	240,000	1,794	3,933	5,834	6,996	8,076
240,000	250,000	1,876	4,112	6,100	7,314	8,443

REV. PROC. 2001–19 TABLE 4

DOLLAR AMOUNTS FOR ELECTRIC AUTOMOBILES WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2001

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
$ 47,000	48,000	9	21	33	40	46
48,000	49,000	17	39	60	71	83
49,000	50,000	25	57	86	104	119
50,000	51,000	33	75	113	135	157
51,000	52,000	42	93	139	167	193
52,000	53,000	50	111	165	199	230
53,000	54,000	58	129	192	231	266
54,000	55,000	66	147	218	263	304
55,000	56,000	74	165	245	295	340
56,000	57,000	82	183	272	326	377
57,000	58,000	91	200	299	358	414
58,000	59,000	99	218	325	390	451
59,000	60,000	107	236	352	422	487
60,000	62,000	119	263	391	470	543
62,000	64,000	136	298	445	533	616
64,000	66,000	152	334	498	597	690
66,000	68,000	168	370	551	661	763
68,000	70,000	185	406	604	724	837
70,000	72,000	201	442	657	788	910
72,000	74,000	217	478	710	852	984
74,000	76,000	234	513	764	915	1057
76,000	78,000	250	549	817	979	1131
78,000	80,000	266	585	870	1,043	1,204

REV. PROC. 2001–19 TABLE 4—Continued

DOLLAR AMOUNTS FOR ELECTRIC AUTOMOBILES
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2001

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
80,000	85,000	295	648	962	1,155	1,332
85,000	90,000	336	737	1,095	1,314	1,517
90,000	95,000	377	826	1,229	1,472	1,701
95,000	100,000	417	916	1,361	1,632	1,885
100,000	110,000	479	1,050	1,560	1,871	2,161
110,000	120,000	560	1,230	1,825	2,190	2,528
120,000	130,000	642	1,408	2,092	2,508	2,895
130,000	140,000	724	1,587	2,357	2,826	3,264
140,000	150,000	805	1,767	2,622	3,145	3,631
150,000	160,000	887	1,946	2,888	3,463	3,998
160,000	170,000	969	2,124	3,154	3,782	4,366
170,000	180,000	1,050	2,304	3,419	4,100	4,374
180,000	190,000	1,132	2,483	3,684	4,419	5,102
190,000	200,000	1,214	2,661	3,951	4,737	5,469
200,000	210,000	1,295	2,841	4,216	5,055	5,837
210,000	220,000	1,377	3,020	4,481	5,374	6,205
220,000	230,000	1,459	3,199	4,747	5,692	6,572
230,000	240,000	1,540	3,378	5,013	6,010	6,940
240,000	250,000	1,622	3,557	5,278	6,329	7,308

04. *Maximum Automobile Value for Using the Cents-per-mile Valuation Rule*.

(1) *Amount of Adjustment*. Under § 1.61–21(e)(1)(iii)(A), the limitation on the fair market value of an employer-provided automobile first made available to any employee for personal use after 1988 is to be adjusted in accordance with § 280F(d)(7). Accordingly, the adjustment for any calendar year is the percentage (if any) by which the CPI automobile component for October of the preceding calendar year exceeds the CPI automobile component for October 1987. *See*, section 4.02(1) of this revenue procedure. The new car component of the CPI was 115.2 for October 1987 and 138.6 for October 2000. The October 2000 index exceeded the October 1987 index by 23.4. The Internal Revenue Service has, therefore, determined that the adjustment for 2001 is 20.31 percent (23.4/115.2 x 100%). This adjustment is applicable to all employer-provided automobiles first made available to any employee for personal use in calendar year 2001. The maximum fair market value specified in § 1.61–21(e)(1)(iii)(A) must therefore be multiplied by a factor of 0.2031, and the resulting increase, after rounding to the nearest $100, is added to $12,800 to give the maximum value for calendar year 2001.

(2) *The Maximum Automobile Value*. For automobiles first made available in calendar year 2001 to any employee of the employer for personal use, the vehicle cents-per-mile valuation rule may be applicable if the fair market value of the automobile on the date it is first made available does not exceed $15,400.

SECTION 5. EFFECTIVE DATE

This revenue procedure applies to automobiles (other than leased automobiles) that are first placed in service during calendar year 2001, to leased automobiles that are first leased during calendar year 2001, and to employer-provided automobiles first made available to employees for personal use in calendar year 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is Bernard P. Harvey of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding the depreciation limitations and lessee inclusion amounts in this revenue procedure, contact Mr. Harvey at (202) 622-3110; for further information regarding the maximum automobile value for applying the vehicle cents-per-mile valuation rule, contact Ms. Lynne Camillo of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622-6040 (not toll-free calls).

Voluntary Compliance on Alien Withholding Program

Rev. Proc. 2001–20

Offer to resolve issues arising from certain tax, withholding, and reporting obligations of public and other not-for-profit colleges and universities with respect to payments to alien individuals.

TABLE OF CONTENTS

SECTION 1. GENERAL

.01 *Background*. This revenue procedure describes the Voluntary Compliance on Alien Withholding Program ("VCAP"), which is available to certain public and other not-for-profit colleges and universities, and their charitable affiliates, with respect to the payment, withholding, and reporting of certain taxes due on payments made to alien individuals.

The Internal Revenue Service ("Service") will begin VCAP as a temporary and experimental program. See section 6 of this revenue procedure for the effective date and sunset date of VCAP. See section 2 of this revenue procedure for the organizations that are eligible to participate in VCAP (eligible organizations). See section 3 of this revenue procedure for the taxes, including excise taxes, and the withholding and reporting obligations covered by VCAP.

.02 *Applicable law*. The objective of VCAP is to enhance voluntary compliance among public and other not-for-profit colleges and universities, and their affiliated charitable organizations, making payments of wages, grants, scholarships, and other income to alien individuals. Generally, income received by a nonresident alien individual from sources within the United States is subject to tax under § 871(a) of the Internal Revenue Code ("Code") unless an exception applies. The tax is imposed, generally on the gross amount of income, at a 30-percent rate if the income is not effectively connected with the conduct of a trade or business in the United States or at a 14-percent rate in the case of income from certain scholarships, fellowships and grants. Section 1441 of the Code requires any person who pays income subject to tax under § 871(a) of the Code to a nonresident alien individual to deduct and withhold the 30% (or 14%) tax from the gross amount paid. The rate of tax, and therefore withholding, may be reduced or eliminated under an income tax treaty. A withholding agent may rely on a claim of treaty benefit if the nonresident alien individual has furnished appropriate documentation. See § 1.1441–6 of the Income Tax Regulations. See also IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*, and IRS Publication 901, *U.S. Tax Treaties*.

Section 871(b) of the Code imposes a graduated rate of tax on a nonresident alien individual's income that is effectively connected with the individual's conduct of a trade or business in the United States. This provision is relevant to income earned for personal services because, under § 864(b) of the Code, the performance of personal services in the United States is considered to be the conduct of a trade or business within the United States. Further, under § 871(c) of the Code, a nonresident alien individual with a specified nonimmigrant status who is a participant in certain exchange or training programs is treated as being engaged in a trade or business within the United States (regardless of whether he is actually so engaged) with regard to income derived in connection with that exchange or training program. A nonresident alien individual's effectively connected services income may also be subject to withholding under § 1441 of the Code (or § 3402 of the Code for most income constituting wages). With respect to reporting obligations, a nonresident alien individual's effectively connected personal services income constituting wages under § 3402 of the Code is subject to wage reporting under chapter 61 of the Code (i.e., on Form 941 and Form W-2), and such individual's nonwage income is subject to reporting under § 1.1461–1(c)(2) of the Income Tax Regulations (i.e., on Form 1042 and Form 1042–S). Additionally, taxes may be imposed on wages paid to alien individuals under §§ 3101 and 3111 of the Code (social security and Medicare taxes).

.03 *Definitions*. For purposes of this revenue procedure, the following definitions apply:

(1) The term "alien individual" means an individual who is not a citizen or a national of the United States. See § 1.1–1(c) of the Income Tax Regulations.

(2) The term "resident alien" means an alien individual described in § 7701(b)(1)(A) of the Code.

(3) The term "nonresident alien" means an alien individual described in § 7701(b)(1)(B) of the Code.

.04 *Summary of VCAP*. Organizations that request consideration under VCAP agree to (1) identify those areas in which they are not in compliance with tax, withholding, and reporting obligations on payments to alien individuals; (2) compute and pay any tax due; and (3) institute procedures and policies which will assure compliance in the future with the organization's tax, withholding, and reporting obligations. Organizations will receive assurance that their proposed procedures and policies relating to tax, withholding, and reporting obligations applicable to alien individuals are acceptable to the Service, and the Service generally will not impose penalties for identified underpayments or deficiencies, if the liability is due to reasonable cause. See sections 5.02(3) and 5.06 of this revenue procedure.

.05 *No waiver of excise tax, FICA, or other tax obligations*. VCAP does not waive or reduce any applicable tax and does not alter an employer's obligations to satisfy any applicable Federal Insurance Contributions Act (FICA) or Federal income tax withholding requirements with regard to any employee. (However, see §§ 3121(b)(10) and 3121(b)(19) of the Code for certain tax-exempt wages.) In addition, VCAP does not affect any other obligations of the taxpayer or the Service that are not within the scope of this revenue procedure or the acknowledgment described in section 5.06 of this revenue procedure.

.06 *Request for comments*. Because of the experimental nature of VCAP, the Service welcomes comments on the format and operation of this program, including suggestions regarding whether the program should be expanded to cover other organizations, such as proprietary colleges and universities and other educational organizations, not listed in section 2 of this revenue procedure, or other types of defects not listed in section 3 of this revenue procedure. The Service also welcomes suggestions regarding possible standardized correction methods for specified defects that could be appropriately addressed under VCAP. Any modifications will be made only by announcements, revenue procedures, notices or other guidance published in the Internal Revenue Bulletin. Comments on VCAP should be mailed to:

Internal Revenue Service
Attention: T:EO:RA:T:G (VCAP)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Comments may also be sent electronically via the Internet to *TE/GE-EO-3@irs.gov.

SEC. 2. ELIGIBLE ORGANIZATIONS

.01 Eligible Organizations. Except as provided in section 2.02, an organization is eligible for VCAP (an "eligible organization") if it is:

(1) A college or university described in § 170(b)(1)(A)(ii) of the Code that is:

(a) Exempt from tax under § 501(a) of the Code as an organization described in § 501(c)(3); or

(b) An agency or instrumentality of any government or any political subdivision thereof, or that is owned or operated by a government or any political subdivision thereof, or by an agency or instrumentality of one or more governments or political subdivisions (a "State college or university"); or

(2) An organization described in § 501(c)(3) of the Code and exempt from income tax under § 501(a) that is affiliated with such a college or university.

An eligible organization may apply for VCAP with respect to any payments made to alien individuals.

.02 *Organizations currently under examination*. An organization is not eligible for VCAP if the organization is under examination on the date of the publication of this revenue procedure, or comes under examination prior to submitting the information required by section 4 of this revenue procedure. For this purpose, an examination is treated as commencing on the date the organization received notification from the Service of an impending examination or of an impending referral for examination. This program is also not available to any organization that has a case pending in Appeals or in litigation on issues involving taxes or withholding obligations described in section 3 of this revenue procedure.

SEC. 3. TAX, WITHHOLDING, AND REPORTING OBLIGATIONS SUBJECT TO VCAP

The defects for which an eligible organization may make a submission under VCAP are:

(1) Failure to pay the correct amount of social security and Medicare excise taxes imposed on employers with respect to wages paid to alien individuals (§ 3111(a) and § 3111(b) of the Code);

(2) Failure to withhold or pay the correct amount of social security and Medicare taxes imposed on employees with respect to wages paid to alien individuals (§ 3101(a) and § 3101(b) of the Code);

(3) Failure to withhold or pay the correct amount of income taxes on wages paid to alien individuals (§ 3402 of the Code);

(4) Failure to withhold or pay the correct amount of income taxes on scholarships, fellowships and grants paid to nonresident alien individuals (§§ 1441—1464 of the Code);

(5) Failure to withhold or pay the correct amount of taxes on compensation for independent personal services paid to nonresident alien individuals (§§ 1441—1464 of the Code);

(6) Failure to withhold or pay the correct amount of taxes on royalties or other types of taxable income paid to nonresident alien individuals (§§ 1441–1464 of the Code); and

(7) Failure to report the correct amount of any or all of the taxes listed above (§§ 1441–1464 and 6011 of the Code).

SEC. 4. SUBMISSION PROCEDURES

.01 *In general*. In general, an eligible organization submits a request under VCAP through a letter to the Tax Exempt/Government Entities (TE/GE) office at the address in section 4.08 of this revenue procedure. The submission must contain the information and documentation described in sections 4.02 and 4.03 of this revenue procedure. The Service will not accept anonymous submissions under VCAP.

.02 *Required information*. The request for consideration under VCAP must contain the following information:

(1) The name, address, and taxpayer identification number of the eligible organization.

(2) A description of the current administrative procedures that the eligible organization uses to determine tax, withholding, and reporting obligations regarding payments to alien individuals.

(3) A description of the defects in the eligible organization's tax, withholding, and reporting procedures for payments to alien individuals, how and why the defects occurred, and the years affected by such defects.

(4) The number of alien individuals affected and how the number was determined.

(5) The number of any affiliated charitable organizations affected by the defects, their names, addresses, and taxpayer identification numbers.

(6) A calculation of the total amount of taxes the eligible organization failed to withhold, pay and/or report, not including interest and penalties, for tax periods open for assessment or collection under the provisions of § 6501 of the Code. This calculation should take into account properly substantiated adjustments under §§ 1463 and 3402(d) of the Code. The eligible organization must agree to pay and remit all of its additional tax due and owing plus interest at the completion of the Service's review or examination. See section 5 of this revenue procedure. (However, regarding the non-assertion of interest, see section 5.02(2) of this revenue procedure.) In certain cases involving large liabilities or underpayments, the Service will consider the organization's proposal for payment of the liability or underpayment in more than one installment, or will consider the organization's posting of a cash bond under the procedures outlined in Rev. Proc. 84–58, 1984–2 C.B. 501. See section 5.02(4) of this revenue procedure.

(7) A detailed description of the methods for correcting the defects that the organization has implemented or proposes to implement. Those methods must ensure that the correct amount of taxes and withholding of taxes on payments to alien individuals will be withheld, paid over, and reported to the Service on the proper forms and in a timely manner.

(8) A statement signed by the eligible organization's officer or authorized representative acknowledging and agreeing that the eligible organization's participation in VCAP will not constitute an employment tax audit of the eligible organization and will not provide a reasonable basis for not treating an individual as an employee under § 530 of the Revenue Act of 1978.

.03 *Required documents*. The submission must be accompanied by the following documentation:

(1) In the case of a college or university, a copy of the organization's determination letter indicating that it is an organization described in §§ 170(b)(1)(A)(ii) and 501(c)(3) of the Code, or sufficient documentation indicating that the organization is a State college or university. In the case of an affiliated charitable organization, the organization must provide both a copy of its determination letter indicating that it is an organization described in § 501(c)(3) of the Code and sufficient documentation indicating its relationship to a college or university that is itself an eligible organization.

(2) Copies of workpapers or schedules that clearly explain the eligible organization's calculation of its correct tax liability regarding payments to alien individuals (see section 4.02(6) of this revenue procedure). The workpapers or schedules should also show to which specific tax returns and tax periods the liability relates.

(3) Copies of the original Forms 941, 945, 1042, if any, as filed that relate to the above calculations.

(4) Copies of Forms 8233, 1001, W-8BEN, W-9, or sufficient information to support tax treaty claims.

(5) In cases involving the failure to pay the correct amount of social security and Medicare excise taxes imposed on employers with to respect wages paid to alien individuals (§ 3111(a) and § 3111(b) of the Code), and the failure to withhold or pay the correct amount of social security and Medicare taxes imposed on employees with respect to wages paid to alien individuals (§ 3101(a) and § 3101(b) of the Code), a description of how Forms W-2C will be prepared and provided to affected employees and the Social Security Administration.

.04 *Signatures*. The submission must be signed by an officer of the eligible organization who is authorized to sign or the eligible organization's authorized representative.

.05 *Power of Attorney requirements*. To sign the submission or to appear before the Service in connection with the submission, a representative must comply with the requirements of section 9 of Rev. Proc. 2001–4, 2000–1 I.R.B. 135.

.06 *Penalty of perjury statement*. The following declaration must accompany a VCAP submission and any factual information submitted after the original submission or any change in the submission at a later time: **"Under penalties of perjury, I declare that I have examined this submission, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the VCAP request are true, correct, and complete."** The declaration must be signed by the eligible organization's officer, not the organization's representative.

.07 *Marked letter and marked envelope*. The letter which transmits the submission to the Service must be marked "VCAP" in the upper right-hand corner of the letter, and the envelope containing the submission must be marked "VCAP" in the lower left-hand corner of the envelope.

.08 *Mailing address*. The submission must be mailed to the address shown below. The Service may issue an announcement later which contains other addresses for the mailing of VCAP submissions.

Internal Revenue Service
Roger Greening
Manager EPP
1100 Commerce Street
MC: 4910DAL
Dallas, TX 75242

SEC. 5. PROCESSING OF VCAP REQUESTS

.01 *Inadequate or incomplete submission or request for additional information*. If the submission fails to comply with the provisions of this revenue procedure or the Service requires additional information, the Service representative assigned to the case will contact the eligible organization or its representative and explain what is needed to complete the submission. The organization will have 90 business days from the date of this contact to provide the requested information. Any request for an extension of the 90-day time period must be made prior to expiration of the period, and must be approved by the TE/GE Area Manager of the appropriate TE/GE Area Office, or his or her designated representative. If the requested information is not received within 90 business days, or an agreement cannot be reached on correction or administrative procedures, the matter will be closed, and the Service may consider the case for examination.

.02 *Determining tax liability*. Once the Service accepts the submission under VCAP, the Service will analyze the eligible organization's calculation of its tax liability regarding payments to alien individuals, and will analyze the accompanying workpapers, schedules, and returns which support such calculation. The Service will generally apply the following approach to determine the tax liability of an eligible organization:

(1) The Service will normally allow tax treaty benefits in the computation of any adjustments to taxes and withholding of taxes on payments to nonresident alien individuals, even in the absence of Forms 8233, 1001, W-9, or W-8BEN if the eligible organization has acted in good faith and provides sufficient information to support the treaty claims.

(2) Interest on the eligible organization's underpayments will be due from the last date prescribed for payment of the taxes (determined without regard to VCAP or any extension of time for payment) to the date on which payment is received; provided, however, that interest-free adjustments of underpayments of certain employment taxes may be made in accordance with § 6205(a)(1) of the Code, Proposed Treas. Reg. § 31.6205–1(b) and (c), and Rev. Rul. 75–464, 1975–2 C.B. 474.

(3) The Service will not assert any penalties on the eligible organization's liability, if the organization's failure to withhold, pay, and report taxes as described in section 1 of this revenue procedure, is due to reasonable cause.

(4) In certain cases involving large liabilities, the Service will consider the eligible organization's proposal for payment of the liability in more than one installment. See Internal Revenue Manual (IRM) Handbook 4.3.2, Examination Collectibility Handbook, Chapter 4, Installment Agreements (05–25–2000). Applicants may also wish to avail themselves of the procedures for making a deposit in the nature of a cash bond as contained in Rev. Proc. 84–58, 1984–2 C.B. 501.

.03 *Review of Eligible Organization's compliance procedures*. The eligible organization must demonstrate to the satisfaction of the Service that it has implemented (or it has plans for implementing) policies and procedures that ensure that the correct amount of taxes and withholding of taxes on payments to alien individuals are reported and paid over to the Service on the proper forms and in a timely manner. The Service will review the eligible organization's policies and procedures to assure itself that the policies and procedures are reasonably likely to bring the organization into compliance on a prospective basis. The Service reserves the right to prescribe appropriate administrative procedures, but will first discuss the appropriateness of existing procedures with the organization. Where the current procedures, or proposed future procedures, are inadequate for complying with the relevant tax, withholding, and reporting requirements, the Service also reserves the right to deny relief under VCAP.

.04 *Other tax liabilities or issues*. If the Service discovers an unrelated tax liability or exemption issue while considering the request, that issue will remain outside the scope of the VCAP submission because it was not voluntarily brought forward by the organization.

.05 *Verification*. As part of the processing of the VCAP submission, the Service reserves the right to verify that corrections have been made to the eligible organization's tax, withholding, and reporting procedures on payments to alien individuals. Verification of such corrections does not constitute an examination of the books and records of the organization. If the Service determines that the eligible organization has not implemented or does not plan to implement the proper corrections and procedures, the case may be considered for examination. The Service does not contemplate opening examinations on VCAP submissions but reserves the right to do so. If the Service decides to examine the eligible organization, the examination will be commenced and completed as soon as possible, with the intention in most cases that the scope of the examination will be limited to tax and withholding obligations on payments to alien individuals and related issues.

.06 *Acknowledgment letter*. If the Service is satisfied at the conclusion of its review that the organization has instituted policies and procedures which ensure that the correct amounts of taxes on payments to alien individuals are withheld, paid, and reported to the Service on the proper forms and in a timely manner, then the Service will issue to the eligible organization an acknowledgment letter indicating that based upon its review, the eligible organization is at that time in substantial compliance with the tax, withholding, and reporting obligations governing payments to alien individuals. Once the organization has received an acknowledgment letter at the completion of the VCAP process, and provided that the organization in fact complies with the agreed upon withholding, payment and reporting procedures, the information submitted by the organization to the Service under VCAP will not be used as the basis to initiate an examination of the organization.

.07 *Failure to reach resolution*. If resolution cannot be reached because sufficient information is not timely provided to the Service or because agreement cannot be reached on correction or administrative procedures, the Service may consider the case for examination.

.08 *Applicability of §§ 6103 and 6110*. The information received or generated by the Service under VCAP is subject to the confidentiality requirements of § 6103 of the Code. The acknowledgment letter is not a written determination letter within the meaning of § 6110 of the Code.

.09 *Conferences*. If the Service initially determines that it cannot issue an acknowledgment letter because the parties cannot agree upon some correction or administrative issue, the organization or the organization's representative may be granted a conference with the Service, at the Service's discretion and upon request by the organization or the organization's representative. The conference can be held either in person or by telephone. If a conference is offered, the organization or its representative will be contacted by the Service representative.

SEC. 6. EFFECTIVE DATE AND SUNSET DATE

VCAP is effective on February 26, 2001. It will be available for submissions made on or before February 28, 2002.

SEC. 7. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545–1735.

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

The collections of information contained in this revenue procedure are in section 4.02 and section 4.03(2). This information will enable the Service to determine whether an organization qualifies for VCAP. The likely respondents are public and other not-for-profit colleges and universities and certain other charitable organizations.

The estimated total annual reporting burden is 346,500 hours.

The estimated average annual burden per respondent is 700 hours. The estimated number of respondents is 495.

The estimated annual frequency of responses is on occasion.

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

SEC. 8. DRAFTING INFORMATION

The principal authors of this revenue procedure are Lowell G. Hancock of the Office of Pre-Filing Services, and Virginia Richardson of the Tax Exempt/Government Entities Division. For more information concerning VCAP, contact Mr. Hancock at (202) 874-1800 or (330) 375-5421 (not toll-free numbers), Ms. Richardson at (202) 283-8938 (not a toll-free number), or Neil Shepherd of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622-6040 (not a toll-free number).

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26 CFR 601.601: Rules and regulations.
(Also Part I, §§ 1001; 1.1001–3, 1.1275–2.)

Rev. Proc. 2001–21

SECTION 1. PURPOSE

This revenue procedure provides an election that will facilitate the substitution of newly issued debt instruments for outstanding debt instruments. Under the election, taxpayers can treat a substitution of debt instruments, in certain circumstances, as a realization event for federal income tax purposes even though it does not result in a significant modification under § 1.1001–3 of the Income Tax Regulations (and, therefore, is not otherwise an exchange for purposes of § 1.1001–1(a)). Under section 4 of this revenue procedure, taxpayers do not recognize any realized gain or loss on the date of the substitution. Instead, the gain or loss generally is taken into account as income or deductions over the term of the new debt instruments.

This revenue procedure modifies and supersedes Rev. Proc. 99–18, 1999–1 C.B. 736, which, as modified by Rev. Proc. 2000–29, 2000–28 I.R.B. 113, applies to substitutions that occur on or after March 1, 1999. The significant changes to Rev. Proc. 99–18 are as follows:

.01 The newly issued debt may be debt issued in a qualified reopening;

.02 The outstanding debt may have been issued with premium; and

.03 The determination of whether a substitution does or does not result in a significant modification may be made on the substitution date or, in most cases, on the date that is two business days before the date on which the substitution offer commences.

SECTION 2. BACKGROUND

.01 Under § 1.1001–1(a), if gain or loss is realized from the exchange of property for other property differing materially either in kind or in extent, it is treated as income or as loss sustained.

.02 Section 1.1001–3 provides rules to determine whether a modification of the terms of a debt instrument results in an exchange of the original debt instrument for a modified instrument that differs materially either in kind or in extent. Under § 1.1001–3(b), a modification of a debt instrument results in an exchange for purposes of § 1.1001–1(a) if, and only if, the modification is significant.

.03 Section 1.1001–3 applies to any modification of a debt instrument, regardless of the form of the modification (including an exchange of a new instrument for an existing instrument). Under § 1.1001–3(c), a modification means any alteration, including any deletion or addition, in whole or in part, of a legal right or obligation of the issuer or a holder of a debt instrument, whether the alteration is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise.

.04 In general, a modification of a debt instrument is a significant modification under § 1.1001–3 only if, based on all the facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant. Section 1.1001–3(e) provides rules to determine whether certain modifications, such as a change in the yield or in the timing of payments, constitute significant modifications.

.05 If the terms of a debt instrument are modified to defer one or more payments and the modification does not result in an exchange under § 1.1001–3, § 1.1275–2(j) provides rules to account for the modified debt instrument. Under § 1.1275–2(j), solely for purposes of §§ 1272 and 1273 of the Internal Revenue Code, the debt instrument is treated as retired and then reissued on the date of the modification for an amount equal to the instrument's adjusted issue price on that date. As a result, the debt instrument is retested for original issue discount based on the instrument's adjusted issue price and the remaining payments, as modified, to be made on the instrument. If the debt instrument has original issue discount as a result of the modification, both the issuer and the holder account for the original issue discount over the remaining term of the instrument. *See* §§ 163(e) and 1272.

.06 An issuer may want to refinance and consolidate outstanding debt instruments in a way that increases the liquidity of the issuer's debt by concentrating more of the issuer's outstanding debt in a smaller number of issues. In general, if the terms of the newly issued debt are not materially different from the terms of the outstanding debt, substituting the newly issued debt for the outstanding debt does not result in a significant modification of the outstanding debt under § 1.1001–3. Therefore, the substitution of the newly issued debt for the outstanding debt in the refinancing and consolidation is not a realization event for federal income tax purposes. Under § 1.1275–2(j), however, some or all of the newly issued debt may have original issue discount in varying amounts, depending upon the terms of the outstanding debt for which the newly issued debt was substituted. As a result, the newly issued debt may not be fungible.

SECTION 3. SCOPE

This revenue procedure applies to the substitution of new debt for old debt if all of the following conditions are satisfied:

.01 Either—

(1) Debt instruments from a single new issue ("new debt") are substituted for debt instruments from two or more outstanding issues of debt ("old debt") (It is not necessary, however, for any single holder of the old debt to have held debt instruments from more than one of the outstanding issues.); or

(2) Debt instruments issued in a qualified reopening (as defined in § 1.1275–2) ("new debt") are substituted for debt instruments from one or more outstanding issues of debt ("old debt").

.02 The substitution does not result in a significant modification of the old debt under § 1.1001–3 and, therefore, is not a realization event under § 1.1001–1. This determination may be made either on–

(1) the substitution date, or

(2) the date that is two business days before the date on which the substitution offer commences, provided that date is no more than 30 business days before the date on which the substitution offer ends.

.03 The new debt and the old debt are publicly traded (within the meaning of § 1.1273–2(f)). If the new debt is issued in a qualified reopening of an outstanding issue of debt, that outstanding issue was also publicly traded.

.04 The old debt was issued at par, at a premium, or with less than a *de minimis* amount of original issue discount (within the meaning of § 1.1273–1(d)).

.05 The new debt is issued at par or with less than a *de minimis* amount of original issue discount or premium. For purposes of this condition, the issue price of the new debt is determined under § 1.1273–2 (rather than under § 1.1275–2 (j)), and the *de minimis* amount for premium is determined using the principles of § 1.1273–1(d).

.06 Neither the new debt nor the old debt is—

(1) a contingent payment debt instrument (within the meaning of § 1.1275–4),

(2) a tax-exempt obligation (as defined in § 1275(a)(3)), or

(3) a convertible debt instrument (within the meaning of § 1.1272–1(e)).

.07 All payments on the old debt and the new debt are denominated in, or determined solely by reference to, U.S. dollars, and the functional currency of the business unit issuing the new debt is the U.S. dollar.

.08 The issuer and one or more holders of the old debt make the election provided in section 4.01 of this revenue procedure.

SECTION 4. APPLICATION

.01 *Election*.

(1) *Manner of making the election*. The issuer and the holders make the election under this revenue procedure by agreeing in writing to treat the substitution for federal income tax purposes in the

manner described in section 4.02 through section 4.04 of this revenue procedure and to comply with all other provisions of this revenue procedure. The written agreement must be entered into no later than the last day of the month in which the substitution occurs.

For example, the written agreement to make the election may be evidenced by a statement in the offering documents for the substitution that—

(a) The issuer, by distributing the documents, elects under this revenue procedure to treat the substitution as a realization event for federal income tax purposes;

(b) Any holder of old debt that tenders its old debt for new debt as part of the substitution thereby makes the election under this revenue procedure; and

(c) The issuer and the holders who have tendered their old debt for the new debt ("electing holders") will comply with the provisions of this revenue procedure.

(2) *Statement attached to return*. If an election is made under section 4.01(1) of this revenue procedure, and if the issuer must file a federal income tax return for the taxable year in which the substitution occurs, the issuer must attach a signed statement to its timely filed (including extensions) federal income tax return for the taxable year in which the substitution occurs. On the statement, the issuer must—

(a) identify the old debt for which new debt was substituted,

(b) identify the new debt that was substituted for the old debt,

(c) indicate the issue price of the new debt (or, if the new debt is issued in a qualified reopening, the adjusted issue price of the new debt immediately after the substitution), and

(d) indicate that the election was made under this revenue procedure.

.02 *Treatment of substitution*. If an election is made under this revenue procedure, the issuer and the electing holders must report the substitution for federal income tax purposes as a repurchase of the old debt in exchange for the new debt in the taxable year in which the substitution occurs. The issuer, however, must account for this deemed exchange under the rules described in section 4.03 of this revenue procedure, and each electing holder must account for this deemed exchange under the rules described in section 4.04 of this revenue procedure.

.03 *Issuer's treatment*.

(1) *In general*. Except as provided in section 4.03(2) of this revenue procedure, the issuer must take into account over the term of the new debt any difference between the adjusted issue prices of the old debt at the time of the substitution and the issue price of the new debt (as determined under § 1.1273–2). If the aggregate issue price of the new debt that is transferred to electing holders as a substitute for the old debt is greater than the aggregate adjusted issue prices of the old debt for which it is substituted, the issuer treats the difference as a reduction in the aggregate issue price of the new debt. As a result, the difference is taken into account by the issuer over the term of the new debt as increased original issue discount or as reduced bond issuance premium (within the meaning of § 1.163–13). If the aggregate issue price of the new debt that is transferred to electing holders as a substitute for the old debt is less than the aggregate adjusted issue prices of the old debt for which it is substituted, the issuer treats the difference as an increase in the aggregate issue price of the new debt. As a result, the difference is taken into account by the issuer over the term of the new debt as reduced original issue discount or increased bond issuance premium.

(2) *Qualified reopening*. If the new debt is issued in a qualified reopening, the issuer applies the rules in section 4.03(1) of this revenue procedure by using the remaining term of the new debt instead of the term of the new debt and by using the adjusted issue price of the new debt immediately after the substitution instead of the issue price of the new debt.

.04 *Electing holder's treatment*.

(1) *In general*. Notwithstanding any provision of subtitle A of the Internal Revenue Code (including §§ 356(a) and 1276(a)), an electing holder does not recognize any gain or loss as a result of the deemed exchange. Instead, the holder's basis (immediately after the substitution) in the new debt is the same as the holder's adjusted basis (determined as of the date of the substitution) in the debt instruments for which the new debt was substituted. In addition, the holder's holding period for the new debt includes the holder's holding period for the old debt.

(2) *Market discount*.

(a) *In general*. If the stated redemption price at maturity of the new debt (as determined under § 1.1273–1(b)) is greater than the holder's basis (immediately after the substitution) in the new debt, the holder treats the difference as market discount on the new debt and the new debt as a market discount bond (unless the amount of the discount is *de minimis* within the meaning of § 1278(a)(2)(C)). *See* §§ 1276 and 1278 for the treatment of market discount. (The issue date of the old debt rather than the issue date of the new debt is used to determine whether the new debt is a short-term obligation for purposes of § 1278(a)(1)(B)(i).) See section 4.04(2)(b) below for the treatment of any accrued market discount on the old debt.

(b) *Accrued market discount*. The rules in this section 4.04(2)(b) apply if, as of the date of the substitution, there is any accrued market discount on the old debt that has not been taken into account by the holder as ordinary income. If, under section 4.04(2)(a) above, there is no market discount on the new debt or the amount of any market discount on the new debt is *de minimis*, the amount of accrued market discount on the new debt is zero, and the accrued market discount on the old debt is ignored. If, under section 4.04(2)(a) above, the amount of market discount on the new debt is more than *de minimis*, the lesser of this market discount and the accrued market discount on the old debt is treated by the holder, as of the date of the substitution, as accrued market discount on the new debt. (Solely for purposes of determining the accruals of any additional market discount on the new debt, the holder's basis is increased by the amount of the accrued market discount on the old debt that is treated as accrued market discount on the new debt.)

(3) *Bond premium*. If the holder's basis in the new debt (immediately after the substitution) is greater than the stated redemption price at maturity of the new debt (as determined under § 1.1273–1(b)), the holder treats the difference as bond premium on the new debt. *See* §§ 1.171–1 through 1.171–5 for the treatment

of bond premium.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–18, as modified by Rev. Proc. 2000–28, is modified and superseded.

SECTION 6. EFFECTIVE DATE

This revenue procedure applies to substitutions that occur on or after March 13, 2001. For substitutions that occur before March 13, 2001, Rev. Proc. 99–18, as currently in effect, continues to apply.

SECTION 7. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1647.

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

The collections of information in this revenue procedure are in section 4.01. This information is required to determine whether an election has been made under this revenue procedure. The collections of information are required to obtain a benefit. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 75 hours.

The estimated annual burden per respondent/recordkeeper varies from 1/2 hour to 1 hour, depending on individual circumstances, with an estimated average of 3/4 hour. The estimated number of respondents is 100.

The estimated annual frequency of responses is on occasion.

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

CONTACT PERSON

For further information regarding this revenue procedure, contact William E. Blanchard of the Office of the Associate Chief Counsel (Financial Institutions and Products) at (202) 622–3950 (not a toll-free call).

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

Rev. Proc. 2001–22

SECTION 1. PURPOSE

.01 This revenue procedure permits a taxpayer subject to the jurisdiction of the Large and Mid-Size Business Division (LMSB) of the Internal Revenue Service (Service) to request the examination of specific issues relating to a tax return before the return is timely filed. This revenue procedure also establishes a framework within which the taxpayer and the Service can work together in a cooperative environment to resolve the examined issues. Finally, if the taxpayer and the Service are able to resolve the examined issues prior to the filing of the return, this revenue procedure authorizes the taxpayer and the Service to finalize their resolution by executing an LMSB Pre-Filing Agreement (LMSB PFA).

.02 The purpose of this revenue procedure is to facilitate and encourage the use of pre-filing examinations to resolve issues involving factual questions under well settled principles of law. A pre-filing examination can often resolve such issues more effectively and efficiently than a post-filing examination because the taxpayer and the Service have more timely access to the records and personnel relevant to the issue. A pre-filing examination also provides the taxpayer with a greater level of certainty regarding the examined issue at an earlier point in time than a post-filing examination. Thus, the use of pre-filing examinations will benefit both taxpayers and the Service by improving the quality of tax compliance while reducing its costs, burdens and delays.

.03 This revenue procedure applies only to issues involving the application of well settled principles of law. This revenue procedure is not intended to resolve issues involving questions of law that are not well settled with respect to the material facts of the issue. Such issues are more appropriately resolved through the private letter ruling process. See Rev. Proc. 2001–1, 2001–1 I.R.B. 1 (or successor).

.04 This revenue procedure is not intended to resolve disputes between the taxpayer and the Service regarding the correct interpretation of the law, except as authorized by Delegation Order Nos. 236 (Application of Appeals Settlement to Coordinated Examination Program Taxpayers) or 247 (Authority of Examination Case Managers to Accept Settlement Offers and Execute Closing Agreements on Industry Specialization Program and International Field Assistance Program Issues).

SECTION 2. BACKGROUND

.01 In Notice 2000–12, 2000–9 I.R.B. 727, the Service announced a pilot program for LMSB PFAs, under which LMSB taxpayers could request examination and resolution of specific issues relating to returns they expected to file between September and December, 2000. The purpose of the pilot program was to determine if taxpayers and Service personnel could resolve, prior to the time for filing the taxpayers' returns, issues that were likely to be disputed in post-filing audits. The Service anticipated that if such issues could be resolved through cooperation of the parties, the results would benefit both taxpayers and the Service.

.02 In evaluating the pilot program, the Service, with considerable input from the participating taxpayers, has concluded that LMSB PFAs allowed taxpayers to file more compliant returns within prescribed time frames, were cost efficient, decreased taxpayer compliance burdens, and conserved Service resources. Accordingly, the Service will offer the LMSB PFA program on a permanent basis.

SECTION 3. SCOPE

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

.02 *Eligible taxable years*. An eligible taxpayer may request an LMSB PFA with respect to the current taxable year or any prior taxable year for which the return is not yet due (including extensions) and is not yet filed. However, taxpayers are reminded that the selection criteria for the LMSB PFA program include both the amount of time remaining until the date for filing the return to which the desired LMSB PFA would relate and the overall likelihood that the LMSB PFA process can be completed prior to such date. *See* section 5.02 of this revenue procedure. Taxpayers are therefore urged to submit their LMSB PFA requests at the earliest possible time in order to maximize the likelihood that they will be selected for the LMSB PFA program and that an LMSB PFA agreement can be finalized prior to the filing of the return(s).

.03 *Eligible issues generally.*

(1) *Factual issues and well established law*. The Service generally will consider entering into an LMSB PFA on any issue that represents either (i) a factual determination or (ii) an application of legal principles to agreed upon facts in which the legal principles are well established in their application to such facts. However, the Service will not consider entering into an LMSB PFA with respect to (i) any international issue that is not listed in section 3.05 of this revenue procedure, or (ii) any excluded issue listed in section 3.06 of this revenue procedure.

(2) *Eligible taxable year(s)*. An eligible issue must relate to an eligible year for which the LMSB PFA is sought; an issue is not an eligible issue if it relates to any prior or subsequent taxable year. Thus, the valuation of a specific asset during an eligible year is generally an eligible issue for the LMSB PFA program, whereas the valuation of an asset during a prior or subsequent taxable year is not.

.04 *Nonexclusive list of eligible domestic issues*. The following is a list of domestic issues that are likely to be suitable for resolution through the LMSB PFA program. This list is **nonexclusive** and is not intended to prevent submission of other domestic issues that fall within the scope of the LMSB PFA program.

(1) the current valuation of specific assets (except in the context of transfer pricing), but not the appropriateness of a valuation methodology;

(2) the allocation of the purchase or sale price of a business among the assets acquired or sold;

(3) the identification and documentation of hedging transactions;

(4) issues relating to in-house research expenses under § 41;

(5) the allocation of costs among different categories of deductible and capital items, in contexts where there is a published revenue ruling, *e.g.* repairs (Rev. Rul. 94–12, 1994–1 C.B. 36), advertising (Rev. Rul. 92–80, 1992–2 C.B. 57), and Y2K costs (Rev. Proc. 97–50, 1997–2 C.B. 525);

(6) identification of investigatory costs incurred to determine whether to enter a new business and, if so, which business to enter, for purposes of qualifying such costs as start-up costs under § 195 (*see* Rev. Rul. 99–23, 1999–1 C.B. 998);

(7) whether a taxpayer's financial statement presentation of its last-in, first-out (LIFO) inventory is consistent with the LIFO conformity requirement under § 1.472–2(e);

(8) whether a taxpayer's inventory contains "sub-normal" goods within the meaning of § 1.471–2(c), and the valuation of such goods;

(9) whether a taxpayer is considered to be the tax owner of the property being produced under § 1.263A–2(a)(1)(ii)(A);

(10) whether a manufacturing contract newly entered into by the taxpayer is required to be accounted for as a long-term contract under § 460;

(11) the determination of appropriate classification under § 168(e) for depreciable property placed in service during the eligible taxable year; and

(12) whether a security became worthless during the eligible taxable year, for purposes of § 165(g).

.05 *Exclusive list of international issues*. The following is a list of international issues that are likely to be suitable for resolution through the LMSB PFA program. This list is **exclusive**; the Service will not consider entering into an LMSB PFA with respect to an international issue that is absent from this list.

(1) the valuation of specified assets, but not a retrospective change in the method of valuation or a determination of appropriate valuation methodology;

(2) the proper SIC or NAIC classification code(s) for the taxpayer's line(s) of business;

(3) whether the taxpayer's apportionment of deductions, including general and administrative expenses, that are related to all gross income properly reflects the factual relationship between deductions and gross income as required by § 1.861–8(f)(5);

(4) whether, as a factual matter, an expense relates to fewer than all members of an affiliated group for purposes of § 1.861–14T(c)(2);

(5) the verification of amounts of foreign taxes paid and the applicable exchange rates, but not whether such taxes are creditable; and

(6) whether the taxpayer must recapture a dual consolidated loss following a triggering event under § 1503(d).

.06 *Excluded issues.* The Service generally will not enter into an LMSB PFA on the following types of issues:

(1) Transfer pricing issues that are addressed under the Advance Pricing Agreement program (Rev. Proc. 96–53, 1996–2 C.B. 375);

(2) Issues for which the taxpayer has filed a request for Competent Authority assistance;

(3) Issues that can be resolved by requesting a change in method of accounting on Form 3115, *Application for Change in Accounting Method*;

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

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

(6) Issues that are, or will be, the subject of a pending or contemplated request for a private letter ruling, accounting method change request, determination letter or technical advice memorandum;

(7) Issues for which the taxpayer proposes a resolution that is contrary to a private letter ruling, accounting method change request, determination letter, technical advice memorandum, or closing

agreement previously issued to or regarding the taxpayer;

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

(9) Issues that are the subject of litigation between the Service and the taxpayer with respect to an earlier taxable period;

(10) Issues that have been designated for litigation by the Office of Chief Counsel;

(11) Issues involving a tax shelter described in § 6662(d)(2)(C)(iii); and

(12) Issues that require a determination of whether the taxpayer, rather than another entity, is the common law employer.

.07 *Methods of accounting*. The LMSB PFA's application of the law to the taxpayer's facts may result in treating an item differently from earlier treatments of similar items in prior taxable years (*e.g.*, deducting items that previously were capitalized, such as certain ISO 9000 costs). If so, the differing treatment may constitute a change in the method of accounting for that item. The LMSB PFA will resolve only the factual characterization of the items at issue for the taxable year(s) to which the LMSB PFA relates, but will not constitute the Commissioner's consent to make any accounting method change that may be required to conform the agreed upon factual characterization of the item with identical items in earlier years. Permission to make any accounting method changes required by the LMSB PFA's resolution of the factual and legal issues must be obtained using the applicable administrative procedures. *See* Rev. Proc. 99–49, 1999–2 C.B. 725 (automatic consent to change certain accounting methods); Rev. Proc. 97–27, 1997–1 C.B. 680.

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

SECTION 4. REQUESTING AN LMSB PRE-FILING AGREEMENT

.01 *General information*. A request for an LMSB PFA must contain the following general information about the taxpayer and its request for an LMSB PFA:

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

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

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

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

(5) A brief description of the taxpayer's business operations, including the NAICS (North American Industry Code System) classification used by the taxpayer on its last filed return; and

(6) The taxable period for which the LMSB PFA is sought, the last date on which the taxpayer may file (with extensions) a timely return for that period, and (if earlier) the date on which the taxpayer intends to file that return;

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

(1) Describes the issue;

(2) Summarizes all the facts that are relevant and material to the issue;

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

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

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

(6) Discusses the suitability of the issue for the LMSB PFA program in light of the purpose and criteria set forth in sections 1, 2, and 3 of this revenue procedure;

(7) Discusses whether the LMSB PFA will have any effect in taxable periods either before or after the taxable period for which the LMSB PFA is sought;

(8) States whether the taxpayer has applied for competent authority assistance with respect to the issue for the year in question or any prior year;

(9) States whether the issue, or any part of the issue, has ever been the subject of a request for private letter ruling, determination letter, consent to change a method of accounting, or technical advice with respect to the year in question or any prior year;

(10) Discusses whether the issue can be resolved by the date on which the taxpayer intends to file its return for the taxable period in question; and

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

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

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

.04 *Agreement regarding examination or inspection of records.* The request for a LMSB PFA must contain a statement by the taxpayer that the taxpayer agrees that the inspection of records and testimony under the LMSB PFA procedures will not preclude or impede (under § 7605(b) or any administrative provisions adopted by the Service) a later examination of a return or inspection of records with respect to any taxable year needed to resolve the issue in the request for an LMSB PFA, and that the Service need not comply with any applicable procedural restrictions (such as providing notice under § 7605(b) before beginning such examination or inspection).

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

.06 *Where to submit request.* A request for an LMSB PFA:

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

(2) In the case of a taxpayer whose return is not currently under examination, should be sent to the following address:

Internal Revenue Service
Attn: LMSB
Manager, Pre-Filing Services,
Mint Building
1111 Constitution Avenue, NW
Washington, DC 20224

(3) Facsimile transmissions may be made to (202) 283-8427 (not a toll free call).

SECTION 5. SELECTING TAXPAYERS FOR LMSB PFA PROGRAM

.01 *Jurisdiction.* The LMSB Industry Director with jurisdiction over the taxpayer will make the final decision whether to proceed with the taxpayer's request for an LMSB PFA. (For purposes of this revenue procedure, the term "LMSB Industry Director" includes a duly authorized designee of an LMSB Industry Director.)

.02 *Criteria for selection.* The criteria for selecting taxpayers to participate in the LMSB PFA program include:

(1) The suitability of the issue presented for the LMSB PFA program;

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

(3) The availability of Service resources;

(4) The ability and willingness of the taxpayer to dedicate sufficient resources to the LMSB PFA process;

(5) The likelihood that the LMSB PFA may result in two or more persons taking contrary positions with respect to an item or transaction ("whipsaw");

(6) The time remaining until the due date of the return to which the LMSB PFA relates; and

(7) The overall probability of completing the process and entering into an LMSB PFA by the proposed date for filing the taxpayer's return.

.03 *Notification.* A representative of LMSB will contact the taxpayer within 14 business days of receipt of the taxpayer's request for an LMSB PFA to discuss the potential suitability of the issue(s) for inclusion in the LMSB PFA program. Thereafter, a representative of LMSB will inform the taxpayer in writing whether it has been selected for participation in the LMSB PFA program.

.04 *Requests not accepted.* A taxpayer is not entitled to a conference to appeal a decision not to go forward with the LMSB PFA process. A taxpayer not selected for the PFA program remains eligible for other procedures for early issue resolution, including the Accelerated Issue Resolution (AIR) program (see Rev. Proc. 94–67, 1994–2 C.B. 800).

SECTION 6. PROCESSING A REQUEST FOR AN LMSB PFA

.01 *Planning.* If the Service accepts the taxpayer's request for an LMSB PFA, a representative of LMSB will contact the taxpayer to schedule an orientation meeting with the taxpayer and examination personnel to discuss the LMSB PFA process and explain the roles and responsibilities of each participant. Immediately following the orientation meeting, the taxpayer and the Service should meet to formulate a plan and timeline that will result in a thorough development of the facts and a successful resolution of the issue prior to the time for filing the taxpayer's return.

.02 *Drafting.* After the development of the facts and issues, the Team Manager will informally meet with the taxpayer to determine whether the parties can reach agreement on a proposed LMSB PFA. If the parties reach agreement, the taxpayer will work with the Service to prepare the initial draft of the LMSB PFA closing agreement. The LMSB PFA will be prepared by the taxpayer and the audit team with assistance, as necessary, from the LMSB PFA Program Manager, the Office of Chief Counsel, or other Service personnel.

.03 *Return filing requirements.* The Service's acceptance of a taxpayer's request for a LMSB PFA does not suspend or waive the normal filing requirements for any tax returns that may be affected by the proposed LMSB PFA. If an LMSB PFA is reached prior to the filing of the return, the taxpayer will report the transaction(s) addressed in the LMSB PFA in accordance with the terms of the LMSB PFA.

.04 *TEFRA taxpayers.* If the taxpayer requesting the LMSB PFA is subject to the procedures set forth in §§ 6221 through 6233 and the issue(s) in the LMSB PFA will become a partnership item or items as defined in § 6231 when the return is filed, the LMSB PFA process will be terminated with respect to such issue(s) if no agreement on such issues is reached with all partners within 30 business days prior to the extended due date of the return.

.05 *Execution prior to filing.* If an LMSB PFA is executed prior to the filing of the return to which the LMSB PFA relates, the taxpayer must file such return according to the terms and conditions set forth in the LMSB PFA. A copy of the LMSB PFA must be attached to the return.

.06 *Execution after filing.* If the Service and the taxpayer cannot reach agreement prior to the filing of the return, the Service and the taxpayer may continue to attempt to resolve the issue and enter into an LMSB PFA. If the Service and the taxpayer desire to execute an LMSB PFA after the filing of a return to which the LMSB PFA relates and the return is not consistent with the terms and conditions of the contemplated LMSB PFA, the taxpayer is expected to file an amended return consistent with the terms and conditions of the LMSB PFA. The LMSB PFA should contain a statement whereby the taxpayer acknowledges the expectation that an amended return will be filed and that if such return is not filed that the Service will assess any additional tax due. A copy of the LMSB PFA must be attached to the amended return.

SECTION 7. NATURE AND EFFECT OF AN LMSB PFA

.01 *Criteria for issuance.* The Director, Field Operations (or other authorized official) may execute an LMSB PFA if:

(1) Entering into the LMSB PFA is consistent with the goals of the LMSB PFA program;

(2) The resolution(s) of issue(s) in the LMSB PFA reflect well settled legal principles and correctly apply those principles (or positions authorized under Delegation Order No. 236 or 247) to the facts established by the audit team; and

(3) There is an advantage in having the issue(s) permanently and conclusively closed for the taxable period covered by the LMSB PFA, or that the taxpayer shows good and sufficient reasons for desiring a closing agreement and that the United States will sustain no disadvantage through consummation of such an agreement (see § 301.7121–1 (a) of the Regulations on Procedure and Administration).

.02 *Form and content generally*. An LMSB PFA between the Service and the taxpayer is a closing agreement under § 7121, and, accordingly, must comply with the requirements of Rev. Proc. 68–16, 1968–1 C.B. 770, regarding the form and content of closing agreements.

.03 *Methods of accounting*. An LMSB PFA shall not constitute a final determination under § 7121 with respect to the methods of accounting of the taxpayer for any taxable year. Further, an LMSB PFA does not constitute the consent of the Commissioner under § 446(e) to any change in method of accounting by the taxpayer.

SECTION 8. WITHDRAWAL

.01 At any time prior to the execution of the LMSB PFA, either the taxpayer or the Service may withdraw from consideration all or part of the request for an LMSB PFA. The withdrawal must be in writing and signed by the party initiating the withdrawal action, *i.e.*, the taxpayer or his authorized representative or the Industry Director.

.02 Notwithstanding the withdrawal by either the taxpayer or the Service of any or all the issues in the request for an LMSB PFA, the taxpayer's agreement under section 4.04 of this revenue procedure will remain effective.

SECTION 9. NO LMSB PFA EXECUTED

.01 *Accelerated issue resolution*. If the Service and the taxpayer cannot agree upon and execute an LMSB PFA with respect to an issue, either before or after the filing of the return to which the LMSB PFA relates, and the Service subsequently disagrees with the taxpayer's treatment of the issue on such return, the taxpayer and the Service may continue their efforts to reach an agreement using post filing procedures, such as the Accelerated Issue Resolution (AIR) procedures under Rev. Proc. 94–67, 1994–2 C.B. 800. This continuation of the resolution process does not require a new application.

.02 *Administrative appeals*. If the Service and the taxpayer are unable to resolve an issue by an LMSB PFA or an AIR agreement, the taxpayer may pursue an administrative appeal either by requesting an Early Referral to Appeals under procedures set forth in Rev. Proc. 99–28, 1999–2 C.B. 109, or by protesting any proposed deficiency related to the issue.

SECTION 10. USER FEE

.01 *Taxpayers subject to fees*. Taxpayers are subject to a user fee only if they are selected to participate in the LMSB PFA program. Taxpayers not selected to participate in the LMSB PFA program are not subject to user fees.

.02 *Amount of fee*. The user fees for taxpayers selected to participate in the LMSB PFA program are:

(1) $10,000 for taxpayers having $250,000,000 or more in assets;

(2) $5,000 for taxpayers having at least $50,000,000, but less than $250,000,000 in assets; and

(3) $1,000 for taxpayers having at least $5,000,000, but less than $50,000,000 in assets.

For purposes of determining the appropriate user fee, the amount of assets held by the taxpayer will be determined by its most recently filed return.

.03 *Time and method of payment*. Taxpayers subject to user fees must submit payment within 30 business days of receiving notification that they have been selected to participate in the LMSB PFA program. Payment must be made by a check or money order payable to the Internal Revenue Service.

.04 *Withdrawal*. Notwithstanding the withdrawal by either the taxpayer or the Service of any or all of the issues in the request for an LMSB PFA, the user fee paid by the taxpayer generally will not be refundable.

SECTION 11. DISCLOSURE

.01 LMSB PFAs are closing agreements entered into pursuant to § 7121. As such, both an LMSB PFA and the information generated or received by the Service during the LMSB PFA process constitute confidential return information as defined by § 6103 (b)(2)(D). As prescribed by Congress, the Service will publish annual reports summarizing the operation of the LMSB PFA program, consistent with the restrictions of § 6103. LMSB PFAs are not written determinations under § 6110, and accordingly, are exempt from disclosure to the public under the Freedom of Information Act (FOIA).

SECTION 12. RECORD KEEPING REQUIREMENTS

.01 No aspect of the LMSB PFA process will affect the record keeping requirements imposed by any section of the Internal Revenue Code.

.02 The taxpayer must maintain a copy of the LMSB PFA supporting documents and books of account and records to enable the Service to insure the taxpayer's compliance with the LMSB PFA. These records may be specified in the LMSB PFA itself or in separate agreements.

SECTION 13. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under the control number 1545–1684.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid OMB control number. The collections of information in this revenue procedure are in sections 4, 6 and 12. The information collected under section 4 is required to provide the Service with the information necessary to determine which taxpayers should be included in the LMSB PFA program. The information collected under section 6 will be used to resolve the taxpayer's issue and to support any PFA entered into between the taxpayer and the Service. The record keeping requirements under section 12 will be used for tax administration. The collections of information under sections 4 and 6 are voluntary. Once an LMSB PFA is entered into, the record keeping requirements under section 12 are mandatory. The likely respondents are businesses or other for-profit institutions.

The estimated total annual reporting and/or record keeping burden is 10,200 hours.

The estimated annual burden per respondent/recordkeeper varies from 5 hours to 126 hours, depending on whether a taxpayer applying to the LMSB PFA program is accepted into the program. The estimated annual burden for taxpayers who apply to the LMSB PFA program and are accepted is 126 hours. The estimated annual burden for taxpayers who apply to the LMSB PFA program and are not accepted is 5 hours. The estimated number of taxpayers who apply to the LMSB PFA program and are accepted is 75. The estimated number of taxpayers who apply to the LMSB PFA program and are not accepted is 150. The estimated total number of respondents and/or recordkeepers is 225.

The estimated annual frequency of responses is on occasion.

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

SECTION 14. DRAFTING INFORMATION

The principal author of this revenue procedure is Grant Anderson of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information about this revenue procedure, contact Mike Mann, Senior Program Analyst, LMSB Office of Pre-filing and Technical Guidance, at (202) 283-8424 (voice)(not a toll free call), (202) 283-8427 (fax) (not a toll-free call), or pfa.info@irs.gov (e-mail).

Part IV. Items of General Interest

New Schedule N (Form 1120), Foreign Operations of U.S. Corporations for the 2000 Tax Year

Announcement 2001–13

New Schedule N (Form 1120) is now available. A corporation that, at any time during the 2000 tax year, had assets in or operated a business in a foreign country or a U.S. possession, may have to file Schedule N (Form 1120) with the corporation's income tax return.

You can obtain Schedule N (Form 1120) by telephone or by using IRS electronic information services.

Request by	*Number or address*
Telephone	**1-800-TAX-FORM** (1-800-829-3676)

Personal computer:

IRS Web Site	**www.irs.gov**
File transfer protocol	**ftp.irs.gov**

Revision of Form 8851, Summary of Archer MSAs

Announcement 2001–21

Purpose

This announcement advises trustees and custodians of medical savings accounts of the requirement to file Form 8851, *Summary of Archer MSAs*, and changes for magnetic and electronic filing.

Background

Sections 201 and 202 of Public Law 106–554, enacted December 21, 2000, change the name of medical savings accounts to Archer MSAs, extend the Archer MSA program through 2002, and reinstate the reporting requirement for trustees and custodians of Archer MSAs.

Reporting Requirements

Filers are required to report on Form 8851 by August 1, 2001, the total number of Archer MSAs they established from January 1, 2001, through June 30, 2001, the total number of previously uninsured account holders, the total number of excludable account holders, and the names and social security numbers of account holders. We expect to make the revised Form 8851 available by May 2001. There are no major changes to the November 1997 version of Form 8851.

Filing Requirements

The minimum reporting requirement to file magnetically or electronically remains at 250 Archer MSAs. However, filers reporting fewer than 250 Archer MSAs are also encouraged to file magnetically or electronically. We will issue a revenue procedure with the magnetic media and electronic filing requirements for Form 8851 no later than May 2001 to update Rev. Proc. 97–25, which will include the following changes.

- The mailing address for the Martinsburg Computing Center has changed. All correspondence and media relating to Forms 8851 should be sent to: IRS-Martinsburg Computing Center, Information Reporting Program, 240 Murall Drive, Kearneysville, WV 25430
- The only acceptable media and method of filing Forms 8851 are as follows:

  ___Magnetic Tape
  ___Tape Cartridge
  ___8mm, 4mm, and Quarter Inch Cartridges (QIC)
  ___3.5-Inch Diskette*
  ___Electronic Filing – FIRE System**

  * The IRS no longer has the capability to process non-MS-DOS compatible diskettes. The 3.5-inch diskettes created on a System 36 or AS400 are **not** acceptable.

  ** The telephone number for the FIRE System is 304-262-2400. If filers have any questions about the FIRE System, they should call the technical staff at 304-263-8700. Filers should use Publication 3609 for electronic filing information until the revised revenue procedure is published.

- The only format change is in the Trustee "A" Record. In the Trustee "A" Record, Field Position 136, Report Period, enter the last digit of the year for which the Form 8851 is being filed (i.e., enter a "1" for tax year 2001).

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of

Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Sinclair, Gerald A.	Hammond, IN	Enrolled Agent	August 16, 2000 to August 15, 2001
Barrett, Norman	Dover, DE	CPA	September 1, 2000 to November 30, 2001
Janus, Stephen E.	Michigan City, IN	CPA	September 20, 2000 to September 19, 2003
McCormack, Frank J.	Castlebury, FL	CPA	September 20, 2000 to September 19, 2003
Serio, Vinson J.	Metairie, LA	Enrolled Agent	October 1, 2000 to September 30, 2003
Baker, Linda L.	West Orange, NJ	CPA	October 20, 2000 to April 19, 2004
Duncanson, Thomas D.	Mankato, MN	CPA	November 7, 2000 to May 6, 2003
West, Keith	Pasadena, CA	Enrolled Agent	November 15, 2000 to May 14, 2001
Overbeck, Marietta	Evansville, IN	CPA	November 15, 2000 to November 14, 2002
Garrison, John L.	Guymon, OK	CPA	November 20, 2000 to November 19, 2002
Aiken, Kim Allen	Olympia, WA	CPA	December 10, 2000 to June 9, 2002
D'Arata, David J.	Buffalo, NY	CPA	January 1, 2001 to June 30, 2003
Gambrel, Thomas R.	Corbin, KY	CPA	January 1, 2001 to December 31, 2004

Announcement of the Expedited Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under title 31 of the Code of Federal Regulations, section 10.76, the Director of Practice is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years, from the date the expedited proceeding is instituted, (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause; or (2) has been convicted of any crime under title 26 of the United States Code or, of a felony under title 18 of the United States Code involving dishonesty or breach of trust.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified pubic accountants, enrolled agents, and enrolled actuaries to identify practitioners under expedited suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent, or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

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

Name	Address	Designation	Date of Suspension
Barger, Robert E.	Garden Ridge, TX	Attorney	Indefinite from October 10, 2000
Roberts, Thomas W.	Cincinnati OH	CPA	Indefinite from October 24, 2000

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individual has been disbarred from futher practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Joyner, Joseph	Gary, IN	CPA	November 24, 2000

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.

Numerical Finding List[1]

Bulletins 2001–1 through 2001–8

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2000–27 through 2000–52 is in Internal Revenue Bulletin 2001–1, dated January 2, 2001.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2000–27 through 2000–52 is in Internal Revenue Bulletin 2001–1, dated January 2, 2001.

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