Internal Revenue bulletin

Bulletin No. 2003-37
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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. 2003–89, page 525.

Fringe benefits aircraft valuation formula. The Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charges in effect for the second half of 2003 are set forth for purposes of determining the value of noncommercial flights on employer-provided aircraft under section 1.61–21(g) of the regulations.

T.D. 9068, page 538.

Final regulations under section 2055 of the Code amend the requirements for qualification of charitable guaranteed annuity and unitrust interests for federal income, gift, and estate tax purposes as a result of the Tax Court's decision in *Estate of Boeshore v. Commissioner*. Rev. Rul. 76–225 revoked.

T.D. 9069, page 525.
REG–138495–02, page 541.

Temporary and proposed regulations under section 1.280F of the Code provide relief from the dollar limits on depreciation imposed by section 280F(a) to taxpayers that use light trucks or vans in their trade or business by amending the definition of "passenger automobile" in order to exclude vans and light trucks that are "qualified nonpersonal use vehicles" as defined in section 1.274–5T(k).

REG–138499–02, page 541.

Proposed regulations under section 168 of the Code provide guidance on how to depreciate property for which the use changes in the hands of the same taxpayer. These regulations explain when a change in use occurs and how a taxpayer should determine depreciation in the year of the change in use and subsequent years. A public hearing is scheduled for December 3, 2003.

REG–121122–03, page 550.

Proposed regulations under section 1042 of the Code provide guidance concerning the notarized statement of purchase requirements for taxpayers electing to defer gain from the sale of certain stock to an employee stock ownership plan.

REG–130262–03, page 553.

Proposed regulations under section 1502 of the Code revise the rules for determining the basis of the stock of the former common parent of a consolidated group after a group structure change. Under the current regulations, the acquiring corporation's basis in the stock of the former common parent is generally redetermined to reflect the former parent's net asset basis. These proposed modifications permit the basis of stock acquired in a fully taxable transaction to reflect the cost of the acquired stock.

EMPLOYEE PLANS

T.D. 9072, page 527.

Final regulations under section 414(v) of the Code provide guidance on the requirements for retirement plans providing for catch-up contributions to individuals age 50 or older. These final regulations will affect section 401(k) plans, section 408(p) SIMPLE IRA plans, section 408(k) simplified employee pensions, section 403(b) tax sheltered annuity contracts, section 457 eligible governmental plans, and participants eligible to make elective deferrals under these plans or contracts.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

EXEMPT ORGANIZATIONS

Announcement 2003–57, page 555.
A list is provided of organizations now classified as private foundations.

ESTATE TAX

T.D. 9068, page 538.
Final regulations under section 2055 of the Code amend the requirements for qualification of charitable guaranteed annuity and unitrust interests for federal income, gift, and estate tax purposes as a result of the Tax Court's decision in *Estate of Boeshore v. Commissioner*. Rev. Rul. 76–225 revoked.

GIFT TAX

T.D. 9068, page 538.
Final regulations under section 2055 of the Code amend the requirements for qualification of charitable guaranteed annuity and unitrust interests for federal income, gift, and estate tax purposes as a result of the Tax Court's decision in *Estate of Boeshore v. Commissioner*. Rev. Rul. 76–225 revoked.

ADMINISTRATIVE

Announcement 2003–51, page 555.
Publication 971, *Innocent Spouse Relief (And Separation of Liability and Equitable Relief)* revised July 2003, is now available from the Internal Revenue Service. It replaces the June 2002 revision.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Section 61.—Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

Fringe benefits aircraft valuation formula. The Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charge in effect for the second half of 2003 are set forth for purposes of determining the value of noncommercial flights on employer-provided aircraft under section 1.61–21(g) of the regulations.

Rev. Rul. 2003–89

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charges and SIFL mileage rates:

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
7/1/03 – 12/31/03	$34.66	Up to 500 miles = $.1896 per mile
		501–1500 miles = $.1445 per mile
		Over 1500 miles = $.1390 per mile

DRAFTING INFORMATION

The principal author of this revenue ruling is Kathleen Edmondson of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Edmondson at (202) 622–6040 (not a toll-free call).

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

26 CFR 1.280F–6T: Special rules and definitions (temporary).

T.D. 9069

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Depreciation of Vans and Light Trucks

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the definition of passenger automobiles for purposes of section 280F(a). These temporary regulations affect certain taxpayers that use vans and light trucks in their trade or business.

DATES: These regulations are effective July 7, 2003.

FOR FURTHER INFORMATION CONTACT: Bernard P. Harvey, (202) 622–3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under section 280F of the Internal Revenue Code of 1986 (Code).

Explanation of Provisions

Section 280F(a) limits annual depreciation deductions for passenger automobiles in order to discourage overspending on passenger automobiles purchased for use in business. For the 2003 taxable year, these limitations delay a portion of the otherwise allowable depreciation deductions for passenger automobiles with a purchase price above $15,300 (for passenger automobiles qualifying for additional first-year depreciation under section 168(k)(1), added by the Job Creation and Worker Assistance Act of 2002 (JCWAA), or under section 168(k)(4), added by Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), the delay affects depreciation deductions for vehicles that cost more than $17,500 or $17,850, respectively). Passenger automobiles are defined in section 280F(d)(5)(A) as any 4-wheeled vehicle which is manufactured primarily for use on public streets, roads, and highways, and which is rated at 6,000 pounds unloaded gross vehicle weight (or, in the case of a truck or van, 6,000 pounds gross vehicle weight) or less. Section 280F(d)(5)(B) provides exceptions from this definition, and allows the Secretary to promulgate regulations to exclude trucks and vans from the definition of passenger automobiles.

While a basic automobile may be fully depreciated over five years under these rules, small business advocates have suggested that taxpayers with a valid business need for a van or light truck cannot fully depreciate a basic van or light truck within the standard five-year recovery period. Treasury and the IRS recognize that these vehicles generally cost more than other passenger automobiles and that even the most basic van or light truck may be subject to the section 280F(a) depreciation limits.

Some commenters on this issue suggested that the dollar limits on trucks and

vans should be raised to reflect the higher cost of these vehicles. Although there is no general authority in section 280F to raise the dollar limits for specific types of vehicle, section 280F(d)(7) provides for adjustments to the dollar limits to reflect automobile price inflation since 1988. Moreover, much of the disparity between the cost of vans and light trucks and the cost of other passenger automobiles is attributable to the higher rate of price inflation for vans and light trucks since 1988. Accordingly, the revenue procedure setting forth the inflation-adjusted dollar limits for vehicles placed in service in 2003 will respond to the suggestion by providing higher dollar limits for vans and light trucks to reflect this higher rate of price inflation.

In addition, as noted above, JCWAA and JGTRRA have provided temporary relief by substantially increasing the first-year depreciation limits for all new passenger automobiles, including vans and light trucks. Thus, a taxpayer electing the 50-percent additional first-year depreciation permitted by JGTRRA can recover the full cost of a new automobile costing nearly $23,000 over the five-year recovery period. The revenue procedure described above would provide an even higher limit for new vans and light trucks.

Comments also suggested that Treasury and the IRS should exercise the regulatory authority in section 280F(d)(5)(B)(ii) to provide an exclusion from the section 280F(a) depreciation limitations for all trucks and vans or for vehicles that are used in a specified manner. Treasury and the IRS have concluded that a limited exclusion is appropriate so long as it is based on objective factors and does not provide an incentive to purchase a truck or van when a less-expensive automobile would be sufficient to fulfill the taxpayer's business needs. Accordingly, the temporary regulations exclude from the definition of passenger automobile any truck or van that is a qualified nonpersonal use vehicle as defined in §1.274–5T(k) of the Income Tax Regulations. Qualified nonpersonal use vehicles include not only the trucks and vans listed in §1.274–5T(k)(2), but also trucks and vans described in §1.274–5T(k)(7) (relating to trucks and vans that have been specially modified, such as by installation of permanent shelving and painting the vehicle to display advertising or the company's name, so that they are not likely to be used more than a *de minimis* amount for personal purposes). These specially manufactured or modified vehicles do not provide significant elements of personal benefit, and a taxpayer is unlikely to purchase these vehicles unless motivated by a valid business purpose that could not be met with a less-expensive vehicle. We welcome comments on other options that provide administrable objective standards and are consistent with the statutory purpose.

The temporary regulations also strike from §1.280F–6T language relating to expired provisions of the Code.

Effective Date

The temporary regulations apply to property placed in service on or after July 7, 2003.

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. For applicablity of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, this Treasury decision will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

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

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.280F–6T also issued under 26 U.S.C. 280F. * * *

Par. 2. Section 1.280F–6T is amended as follows:

1. Paragraph (a)(1) is amended by removing the language "the amount of any credit allowable under section 38 to the employee or".

2. Paragraph (c)(3)(iii) is revised.

3. Paragraph (d)(3) is amended by removing the language "investment tax credit or" and "the investment tax credit and".

4. The authority citation at the end of the section is removed.

The revision reads as follows:

§1.280F–6T Special rules and definitions (temporary).

* * * * *

(c) * * *

(3) * * *

(iii) Truck or van that is a qualified nonpersonal use vehicle as defined under §1.274–5T(k).

* * * * *

Robert E. Wenzel,
Deputy Commissioner for Services and Enforcement.

Approved June 27, 2003.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 3, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 7, 2003, 68 F.R. 68 40129)

Section 414(v).—Definitions and Special Rules

26 CFR 1.414(v)–1: Catch-up contributions.

T.D. 9072

DEPARTMENT OF THE TREASURY
Internal Revenue Service (IRS)
26 CFR Part 1

Catch-Up Contributions for Individuals Age 50 or Older

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Final regulations

SUMMARY: This document contains final regulations that provide guidance concerning the requirements for retirement plans providing catch-up contributions to individuals age 50 or older pursuant to the provisions of section 414(v). These final regulations affect section 401(k) plans, section 408(p) SIMPLE IRA plans, section 408(k) simplified employee pensions, section 403(b) tax-sheltered annuity contracts, and section 457 eligible governmental plans, and affect participants eligible to make elective deferrals under these plans or contracts.

DATES: *Effective Date:* These final regulations are effective on July 8, 2003.

Applicability Date: These final regulations are applicable to contributions in taxable years beginning on or after January 1, 2004.

FOR FURTHER INFORMATION CONTACT: R. Lisa Mojiri-Azad or John T. Ricotta at (202) 622–6060.

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under sections 402(g) and 414(v) of the Internal Revenue Code (Code). Section 414(v), added by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (Public Law 107–16; 115 Stat. 38), effective for years beginning after December 31, 2001, permits an individual age 50 or older to make additional elective deferrals each year, up to a dollar limit, if certain requirements provided under that section are satisfied. Under section 414(v)(3), these additional elective deferrals are not subject to certain otherwise applicable limitations on elective deferrals and are excluded from consideration for certain nondiscrimination tests. Under section 414(v)(4), catch-up contributions generally must be made available to all catch-up eligible individuals who participate under any plan maintained by the employer that provides for elective deferrals.

Section 402(g)(1)(C) was added by the Job Creation and Worker Assistance Act of 2002, (JCWAA) (Public Law 107–147; 116 Stat. 21), effective for years beginning after December 31, 2001. This section increases the amount of elective deferrals that a catch-up eligible participant, as defined in section 414(v), may exclude from gross income under section 402(g) by the same dollar limit applicable for the year under section 414(v).

JCWAA also included technical corrections to section 414(v), including clarifications relating to: initial eligibility to make catch-up contributions, coordination of section 414(v) catch-up contributions for individuals who participate in more than one plan, coordination of section 414(v) catch-up contributions with the catch-up contributions provided under section 457(b)(3), and the application of the universal availability requirement of section 414(v)(4) in connection with mergers and acquisitions.

Proposed regulations under section 414(v) were published in the **Federal Register** on October 23, 2001 (REG–142499–01, 2001–2 C.B. 476 [66 FR 53555]). On February 21, 2002, a public hearing was held on the proposed regulations. Notice 2002–4, 2002–1 C.B. 298, provided transitional rules for complying with the universal availability requirement of section 414(v)(4) and the proposed regulations.

After consideration of the comments and the changes made by JCWAA, these final regulations adopt the provisions of the proposed regulations with certain modifications, the most significant of which are highlighted below.

Explanation of Provisions

Under these final regulations, an applicable employer plan is not treated as violating any provision of the Code merely because the plan permits a catch-up eligible participant to make catch-up contributions. For this purpose, an applicable employer plan is a section 401(k) plan, a SIMPLE IRA plan (as defined in section 408(p)), a simplified employee pension (as defined in section 408(k)) (SEP), a plan or contract that satisfies the requirements of section 403(b), or a section 457 plan maintained by an eligible governmental employer (a section 457 eligible governmental plan).

Catch-up contributions are elective deferrals made by a catch-up eligible participant that exceed an otherwise applicable limit and that are treated as catch-up contributions under the plan, but only to the extent they do not exceed the maximum amount of catch-up contributions permitted for the taxable year. An employer is not required to provide for catch-up contributions in any of its plans. However, if any plan of an employer provides for catch-up contributions, all plans of the employer that provide for elective deferrals must comply with the universal availability requirement described below, to the extent applicable.

A. Eligibility for Catch-up Contributions

As under the proposed regulations, a participant is a catch-up eligible participant, and thus is permitted to make catch-up contributions, if the participant is otherwise eligible to make elective deferrals under the plan and would attain age 50 or older before the end of the participant's taxable year. In the case of a non-calendar year plan, a participant is treated as a catch-up eligible participant beginning on January 1 of the calendar year that includes the participant's 50th birthday, without regard to the plan year.

B. Determination of Catch-up Contributions

These final regulations retain the same basic structure for determining catch-up contributions as provided in the proposed regulations. Elective deferrals made by a catch-up eligible participant are treated as catch-up contributions if they exceed any otherwise applicable limit, to the extent

they do not exceed the maximum dollar amount of catch-up contributions permitted under section 414(v). Catch-up contributions are determined by reference to three types of otherwise applicable limits: statutory limits, employer-provided limits, and the actual deferral percentage (ADP) limit.

A statutory limit is a limit contained in the Code on elective deferrals or annual additions permitted to be made under the plan or contract (without regard to section 414(v)). Statutory limits include the requirement under section 401(a)(30) that a plan limit all elective deferrals within a calendar year under the plan and other plans (or contracts) maintained by members of a controlled group to the amount permitted under section 402(g).

An employer-provided limit is a limit on the elective deferrals an employee can make under the plan (without regard to section 414(v)) that is contained in the terms of the plan, but is not a statutory limit or the ADP limit. A number of commentators suggested that the regulations specifically provide that a limitation on elective deferrals set by the plan administrator in accordance with plan terms is a limit contained in the terms of the plan. As noted in the preamble to the proposed regulations, the condition that an employer-provided limit be contained in the terms of the plan is intended to correspond with the requirements of §1.401–1 that a qualified plan be a definite written program and provide for a definite predetermined formula for allocating contributions made to the plan. Accordingly, if a limit is otherwise permissible under a section 401(k) plan, the limit will also satisfy the requirement in section 414(v)(5) that the limit be contained in the terms of the plan.

The ADP limit is the highest dollar amount of elective deferrals that any highly compensated employee (HCE) is permitted under a section 401(k) plan for a plan year by reason of the ADP test under section 401(k)(3) (without regard to section 414(v)). The ADP limit is determined after taking into account all elective deferrals (other than elective deferrals that are catch-up contributions because of an employer-provided limit or statutory limit) and qualified nonelective contributions or qualified matching contributions for the plan year in accordance with section 401(k)(3) and the applicable regulations, and after any necessary correction under section 401(k)(8).

The final regulations retain the rule that the amount of elective deferrals in excess of an applicable limit is generally determined as of the end of a plan year by comparing the total elective deferrals for the plan year with the applicable limit for the plan year. For an applicable limit that is determined on the basis of a year other than a plan year (such as the calendar year limit on elective deferrals under section 401(a)(30)), the determination of whether elective deferrals are in excess of the applicable limit is made on the basis of such other year.

As under the proposed regulations, this annual method for determining whether amounts are in excess of an applicable limit also applies to an employer-provided limit that is applied on a payroll-by-payroll basis during the plan year. A number of commentators suggested that plans that provide for payroll-by-payroll limits, or similar limits that apply to a portion of the plan year, be permitted to determine amounts in excess of an applicable limit based on the period for which the limit is applied. These commentators noted that, although a plan is permitted to determine an additional amount of elective deferrals that a catch-up eligible participant is permitted to make on a payroll-by-payroll basis, the plan could not designate these elective deferrals as catch-up contributions on the same basis. These commentators suggested that for such a plan, an annual determination process would require the plan to collect and retain additional data during the year. In many cases, plans use a definition of compensation for purposes of ADP testing that is different from the definition used during the year to determine elective deferrals. Recordkeepers for these plans must collect and retain payroll-by-payroll compensation, and then determine the employer-provided limit on an annual basis before determining the amount of elective deferrals that are catch-up contributions.

A number of advocates for a payroll-by-payroll determination of catch-up contributions acknowledged that their proposal creates a risk that ADP testing could be distorted through changes in plan limits during the year. For example, if a plan were to provide that HCEs' elective deferrals are limited, on a payroll-by-payroll basis, to 1% of compensation for the first 2 months of the plan year, and then to 15% of compensation for the remainder of the year, the result would be equivalent to treating the first dollars deferred as catch-up contributions. While few employers might be likely to adopt such a design, a payroll-by-payroll system for determining catch-up contributions would require restrictions on the extent to which changes in employer-provided limits during the year could be made.

After considering these comments, Treasury and the IRS have determined that the need for rules to prevent abuse associated with a payroll-by-payroll method of determining catch-up contributions outweighs the relative administrative advantages of that method, and these regulations retain the annual method. However, to address administrative concerns raised in these comments, these regulations also expand the alternative methods for determining an employer-provided limit in order to avoid requiring plans that use one definition of compensation for elective deferrals and another definition for ADP testing purposes to collect and retain data on both definitions.

These final regulations retain the rule in the proposed regulations that a plan that changes an employer-provided limit during the plan year is permitted to use a time-weighted average of these limits as the employer-provided limit. For example, under this alternative method, a plan that provides for an employer-provided limit of 8% for the first 6 months of the plan year and 10% for the second 6 months is permitted to use 9% as the employer-provided limit for the plan year. These final regulations also provide that the plan is permitted to use the definition of compensation used for ADP testing purposes for this weighted-average simplification, and can use this alternative method without regard to whether the employer-provided limit is changed during the plan year.

C. Treatment of Catch-up Contributions

An elective deferral that is treated as a catch-up contribution is not subject to otherwise applicable limits under the applicable employer plan and the plan will not be treated as failing otherwise applicable nondiscrimination requirements because of catch-up contributions. Under these final regulations (including changes

from the proposed regulations to reflect the provisions of JCWAA), catch-up contributions are not taken into account in applying the limits of section 401(a)(30), 402(h), 403(b), 408, 415(c), or 457(b)(2) (determined without regard to section 457(b)(3)) to other contributions or benefits under the plan offering catch-up contributions or under any other plan of the employer.

Elective deferrals that are treated as catch-up contributions under a plan because they exceed a statutory limit or an employer-provided limit are disregarded for purposes of ADP testing. These catch-up contributions are subtracted from the participant's elective deferrals for the plan year prior to determining the participant's actual deferral ratio. This subtraction applies without regard to whether the catch-up eligible participant is an HCE or a nonhighly compensated employee (NHCE). If a plan needs to take corrective action under section 401(k)(8), the plan must determine the amount of elective deferrals for HCEs that are catch-up contributions because they are in excess of the ADP limit and retain such amounts. The plan would not be treated as failing section 401(k)(8) because these excess contributions are treated as catch-up contributions and retained.

Amounts in excess of an applicable limit are treated as catch-up contributions only to the extent that such excess amounts, combined with amounts previously treated as catch-up contributions for the taxable year, do not exceed the catch-up contribution limit for the year. As discussed above, whether elective deferrals in excess of an applicable limit can be treated as catch-up contributions is determined based on the year (*e.g.*, plan year, calendar year, or limitation year) with respect to which each applicable limit is applied.

The interaction of this timing rule and the catch-up contribution limit for the year is most significant for a plan with a plan year that is not the calendar year. For example, in a plan with a plan year ending on June 30, 2005, elective deferrals in excess of the employer-provided limit or the ADP limit for the plan year ending June 30, 2005, would be treated as catch-up contributions as of the last day of the plan year, up to the catch-up contribution limit for 2005. These catch-up contributions are not taken into account for purposes of compliance with section 401(a)(30) for 2005. After June 30, 2005, the catch-up eligible participant is permitted to continue to make elective deferrals up to the section 401(a)(30) limit for 2005 (disregarding any amounts treated as catch-up contributions for 2005, as of June 30, 2005) and these additional contributions are not treated as contributions in excess of the section 401(a)(30) limit. Accordingly, these additional contributions are generally taken into account under the ADP test for the plan year ending June 30, 2006. In addition, to the extent the catch-up eligible participant has not made catch-up contributions up to the catch-up contribution limit for 2005, the participant can make additional catch-up contributions in excess of the section 401(a)(30) limit for 2005. These latter contributions are catch-up contributions which will not be taken into account under the ADP test for the plan year ending June 30, 2006.

Without regard to their special treatment under certain nondiscrimination provisions and limitations under the Code, catch-up contributions are elective deferrals and remain subject to the applicable requirements for elective deferrals. For example, catch-up contributions under an applicable employer plan that is a section 401(k) plan are subject to the distribution and vesting restrictions of section 401(k)(2)(B) and (C), although the plan provisions applicable to distributions of elective deferrals treated as catch-up contributions may differ from those applicable to other elective deferrals under the plan (as long as each provision complies with the distribution restrictions of section 401(k)(2)(B)). In addition, excess contributions treated as catch-up contributions nevertheless remain excess contributions for purposes of section 411(a)(3)(G). Therefore, the plan is permitted to provide that matching contributions related to excess contributions treated as catch-up contributions are forfeited. However, as discussed below, it is also permissible for a plan to provide that these matching contributions are not forfeited, without violating section 401(a)(4).

These final regulations retain the rules of the proposed regulations on the treatment of catch-up contributions for purposes of sections 416, 410(b) and 401(a)(4). Catch-up contributions for the current plan year are not taken into account under section 416 or 410(b). However, catch-up contributions for prior years are taken into account in determining whether a plan is top-heavy under section 416, and for purposes of average benefit percentage testing to the extent prior years' contributions are taken into account (*i.e.*, if accrued-to-date calculations are used). In addition, a plan does not fail the requirements of section 401(a)(4) merely because it permits only catch-up eligible participants to make catch-up contributions, without regard to whether the group of catch-up eligible employees would satisfy section 410(b). Similarly, if a plan applies a single matching formula to elective deferrals whether or not they are catch-up contributions, the matching formula as applied to catch-up eligible participants is not treated as a separate benefit, right, or feature under §1.401(a)(4)–4 from the matching formula as applied to the other participants. However, the matching contributions under the plan must satisfy the actual contribution percentage test under section 401(m)(2) taking into account all matching contributions, including matching contributions on catch-up contributions.

A number of commentators indicated that some employers would not want to provide matching contributions on catch-up contributions and requested guidance on how they might accomplish that goal in light of the annual determination of whether amounts are in excess of an employer-provided limit. The IRS and Treasury believe that employers can achieve their desired goal by specifying which contributions will be matched, rather than specifying which contributions will not be matched. For example, if an employer-provided limit on elective deferrals is 10% of compensation for each payroll period, the plan can specify that matching contributions will be made based on elective deferrals that do not exceed 10% of compensation for that payroll period (and that do not exceed a statutory limit), and that matching contributions on elective deferrals in excess of the ADP limit will be forfeited, with the assurance that the plan will not be matching catch-up contributions.

D. Universal Availability

Section 414(v)(4)(A) provides that an applicable employer plan is treated as failing to comply with section 401(a)(4) unless the plan allows all catch-up eligible participants to make the same election with respect to additional elective deferrals. Section 414(v)(4)(B) provides that, for this purpose, all plans maintained by employers treated as a single employer under section 414(b), (c), (m) or (o) are treated as a single plan. The proposed regulations provided that, if an applicable employer plan otherwise subject to section 401(a)(4) provides for catch-up contributions, all other applicable employer plans in the controlled group that provide for elective deferrals (including plans not subject to section 401(a)(4)) must provide catch-up eligible participants with the same effective opportunity to make catch-up contributions. The proposed regulations also included a transition rule for collectively bargained plans and an exception related to mergers and acquisitions.

Several commentators requested that collectively bargained employees described in section 410(b)(3) be disregarded for purposes of the universal availability requirement, just as they are disregarded for purposes of section 401(a)(4) compliance. These commentators explained that it is difficult to coordinate catch-up contributions among non-collectively bargained employees and collectively bargained employees, particularly when more than one collective bargaining unit is involved. For employers participating in multiemployer plans, the difficulties are increased significantly, because of the implications for other, unrelated employers. Some commentators also requested that other groups of employees be excluded pursuant to provisions of the regulations under section 410(b) allowing employees to be excluded based on plan design, such as participants who have not met the minimum age and service requirements of section 410(a)(1) or employees in different qualified separate lines of business under section 414(r).

In response to comments, these final regulations provide that employees described in section 410(b)(3), most notably collectively bargained employees, are disregarded for purposes of determining whether an applicable employer plan complies with the universal availability requirement. Pursuant to sections 401(a)(4) and 410(b)(3), collectively bargained employees are disregarded for purposes of section 401(a)(4), without regard to plan design or an employer's choice of testing method. The final regulations do not adopt the other suggested exclusions, participants who have not met minimum age and service or participants in different qualified separate lines of business, because these exclusions are based on plan design and testing choices.

These regulations otherwise retain the basic rules of the proposed regulations relating to universal availability and provide that a plan that offers catch-up contributions satisfies the requirements of section 401(a)(4) only if all catch-up eligible participants are provided with an effective opportunity to make the same dollar amount of catch-up contributions. Catch-up eligible participants do not have an effective opportunity to make catch-up contributions unless the applicable employer plan permits each catch-up eligible participant to make sufficient elective deferrals during the year so that the participant has the opportunity to make elective deferrals up to the otherwise applicable limit plus the catch-up contribution limit. An effective opportunity could be provided in several different ways. For example, a plan that limits elective deferrals on a payroll-by-payroll basis might also provide participants with an opportunity to make catch-up contributions that is administered on a payroll-by-payroll basis (*i.e.*, by allowing catch-up eligible participants to increase their deferrals above the otherwise applicable limit by a *pro-rata* portion of the catch-up limit for the year). The plan would satisfy the effective opportunity requirement even though, as discussed above, whether these elective deferrals are treated as catch-up contributions would not be determined until the end of the year.

A plan will not fail the universal availability requirement solely because an employer-provided limit does not apply to all employees or different employer-provided limits apply to different groups of employees, as long as each limit satisfies the nondiscriminatory availability requirements of §1.401(a)(4)–4 for benefits, rights, and features. Thus, for example, a plan could provide for an employer-provided limit that applies to HCEs, even though no employer-provided limit applies to NHCEs. However, as under the proposed regulations, these final regulations retain the rule that an applicable employer plan is not permitted to provide lower employer-provided limits for catch-up eligible participants. Furthermore, a plan fails to provide an effective opportunity to make catch-up contributions if it has an applicable limit (*e.g.*, an employer-provided limit) and does not permit all catch-up eligible participants to make elective deferrals in excess of that limit.

In addition to the exclusion for collectively bargained employees discussed above, these final regulations include several other exceptions to the universal availability requirement. Under these regulations, a plan does not fail the universal availability requirement because it restricts elective deferrals, including elective deferrals for catch-up eligible participants, under a cash availability limit. A cash availability limit is a limit that restricts elective deferrals to amounts available after withholding from the employee's pay (*e.g.*, after deduction of all applicable income and employment taxes). For this purpose, a limit of 75% of compensation or higher will be treated as limiting employees to amounts available after other withholdings.

These final regulations also include a broader exception to the universal availability requirement during the transition period provided under section 410(b)(6)(C) than was included in the proposed regulations, consistent with the amendments made by JCWAA. Under these final regulations, an applicable employer plan that satisfies the universal availability requirement before an acquisition or disposition described in §1.410(b)–2(f) continues to be treated as satisfying the universal availability requirement of section 414(v)(4) through the end of the period described in section 410(b)(6)(C). These final regulations also retain a rule providing for coordination between catch-up contributions under section 414(v) and the provisions of section 457(b)(3), in accordance with section 414(v)(6)(C).

A number of comments were received on the application of the universal

availability requirement to an applicable employer plan that is qualified under Puerto Rico tax law as well as under the Code. These final regulations do not affect the transitional relief granted in Notice 2002–4 that provides that an applicable employer plan will not fail to satisfy the universal availability requirement solely because another applicable employer plan of the employer that is qualified under Puerto Rico law does not provide for catch-up contributions.

E. Participants in Multiple Plans

The technical corrections in JCWAA amended section 414(v) to provide that all applicable employer plans of an employer, other than section 457 eligible governmental plans, are treated as one plan for purposes of determining the amount of catch-up contributions and all section 457 eligible governmental plans of the same employer are treated as one plan for this purpose. Statutory limits, such as the limits under section 401(a)(30) or 415, already provide for coordination among plans in the same controlled group, and elective deferrals in addition to the amounts permitted under these limits are similarly coordinated. Employer-provided limits, however, apply only to the plan that provides for the limit, and the ADP limit applies only to section 401(k) plans. Accordingly, these final regulations provide guidance on coordination of the amount in excess of these limits on a controlled-group basis.

With respect to employer-provided limits, these regulations allow a plan to permit a catch-up eligible participant to defer an amount in addition to the amount allowed under the employer-provided limit, without regard to whether the employee has already utilized his or her catch-up opportunity under another plan of the same employer. However, to the extent elective deferrals under another plan maintained by the employer have already been treated as catch-up contributions during the taxable year, the elective deferrals under the plan may be treated as catch-up contributions only up to the amount remaining under the catch-up limit for the year. Any other elective deferrals that exceed the employer-provided limit may not be treated as catch-up contributions and must satisfy the otherwise applicable nondiscrimination rules. For example, the right to make contributions in excess of the employer-provided limit is an other right or feature which must satisfy §1.401(a)(4)–4 to the extent that the contributions are not catch-up contributions. Also, contributions in excess of the employer-provided limit are taken into account under the ADP test to the extent they are not catch-up contributions.

Finally, these regulations retain the allocation rule included in the proposed regulations. When a participant is eligible under more than one applicable employer plan maintained by the same employer, the specific plan under which amounts in excess of an applicable limit are treated as catch-up contributions is permitted to be determined in any manner that is not inconsistent with the manner in which such amounts were actually deferred under the plans.

F. Excludability of Catch-up Contributions

JCWAA amended section 402(g) to increase the elective deferral limit for a catch-up eligible participant by the amount of the allowable catch-up contributions for the taxable year. The provisions of these final regulations related to these provisions are under new §1.402(g)–2, rather than under §1.414(v)–1, as in the proposed regulations. Under §1.402(g)–2, the amount of elective deferrals that a catch-up eligible participant is permitted to exclude from income under section 402(g) for the taxable year is increased by the maximum amount of catch-up contributions permitted for the taxable year under section 414(v). This treatment by the catch-up eligible participant is not affected by whether the applicable employer plans treat the elective deferrals as catch-up contributions. Thus, a catch-up eligible participant who participates in plans of two or more employers is permitted to exclude from gross income elective deferrals that exceed the section 402(g) limit, even though neither plan treats those elective deferrals as catch-up contributions. In addition, the treatment by an individual of such elective deferrals as catch-up contributions will not have any effect on either employer's plan.

Effective Date

These final regulations are applicable to contributions in taxable years beginning on or after January 1, 2004. Taxpayers are permitted to rely on these final regulations and the proposed regulations for taxable years beginning prior to January 1, 2004.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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. Because §§1.402(g)–2 and 1.414(v)–1 impose no new collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are R. Lisa Mojiri-Azad and John T. Ricotta of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.402(g)–2 is added to read as follows:

§1.402(g)–2 Increased limit for catch-up contributions.

(a) *General rule*. Under section 402(g)(1)(C), in determining the amount of elective deferrals that are includible in gross income under section 402(g) for a catch-up eligible participant (within the

meaning of §1.414(v)–1(g)), the otherwise applicable dollar limit under section 402(g)(1)(B) (as increased under section 402(g)(7), to the extent applicable) shall be further increased by the applicable dollar catch-up limit as set forth under §1.414(v)–1(c)(2).

(b) *Participants in multiple plans*. Paragraph (a) of this section applies without regard to whether the applicable employer plans (within the meaning of section 414(v)(6)) treat the elective deferrals as catch-up contributions. Thus, a catch-up eligible participant who makes elective deferrals under applicable employer plans of two or more employers that in total exceed the applicable dollar amount under section 402(g)(1) by an amount that does not exceed the applicable dollar catch-up limit under either plan may exclude the elective deferrals from gross income, even if neither applicable employer plan treats those elective deferrals as catch-up contributions.

(c) *Effective date*—(1) *Statutory effective date*. Section 402(g)(1)(C) applies to contributions in taxable years beginning on or after January 1, 2002.

(2) *Regulatory effective date*. Paragraphs (a) and (b) of this section apply to contributions in taxable years beginning on or after January 1, 2004.

Par. 3. Section 1.414(v)–1 is added to read as follows:

§1.414(v)–1 Catch-up contributions.

(a) *Catch-up contributions*—(1) *General rule*. An applicable employer plan shall not be treated as failing to meet any requirement of the Internal Revenue Code solely because the plan permits a catch-up eligible participant to make catch-up contributions in accordance with section 414(v) and this section. With respect to an applicable employer plan, catch-up contributions are elective deferrals made by a catch-up eligible participant that exceed any of the applicable limits set forth in paragraph (b) of this section and that are treated under the applicable employer plan as catch-up contributions, but only to the extent they do not exceed the catch-up contribution limit described in paragraph (c) of this section (determined in accordance with the special rules for employers that maintain multiple applicable employer plans in paragraph (f) of this section, if applicable). To the extent provided under paragraph (d) of this section, catch-up contributions are disregarded for purposes of various statutory limits. In addition, unless otherwise provided in paragraph (e) of this section, all catch-up eligible participants of the employer must be provided the opportunity to make catch-up contributions in order for an applicable employer plan to comply with the universal availability requirement of section 414(v)(4). The definitions in paragraph (g) of this section apply for purposes of this section and §1.402(g)–2.

(2) *Treatment as elective deferrals*. Except as specifically provided in this section, elective deferrals treated as catch-up contributions remain subject to statutory and regulatory rules otherwise applicable to elective deferrals. For example, catch-up contributions under an applicable employer plan that is a section 401(k) plan are subject to the distribution and vesting restrictions of section 401(k)(2)(B) and (C). In addition, the plan is permitted to provide a single election for catch-up eligible participants, with the determination of whether elective deferrals are catch-up contributions being made under the terms of the plan.

(3) *Coordination with section 457(b)(3)*. In the case of an applicable employer plan that is a section 457 eligible governmental plan, the catch-up contributions permitted under this section shall not apply to a catch-up eligible participant for any taxable year for which a higher limitation applies to such participant under section 457(b)(3). For additional guidance, see regulations under section 457.

(b) *Elective deferrals that exceed an applicable limit*—(1) *Applicable limits*. An applicable limit for purposes of determining catch-up contributions for a catch-up eligible participant is any of the following:

(i) *Statutory limit*. A statutory limit is a limit on elective deferrals or annual additions permitted to be made (without regard to section 414(v) and this section) with respect to an employee for a year provided in section 401(a)(30), 402(h), 403(b), 408, 415(c), or 457(b)(2) (without regard to section 457(b)(3)), as applicable.

(ii) *Employer-provided limit*. An employer-provided limit is any limit on the elective deferrals an employee is permitted to make (without regard to section 414(v) and this section) that is contained in the terms of the plan, but which is not required under the Internal Revenue Code. Thus, for example, if, in accordance with the terms of the plan, highly compensated employees are limited to a deferral percentage of 10% of compensation, this limit is an employer-provided limit that is an applicable limit with respect to the highly compensated employees.

(iii) *Actual deferral percentage (ADP) limit*. In the case of a section 401(k) plan that would fail the ADP test of section 401(k)(3) if it did not correct under section 401(k)(8), the ADP limit is the highest amount of elective deferrals that can be retained in the plan by any highly compensated employee under the rules of section 401(k)(8)(C) (without regard to paragraph (d)(2)(iii) of this section). In the case of a simplified employee pension (SEP) with a salary reduction arrangement (within the meaning of section 408(k)(6)) that would fail the requirements of section 408(k)(6)(A)(iii) if it did not correct in accordance with section 408(k)(6)(C), the ADP limit is the highest amount of elective deferrals that can be made by any highly compensated employee under the rules of section 408(k)(6) (without regard to paragraph (d)(2)(iii) of this section).

(2) *Contributions in excess of applicable limit*—(i) *Plan year limits*—(A) *General rule*. Except as provided in paragraph (b)(2)(ii) of this section, the amount of elective deferrals in excess of an applicable limit is determined as of the end of the plan year by comparing the total elective deferrals for the plan year with the applicable limit for the plan year. In addition, except as provided in paragraph (b)(2)(i)(B) of this section, in the case of a plan that provides for separate employer-provided limits on elective deferrals for separate portions of plan compensation within the plan year, the applicable limit for the plan year is the sum of the dollar amounts of the limits for the separate portions. For example, if a plan sets a deferral percentage limit for each payroll period, the applicable limit for the plan year is the sum of the dollar amounts of the limits for the payroll periods.

(B) *Alternative method for determining employer-provided limit*—(*1*) *General rule*. If the plan limits elective deferrals for separate portions of the plan year,

then, solely for purposes of determining the amount that is in excess of an employer-provided limit, the plan is permitted to provide that the applicable limit for the plan year is the product of the employee's plan year compensation and the time-weighted average of the deferral percentage limits, rather than determining the employer-provided limit as the sum of the limits for the separate portions of the year. Thus, for example, if, in accordance with the terms of the plan, highly compensated employees are limited to 8% of compensation during the first half of the plan year and 10% of compensation for the second half of the plan year, the plan is permitted to provide that the applicable limit for a highly compensated employee is 9% of the employee's plan year compensation.

(*2*) *Alternative definition of compensation permitted*. A plan using the alternative method in this paragraph (b)(2)(i)(B) is permitted to provide that the applicable limit for the plan year is determined as the product of the catch-up eligible participant's compensation used for purposes of the ADP test and the time-weighted average of the deferral percentage limits. The alternative calculation in this paragraph (b)(2)(i)(B)(*2*) is available regardless of whether the deferral percentage limits change during the plan year.

(ii) *Other year limit*. In the case of an applicable limit that is applied on the basis of a year other than the plan year (*e.g.*, the calendar-year limit on elective deferrals under section 401(a)(30)), the determination of whether elective deferrals are in excess of the applicable limit is made on the basis of such other year.

(c) *Catch-up contribution limit*—(1) *General rule*. Elective deferrals with respect to a catch-up eligible participant in excess of an applicable limit under paragraph (b) of this section are treated as catch-up contributions under this section as of a date within a taxable year only to the extent that such elective deferrals do not exceed the catch-up contribution limit described in paragraphs (c)(1) and (2) of this section, reduced by elective deferrals previously treated as catch-up contributions for the taxable year, determined in accordance with paragraph (c)(3) of this section. The catch-up contribution limit for a taxable year is generally the applicable dollar catch-up limit for such taxable year, as set forth in paragraph (c)(2) of this section. However, an elective deferral is not treated as a catch-up contribution to the extent that the elective deferral, when added to all other elective deferrals for the taxable year under any applicable employer plan of the employer, exceeds the participant's compensation (determined in accordance with section 415(c)(3)) for the taxable year. See also paragraph (f) of this section for special rules for employees who participate in more than one applicable employer plan maintained by the employer.

(2) *Applicable dollar catch-up limit*—(i) *In general*. The applicable dollar catch-up limit for an applicable employer plan, other than a plan described in section 401(k)(11) or 408(p), is determined under the following table:

For Taxable Years Beginning in	Applicable Dollar Catch-up Limit
2002	$1,000
2003	$2,000
2004	$3,000
2005	$4,000
2006	$5,000

(ii) *SIMPLE plans*. The applicable dollar catch-up limit for a SIMPLE 401(k) plan described in section 401(k)(11) or a SIMPLE IRA plan as described in section 408(p) is determined under the following table:

For Taxable Years Beginning in	Applicable Dollar Catch-up Limit
2002	$500
2003	$1,000
2004	$1,500
2005	$2,000
2006	$2,500

(iii) *Cost of living adjustments*. For taxable years beginning after 2006, the applicable dollar catch-up limit is the applicable dollar catch-up limit for 2006 described in paragraph (c)(2)(i) or (ii) of this section increased at the same time and in the same manner as adjustments under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2005, and any increase that is not a multiple of $500 shall be rounded to the next lower multiple of $500.

(3) *Timing rules*. For purposes of determining the maximum amount of permitted catch-up contributions for a catch-up eligible participant, the determination of whether an elective deferral is a catch-up contribution is made as of the last day of

the plan year (or in the case of section 415, as of the last day of the limitation year), except that, with respect to elective deferrals in excess of an applicable limit that is tested on the basis of the taxable year or calendar year (*e.g.*, the section 401(a)(30) limit on elective deferrals), the determination of whether such elective deferrals are treated as catch-up contributions is made at the time they are deferred.

(d) *Treatment of catch-up contributions*—(1) *Contributions not taken into account for certain limits*. Catch-up contributions are not taken into account in applying the limits of section 401(a)(30), 402(h), 403(b), 408, 415(c), or 457(b)(2) (determined without regard to section 457(b)(3)) to other contributions or benefits under an applicable employer plan or any other plan of the employer.

(2) *Contributions not taken into account in application of ADP test*—(i) *Calculation of ADR*. Elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section with respect to a section 401(k) plan because they exceed a statutory or employer-provided limit described in paragraph (b)(1)(i) or (ii) of this section, respectively, are subtracted from the catch-up eligible participant's elective deferrals for the plan year for purposes of determining the actual deferral ratio (ADR) (as defined in regulations under section 401(k)) of a catch-up eligible participant. Similarly, elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section with respect to a SEP because they exceed a statutory or employer-provided limit described in paragraph (b)(1)(i) or (ii) of this section, respectively, are subtracted from the catch-up eligible participant's elective deferrals for the plan year for purposes of determining the deferral percentage under section 408(k)(6)(D) of a catch-up eligible participant.

(ii) *Adjustment of elective deferrals for correction purposes*. For purposes of the correction of excess contributions in accordance with section 401(k)(8)(C), elective deferrals under the plan treated as catch-up contributions for the plan year and not taken into account in the ADP test under paragraph (d)(2)(i) of this section are subtracted from the catch-up eligible participant's elective deferrals under the plan for the plan year.

(iii) *Excess contributions treated as catch-up contributions*. A section 401(k) plan that satisfies the ADP test of section 401(k)(3) through correction under section 401(k)(8) must retain any elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section because they exceed the ADP limit in paragraph (b)(1)(iii) of this section. In addition, a section 401(k) plan is not treated as failing to satisfy section 401(k)(8) merely because elective deferrals described in the preceding sentence are not distributed or recharacterized as employee contributions. Similarly, a SEP is not treated as failing to satisfy section 408(k)(6)(A)(iii) merely because catch-up contributions are not treated as excess contributions with respect to a catch-up eligible participant under the rules of section 408(k)(6)(C). Notwithstanding the fact that elective deferrals described in this paragraph (d)(2)(iii) are not distributed, such elective deferrals are still considered to be excess contributions under section 401(k)(8), and accordingly, matching contributions with respect to such elective deferrals are permitted to be forfeited under the rules of section 411(a)(3)(G).

(3) *Contributions not taken into account for other nondiscrimination purposes*—(i) *Application for top-heavy*. Catch-up contributions with respect to the current plan year are not taken into account for purposes of section 416. However, catch-up contributions for prior years are taken into account for purposes of section 416. Thus, catch-up contributions for prior years are included in the account balances that are used in determining whether the plan is top-heavy under section 416(g).

(ii) *Application for section 410(b)*. Catch-up contributions with respect to the current plan year are not taken into account for purposes of section 410(b). Thus, catch-up contributions are not taken into account in determining the average benefit percentage under §1.410(b)–5 for the year if benefit percentages are determined based on current year contributions. However, catch-up contributions for prior years are taken into account for purposes of section 410(b). Thus, catch-up contributions for prior years would be included in the account balances that are used in determining the average benefit percentage if allocations for prior years are taken into account.

(4) *Availability of catch-up contributions*. An applicable employer plan does not violate §1.401(a)(4)–4 merely because the group of employees for whom catch-up contributions are currently available (*i.e.*, the catch-up eligible participants) is not a group of employees that would satisfy section 410(b) (without regard to §1.410(b)–5). In addition, a catch-up eligible participant is not treated as having a right to a different rate of allocation of matching contributions merely because an otherwise nondiscriminatory schedule of matching rates is applied to elective deferrals that include catch-up contributions. The rules in this paragraph (d)(4) also apply for purposes of satisfying the requirements of section 403(b)(12).

(e) *Universal availability requirement*—(1) *General rule*—(i) *Effective opportunity*. An applicable employer plan that offers catch-up contributions and that is otherwise subject to section 401(a)(4) (including a plan that is subject to section 401(a)(4) pursuant to section 403(b)(12)) will not satisfy the requirements of section 401(a)(4) unless all catch-up eligible participants who participate under any applicable employer plan maintained by the employer are provided with an effective opportunity to make the same dollar amount of catch-up contributions. A plan fails to provide an effective opportunity to make catch-up contributions if it has an applicable limit (*e.g.*, an employer-provided limit) that applies to a catch-up eligible participant and does not permit the participant to make elective deferrals in excess of that limit. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) solely because an employer-provided limit does not apply to all employees or different limits apply to different groups of employees under paragraph (b)(2)(i) of this section. However, a plan may not provide lower employer-provided limits for catch-up eligible participants.

(ii) *Certain practices permitted*—(A) *Proration of limit*. A applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because the plan allows participants to defer an amount equal to a specified percentage of compensation for each payroll period and for each payroll period permits each catch-up eligible participant

to defer a *pro-rata* share of the applicable dollar catch-up limit in addition to that amount.

(B) *Cash availability*. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because it restricts the elective deferrals of any employee (including a catch-up eligible participant) to amounts available after other withholding from the employee's pay (*e.g.*, after deduction of all applicable income and employment taxes). For this purpose, an employer limit of 75% of compensation or higher will be treated as limiting employees to amounts available after other withholdings.

(2) *Certain employees disregarded*. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because employees described in section 410(b)(3) (*e.g.*, collectively bargained employees) are not provided the opportunity to make catch-up contributions.

(3) *Exception for certain plans*. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because another applicable employer plan that is a section 457 eligible governmental plan does not provide for catch-up contributions to the extent set forth in section 414(v)(6)(C) and paragraph (a)(3) of this section.

(4) *Exception for section 410(b)(6)(C)(ii) period*. If an applicable employer plan satisfies the universal availability requirement of this paragraph (e) before an acquisition or disposition described in §1.410(b)–2(f) and would fail to satisfy the universal availability requirement of this paragraph (e) merely because of such event, then the applicable employer plan shall continue to be treated as satisfying this paragraph (e) through the end of the period determined under section 410(b)(6)(C)(ii).

(f) *Special rules for an employer that sponsors multiple plans*—(1) *General rule*. For purposes of paragraph (c) of this section, all applicable employer plans, other than section 457 eligible governmental plans, maintained by the same employer are treated as one plan and all section 457 eligible governmental plans maintained by the same employer are treated as one plan. Thus, the total amount of catch-up contributions under all applicable employer plans of an employer (other than section 457 eligible governmental plans) is limited to the applicable dollar catch-up limit for the taxable year, and the total amount of catch-up contributions for all section 457 eligible governmental plans of an employer is limited to the applicable dollar catch-up limit for the taxable year.

(2) *Coordination of employer-provided limits*. An applicable employer plan is permitted to allow a catch-up eligible participant to defer amounts in excess of an employer-provided limit under that plan without regard to whether elective deferrals made by the participant have been treated as catch-up contributions for the taxable year under another applicable employer plan aggregated with such plan under this paragraph (f). However, to the extent elective deferrals under another plan maintained by the employer have already been treated as catch-up contributions during the taxable year, the elective deferrals under the plan may be treated as catch-up contributions only up to the amount remaining under the catch-up limit for the year. Any other elective deferrals that exceed the employer-provided limit may not be treated as catch-up contributions and must satisfy the otherwise applicable nondiscrimination rules. For example, the right to make contributions in excess of the employer-provided limit is an other right or feature which must satisfy §1.401(a)(4)–4 to the extent that the contributions are not catch-up contributions. Also, contributions in excess of the employer provided limit are taken into account under the ADP test to the extent they are not catch-up contributions.

(3) *Allocation rules*. If a catch-up eligible participant makes additional elective deferrals in excess of an applicable limit under paragraph (b)(1) of this section under more than one applicable employer plan that is aggregated under the rules of this paragraph (f), the applicable employer plan under which elective deferrals in excess of an applicable limit are treated as catch-up contributions is permitted to be determined in any manner that is not inconsistent with the manner in which such amounts were actually deferred under the plan.

(g) *Definitions*—(1) *Applicable employer plan*. The term applicable employer plan means a section 401(k) plan, a SIMPLE IRA plan as defined in section 408(p), a simplified employee pension plan as defined in section 408(k) (SEP), a plan or contract that satisfies the requirements of section 403(b), or a section 457 eligible governmental plan.

(2) *Elective deferral*. The term elective deferral means an elective deferral within the meaning of section 402(g)(3) or any contribution to a section 457 eligible governmental plan.

(3) *Catch-up eligible participant*. An employee is a catch-up eligible participant for a taxable year if—

(i) The employee is eligible to make elective deferrals under an applicable employer plan (without regard to section 414(v) or this section); and

(ii) The employee's 50th or higher birthday would occur before the end of the employee's taxable year.

(4) *Other definitions*. (i) The terms employer, employee, section 401(k) plan, and highly compensated employee have the meanings provided in §1.410(b)–9.

(ii) The term section 457 eligible governmental plan means an eligible deferred compensation plan described in section 457(b) that is established and maintained by an eligible employer described in section 457(e)(1)(A).

(h) *Examples*. The following examples illustrate the application of this section. For purposes of these examples, the limit under section 401(a)(30) is $15,000 and the applicable dollar catch-up limit is $5,000 and, except as specifically provided, the plan year is the calendar year. In addition, it is assumed that the participant's elective deferrals under all plans of the employer do not exceed the participant's section 415(c)(3) compensation, that the taxable year of the participant is the calendar year and that any correction pursuant to section 401(k)(8) is made through distribution of excess contributions. The examples are as follows:

Example 1. (i) Participant A is eligible to make elective deferrals under a section 401(k) plan, Plan P. Plan P does not limit elective deferrals except as necessary to comply with sections 401(a)(30) and 415. In 2006, Participant A is 55 years old. Plan P also provides that a catch-up eligible participant is permitted to defer amounts in excess of the section 401(a)(30) limit up to the applicable dollar catch-up limit for the year. Participant A defers $18,000 during 2006.

(ii) Participant A's elective deferrals in excess of the section 401(a)(30) limit ($3,000) do not exceed the applicable dollar catch-up limit for 2006 ($5,000). Under paragraph (a)(1) of this section, the $3,000 is

a catch-up contribution and, pursuant to paragraph (d)(2)(i) of this section, it is not taken into account in determining Participant A's ADR for purposes of section 401(k)(3).

Example 2. (i) Participants B and C, who are highly compensated employees each earning $120,000, are eligible to make elective deferrals under a section 401(k) plan, Plan Q. Plan Q limits elective deferrals as necessary to comply with section 401(a)(30) and 415, and also provides that no highly compensated employee may make an elective deferral at a rate that exceeds 10% of compensation. However, Plan Q also provides that a catch-up eligible participant is permitted to defer amounts in excess of 10% during the plan year up to the applicable dollar catch-up limit for the year. In 2006, Participants B and C are both 55 years old and, pursuant to the catch-up provision in Plan Q, both elect to defer 10% of compensation plus a *pro-rata* portion of the $5,000 applicable dollar catch-up limit for 2006. Participant B continues this election in effect for the entire year, for a total elective contribution for the year of $17,000. However, in July 2006, after deferring $8,500, Participant C discontinues making elective deferrals.

(ii) Once Participant B's elective deferrals for the year exceed the section 401(a)(30) limit ($15,000), subsequent elective deferrals are treated as catch-up contributions as they are deferred, provided that such elective deferrals do not exceed the catch-up contribution limit for the taxable year. Since the $2,000 in elective deferrals made after Participant B reaches the section 402(g) limit for the calendar year does not exceed the applicable dollar catch-up limit for 2006, the entire $2,000 is treated as a catch-up contribution.

(iii) As of the last day of the plan year, Participant B has exceeded the employer-provided limit of 10% (10% of $120,000 or $12,000 for Participant B) by an additional $3,000. Since the additional $3,000 in elective deferrals does not exceed the $5,000 applicable dollar catch-up limit for 2006, reduced by the $2,000 in elective deferrals previously treated as catch-up contributions, the entire $3,000 of elective deferrals is treated as a catch-up contribution.

(iv) In determining Participant B's ADR, the $5,000 of catch-up contributions are subtracted from Participant B's elective deferrals for the plan year under paragraph (d)(2)(i) of this section. Accordingly, Participant B's ADR is 10% ($12,000 / $120,000). In addition, for purposes of applying the rules of section 401(k)(8), Participant B is treated as having elective deferrals of $12,000.

(v) Participant C's elective deferrals for the year do not exceed an applicable limit for the plan year. Accordingly, Participant C's $8,500 of elective deferrals must be taken into account in determining Participant C's ADR for purposes of section 401(k)(3).

Example 3. (i) The facts are the same as in *Example 2*, except that Plan Q is amended to change the maximum permitted deferral percentage for highly compensated employees to 7%, effective for deferrals after April 1, 2006. Participant B, who has earned $40,000 in the first 3 months of the year and has been deferring at a rate of 10% of compensation plus a *pro-rata* portion of the $5,000 applicable dollar catch-up limit for 2006, reduces the 10% of pay deferral rate to 7% for the remaining 9 months of the year (while continuing to defer a *pro-rata* portion of the $5,000 applicable dollar catch-up limit for 2006). During those 9 months, Participant B earns $80,000. Thus, Participant B's total elective deferrals for the year are $14,600 ($4,000 for the first 3 months of the year plus $5,600 for the last 9 months of the year plus an additional $5,000 throughout the year).

(ii) The employer-provided limit for Participant B for the plan year is $9,600 ($4,000 for the first 3 months of the year, plus $5,600 for the last 9 months of the year). Accordingly, Participant B's elective deferrals for the year that are in excess of the employer-provided limit are $5,000 (the excess of $14,600 over $9,600), which does not exceed the applicable dollar catch-up limit of $5,000.

(iii) Alternatively, Plan Q may provide that the employer-provided limit is determined as the time-weighted average of the different deferral percentage limits over the course of the year. In this case, the time-weighted average limit is 7.75% for all participants, and the applicable limit for Participant B is 7.75% of $120,000, or $9,300. Accordingly, Participant B's elective deferrals for the year that are in excess of the employer-provided limit are $5,300 (the excess of $14,600 over $9,300). Since the amount of Participant B's elective deferrals in excess of the employer-provided limit ($5,300) exceeds the applicable dollar catch-up limit for the taxable year, only $5,000 of Participant B's elective deferrals may be treated as catch-up contributions. In determining Participant B's actual deferral ratio, the $5,000 of catch-up contributions are subtracted from Participant B's elective deferrals for the plan year under paragraph (d)(2)(i) of this section. Accordingly, Participant B's actual deferral ratio is 8% ($9,600 / $120,000). In addition, for purposes of applying the rules of section 401(k)(8), Participant B is treated as having elective deferrals of $9,600.

Example 4. (i) The facts are the same as in *Example 1*. In addition to Participant A, Participant D is a highly compensated employee who is eligible to make elective deferrals under Plan P. During 2006, Participant D, who is 60 years old, elects to defer $14,000.

(ii) The ADP test is run for Plan P (after excluding the $3,000 in catch-up contributions from Participant A's elective deferrals), but Plan P needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(B), the maximum deferrals which may be retained by any highly compensated employee in Plan P is $12,500.

(iii) Pursuant to paragraph (b)(1)(iii) of this section, the ADP limit under Plan P of $12,500 is an applicable limit. Accordingly, $1,500 of Participant D's elective deferrals exceed the applicable limit. Similarly, $2,500 of Participant A's elective deferrals (other than the $3,000 of elective deferrals treated as catch-up contributions because they exceed the section 401(a)(30) limit) exceed the applicable limit.

(iv) The $1,500 of Participant D's elective deferrals that exceed the applicable limit are less than the applicable dollar catch-up limit and are treated as catch-up contributions. Pursuant to paragraph (d)(2)(iii) of this section, Plan P must retain Participant D's $1,500 in elective deferrals and Plan P is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant D.

(v) The $2,500 of Participant A's elective deferrals that exceed the applicable limit are greater than the portion of the applicable dollar catch-up limit ($2,000) that remains after treating the $3,000 of elective deferrals in excess of the section 401(a)(30) limit as catch-up contributions. Accordingly, $2,000 of Participant A's elective deferrals are treated as catch-up contributions. Pursuant to paragraph (d)(2)(iii) of this section, Plan P must retain Participant A's $2,000 in elective deferrals and Plan P is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant A. However, $500 of Participant A's elective deferrals can not be treated as catch-up contributions and must be distributed to Participant A in order to satisfy section 401(k)(8).

Example 5. (i) Participant E is a highly compensated employee who is a catch-up eligible participant under a section 401(k) plan, Plan R, with a plan year ending October 31, 2006. Plan R does not limit elective deferrals except as necessary to comply with section 401(a)(30) and section 415. Plan R permits all catch-up eligible participants to defer an additional amount equal to the applicable dollar catch-up limit for the year ($5,000) in excess of the section 401(a)(30) limit. Participant E did not exceed the section 401(a)(30) limit in 2005 and did not exceed the ADP limit for the plan year ending October 31, 2005. Participant E made $3,200 of deferrals in the period November 1, 2005, through December 31, 2005, and an additional $16,000 of deferrals in the first 10 months of 2006, for a total of $19,200 in elective deferrals for the plan year.

(ii) Once Participant E's elective deferrals for the calendar year 2006 exceed $15,000, subsequent elective deferrals are treated as catch-up contributions at the time they are deferred, provided that such elective deferrals do not exceed the applicable dollar catch-up limit for the taxable year. Since the $1,000 in elective deferrals made after Participant E reaches the section 402(g) limit for the calendar year does not exceed the applicable dollar catch-up limit for 2006, the entire $1,000 is a catch-up contribution. Pursuant to paragraph (d)(2)(i) of this section, $1,000 is subtracted from Participant E's $19,200 in elective deferrals for the plan year ending October 31, 2006, in determining Participant E's ADR for that plan year.

(iii) The ADP test is run for Plan R (after excluding the $1,000 in elective deferrals in excess of the section 401(a)(30) limit), but Plan R needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(C), the maximum deferrals that may be retained by any highly compensated employee under Plan R for the plan year ending October 31, 2006, (the ADP limit) is $14,800.

(iv) Under paragraph (d)(2)(ii) of this section, elective deferrals that exceed the section 401(a)(30) limit under Plan R are also subtracted from Participant E's elective deferrals under Plan R for purposes of applying the rules of section 401(k)(8). Accordingly, for purposes of correcting the failed ADP test, Participant E is treated as having contributed $18,200 of elective deferrals in Plan R. The amount of elective deferrals that would have to be distributed to Participant E in order to satisfy section 401(k)(8)(C) is $3,400 ($18,200 minus $14,800), which is less than the excess of the applicable dollar catch-up limit

($5,000) over the elective deferrals previously treated as catch-up contributions under Plan R for the taxable year ($1,000). Under paragraph (d)(2)(iii) of this section, Plan R must retain Participant E's $3,400 in elective deferrals and is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant E.

(v) Even though Participant E's elective deferrals for the calendar year 2006 have exceeded the section 401(a)(30) limit, Participant E can continue to make elective deferrals during the last 2 months of the calendar year, since Participant E's catch-up contributions for the taxable year are not taken into account in applying the section 401(a)(30) limit for 2006. Thus, Participant E can make an additional contribution of $3,400 ($15,000 minus ($16,000 minus $4,400)) without exceeding the section 401(a)(30) for the calendar year and without regard to any additional catch-up contributions. In addition, Participant E may make additional catch-up contributions of $600 (the $5,000 applicable dollar catch-up limit for 2006, reduced by the $4,400 ($1,000 plus $3,400) of elective deferrals previously treated as catch-up contributions during the taxable year). The $600 of catch-up contributions will not be taken into account in the ADP test for the plan year ending October 31, 2007.

Example 6. (i) The facts are the same as in *Example 5*, except that Participant E exceeded the section 401(a)(30) limit for 2005 by $1,300 prior to October 31, 2005, and made $600 of elective deferrals in the period November 1, 2005, through December 31, 2005 (which were catch-up contributions for 2005). Thus, Participant E made $16,600 of elective deferrals for the plan year ending October 31, 2006.

(ii) Once Participant E's elective deferrals for the calendar year 2006 exceed $15,000, subsequent elective deferrals are treated as catch-up contributions as they are deferred, provided that such elective deferrals do not exceed the applicable dollar catch-up limit for the taxable year. Since the $1,000 in elective deferrals made after Participant E reaches the section 402(g) limit for calendar year 2006 does not exceed the applicable dollar catch-up limit for 2006, the entire $1,000 is a catch-up contribution. Pursuant to paragraph (d)(2)(i) of this section, $1,000 is subtracted from Participant E's elective deferrals in determining Participant E's ADR for the plan year ending October 31, 2006. In addition, the $600 of catch-up contributions from the period November 1, 2005, to December 31, 2005, are subtracted from Participant E's elective deferrals in determining Participant E's ADR. Thus, the total elective deferrals taken into account in determining Participant E's ADR for the plan year ending October 31, 2006, is $15,000 ($16,600 in elective deferrals for the current plan year, less $1,600 in catch-up contributions).

(iii) The ADP test is run for Plan R (after excluding the $1,600 in elective deferrals in excess of the section 401(a)(30) limit), but Plan R needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(C), the maximum deferrals that may be retained by any highly compensated employee under Plan R (the ADP limit) is $14,800.

(iv) Under paragraph (d)(2)(ii) of this section, elective deferrals that exceed the section 401(a)(30) limit under Plan R are also subtracted from Participant E's elective deferrals under Plan R for purposes of applying the rules of section 401(k)(8). Accordingly, for purposes of correcting the failed ADP test, Participant E is treated as having contributed $15,000 of elective deferrals in Plan R. The amount of elective deferrals that would have to be distributed to Participant E in order to satisfy section 401(k)(8)(C) is $200 ($15,000 minus $14,800), which is less than the excess of the applicable dollar catch-up limit ($5,000) over the elective deferrals previously treated as catch-up contributions under Plan R for the taxable year ($1,000). Under paragraph (d)(2)(iii) of this section, Plan R must retain Participant E's $200 in elective deferrals and is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant E.

(v) Even though Participant E's elective deferrals for calendar year 2006 have exceeded the section 401(a)(30) limit, Participant E can continue to make elective deferrals during the last 2 months of the calendar year, since Participant E's catch-up contributions for the taxable year are not taken into account in applying the section 401(a)(30) limit for 2006. Thus Participant E can make an additional contribution of $200 ($15,000 minus ($16,000 minus $1,200)) without exceeding the section 401(a)(30) for the calendar year and without regard to any additional catch-up contributions. In addition, Participant E may make additional catch-up contributions of $3,800 (the $5,000 applicable dollar catch-up limit for 2006, reduced by the $1,200 ($1,000 plus $200) of elective deferrals previously treated as catch-up contributions during the taxable year). The $3,800 of catch-up contributions will not be taken into account in the ADP test for the plan year ending October 31, 2007.

Example 7. (i) Participant F, who is 58 years old, is a highly compensated employee who earns $100,000 per year. Participant F participates in a section 401(k) plan, Plan S, for the first 6 months of the year and then transfers to another section 401(k) plan, Plan T, sponsored by the same employer, for the second 6 months of the year. Plan S limits highly compensated employees' elective deferrals to 6% of compensation for the period of participation, but permits catch-up eligible participants to defer amounts in excess of 6% during the plan year, up to the applicable dollar catch-up limit for the year. Plan T limits highly compensated employees' elective deferrals to 8% of compensation for the period of participation, but permits catch-up eligible participants to defer amounts in excess of 8% during the plan year, up to the applicable dollar catch-up limit for the year. Participant F earned $50,000 in the first 6 months of the year and deferred $6,000 under Plan S. Participant F also deferred $6,500 under Plan T.

(ii) As of the last day of the plan year, Participant F has $3,000 in elective deferrals under Plan S that exceed the employer-provided limit of $3,000. Under Plan T, Participant F has $2,500 in elective deferrals that exceed the employer-provided limit of $4,000. The total amount of elective deferrals in excess of employer-provided limits, $5,500, exceeds the applicable dollar catch-up limit by $500. Accordingly, $500 of the elective deferrals in excess of the employer-provided limits are not catch-up contributions and are treated as regular elective deferrals (and are taken into account in the ADP test). The determination of which elective deferrals in excess of an applicable limit are treated as catch-up contributions is permitted to be made in any manner that is not inconsistent with the manner in which such amounts were actually deferred under Plan S and Plan T.

Example 8. (i) Employer X sponsors Plan P, which provides for matching contributions equal to 50% of elective deferrals that do not exceed 10% of compensation. Elective deferrals for highly compensated employees are limited, on a payroll-by-payroll basis, to 10% of compensation. Employer X pays employees on a monthly basis. Plan P also provides that elective contributions are limited in accordance with section 401(a)(30) and other applicable statutory limits. Plan P also provides for catch-up contributions. Under Plan P, for purposes of calculating the amount to be treated as catch-up contributions (and to be excluded from the ADP test), amounts in excess of the 10% limit for highly compensated employees are determined at the end of the plan year based on compensation used for purposes of ADP testing (testing compensation), a definition of compensation that is different from the definition used under the plan for purposes of calculating elective deferrals and matching contributions during the plan year (deferral compensation).

(ii) Participant A, a highly compensated employee, is a catch-up eligible participant under Plan P with deferral compensation of $10,000 per monthly payroll period. Participant A defers 10% per payroll period for the first 10 months of the year, and is allocated a matching contribution each payroll period of $500. In addition, Participant A defers an additional $4,000 during the first 10 months of the year. Participant A then reduces deferrals during the last 2 months of the year to 5% of compensation. Participant A is allocated a matching contribution of $250 for each of the last 2 months of the plan year. For the plan year, Participant A has $15,000 in elective deferrals and $5,500 in matching contributions.

(iii) A's testing compensation is $118,000. At the end of the plan year, based on 10% of testing compensation, or $11,800, Plan P determines that A has $3,200 in deferrals that exceed the 10% employer provided limit. Plan P excludes $3,200 from ADP testing and calculates A's ADR as $11,800 divided by $118,000, or 10%. Although A has not been allocated a matching contribution equal to 50% of $11,800, because Plan P provides that matching contributions are calculated based on elective deferrals during a payroll period as a percentage of deferral compensation, Plan P is not required to allocate an additional $400 of matching contributions to A.

(i) *Effective date*—(1) *Statutory effective date*. Section 414(v) applies to contributions in taxable years beginning on or after January 1, 2002.

(2) *Regulatory effective date*. Paragraphs (a) through (h) of this section apply to contributions in taxable years beginning on or after January 1, 2004.

Robert E. Wenzel,
Deputy Commissioner for Services and Enforcement.

Approved June 27, 2003.

Pamela F. Olson,
Assistant Secretary (Tax Policy).

(Filed by the Office of the Federal Register on July 7, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 8, 2003, 68 F.R. 40510)

Section 2055.—Transfers for Public, Charitable, and Religious Uses

26 CFR 20.2055–2: Transfers not exclusively for charitable purposes.

T.D. 9068

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

Definition of Guaranteed Annuity and Lead Unitrust Interests

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document amends the income, estate, and gift tax regulations to conform to the Tax Court's decision in *Estate of Boeshore v. Commissioner*, 78 T.C. 523 (1982), *acq. in result*, 1987–2 C.B. 1. In *Estate of Boeshore*, the Tax Court held §20.2055–2(e)(2)(vi)(*e*) of the Estate Tax Regulations invalid to the extent that it disallows a deduction for the value of a charitable unitrust interest if the charitable interest is preceded by a noncharitable interest that is in the form of a unitrust interest. This action is necessary to conform the income, estate, and gift tax regulations to the Tax Court's decision in *Estate of Boeshore*. The effect of these regulations is to allow an income, estate, or gift tax charitable deduction for charitable annuity or unitrust interests that are preceded by a noncharitable unitrust or annuity interest.

DATES: The regulations are effective July 7, 2003.

FOR FURTHER INFORMATION CONTACT: Susan Hurwitz (202) 622–3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

On July 23, 2002, the Treasury Department and the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–115781–01, 2002–2 C.B. 380 [67 FR 48070]) conforming the income, gift, and estate tax regulations to the Tax Court's decision in *Estate of Boeshore v. Commissioner*, 78 T.C. 523 (1982), *acq. in result*, 1987–2 C.B. 1. Specifically, the existing regulations under section 170, 2055, and 2522 governing charitable guaranteed annuity and unitrust interests were proposed to be amended to eliminate the requirement that the charitable interest commence no later than the commencement of a noncharitable interest that is in the form of a guaranteed annuity or unitrust interest. The regulations will continue to require that any amounts payable for a private purpose before the expiration of the charitable annuity or unitrust interest either must be in the form of a guaranteed annuity or unitrust interest or must be payable from a separate group of assets devoted exclusively to private purposes.

No public hearing was requested or held, but one written comment was received. The commentator suggested that any charitable lead interest in a charitable remainder trust should be taken into account along with the remainder interest for purposes of satisfying the 10 percent test contained in sections 664(d)(1)(D) and (d)(2)(D) of the Internal Revenue Code. Among the requirements for a trust to qualify as a charitable remainder trust, sections 664(d)(1)(D) and (d)(2)(D) provide that the present value of the remainder interest must be equal to at least 10 percent of the initial fair market value of all property placed in the trust. Because the statutory requirement is based solely on the value of the remainder interest, it is not possible to take into account any lead interests that pass to charity for purposes of satisfying this requirement. Accordingly, this document adopts final regulations with respect to the notice of proposed rulemaking without any changes.

Effect on Other Documents

The following publication is revoked as of July 7, 2003:

Rev. Rul. 76–225 (1976–1 C.B. 281)

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information requirement on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply.

Drafting Information

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

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.170A–6 is amended as follows:

1. Paragraph (c)(2)(i)(E) is revised and the example following paragraph (c)(2)(i)(E) is removed.

2. Paragraph (c)(2)(ii)(D) is revised.

The revisions read as follows:

§1.170A–6 Charitable contributions in trust.

* * * * *

(c) * * *

(2) * * *

(i) * * *

(E) Where a charitable interest in the form of a guaranteed annuity interest is transferred after May 21, 1972, the charitable interest generally is not a guaranteed annuity interest if any amount may be

paid by the trust for a private purpose before the expiration of all the charitable annuity interests. There are two exceptions to this general rule. First, the charitable interest is a guaranteed annuity interest if the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. Second, the charitable interest is a guaranteed annuity interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(i)(E), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947–1(c) of this chapter for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

* * * * *

(ii) * * *

(D) Where a charitable interest is in the form of a unitrust interest, the charitable interest generally is not a unitrust interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable unitrust interests. There are two exceptions to this general rule. First, the charitable interest is a unitrust interest if the amount payable for a private purpose is in the form of a unitrust interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private unitrust interest as opposed to the charitable unitrust interest. Second, the charitable interest is a unitrust interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(ii)(D), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947–1(c) of this chapter for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

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

Par. 3. The authority citation for part 20 continues to read in part as follows:

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

Par. 4. Section 20.2055–2 is amended as follows:

1. Paragraph (e)(2)(vi)(*f*) is revised.
2. Paragraph (e)(2)(vii)(*e*) is revised.
3. In paragraph (f)(2)(iv), *Example (4)* is removed.

The revisions read as follows:

§20.2055–2 Transfers not exclusively for charitable purposes.

* * * * *

(e) * * *

(2) * * *

(vi) * * *

(*f*) Where a charitable interest in the form of a guaranteed annuity interest is in trust, the charitable interest generally is not a guaranteed annuity interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable annuity interests. There are two exceptions to this general rule. First, the charitable interest is a guaranteed annuity interest if the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. Second, the charitable interest is a guaranteed annuity interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (e)(2)(vi)(*f*), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947–1(c) of this chapter for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

* * * * *

(vii) * * *

(*e*) Where a charitable interest in the form of a unitrust interest is in trust, the charitable interest generally is not a unitrust interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable unitrust interests. There are two exceptions to this general rule. First, the charitable interest is a unitrust interest if the amount payable for a private purpose is in the form of a unitrust interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private unitrust interest as opposed to the charitable unitrust interest. Second, the charitable interest is a unitrust interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (e)(2)(vii)(*e*), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947–1(c) of this chapter for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

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

Par. 5. The authority for part 25 continues to read in part as follows:

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

Par. 6. Section 25.2522(c)–3 is amended as follows:

1. Paragraph (c)(2)(vi)(*f*) is revised.
2. Paragraph (c)(2)(vii)(*e*) is revised.
3. In paragraph (d)(2)(iv), *Example (4)* is removed.

The revisions read as follows:

§25.2522(c)–3 Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

* * * * *

(c) * * *

(2) * * *

(vi) * * *

(*f*) Where a charitable interest in the form of a guaranteed annuity interest is in trust, and the gift of such interest is made

after May 21, 1972, the charitable interest generally is not a guaranteed annuity interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable annuity interests. There are two exceptions to this general rule. First, the charitable interest is a guaranteed annuity interest if the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. Second, the charitable interest is a guaranteed annuity interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(vi)(*f*), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947–1(c) of this chapter for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

* * * * *

(vii) * * *

(*e*) Where a charitable interest in the form of a unitrust interest is in trust, the charitable interest generally is not a unitrust interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable unitrust interests. There are two exceptions to this general rule. First, the charitable interest is a unitrust interest if the amount payable for a private purpose is in the form of a unitrust interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private unitrust interest as opposed to the charitable unitrust interest. Second, the charitable interest is a unitrust interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(vii)(*e*), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947–1(c) of this chapter for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

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Robert E. Wenzel,
Deputy Commissioner for Services and Enforcement.

Approved June 20, 2003.

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

(Filed by the Office of the Federal Register on July 3, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 7, 2003, 68 F.R. 40130)

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross Reference to Temporary Regulations

Depreciation of Vans and Light Trucks

REG–138495–02

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9069) that modify the existing regulations promulgated under section 280F(a) of the Internal Revenue Code relating to limitations on the depreciation allowance for passenger automobiles. The temporary regulations, which amend the definition of passenger automobiles for purposes of section 280F(a), affect certain taxpayers that use vans and light trucks in their trade or business. The text of the temporary regulations also serves as the text of these proposed regulations.

DATES: Written comments and requests for a public hearing must be received by October 6, 2003.

ADDRESSES: Send submissions to: CC:PA:RU (REG–138495–02), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, submissions may be hand delivered Monday though Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (REG–138495–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Comments may also be submitted electronically to the IRS Internet site at *www.irs.gov/regs*.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Bernard P. Harvey, (202) 622–3110; concerning submissions and to request a hearing, LaNita Van Dyke, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Explanation of Provisions

The temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) under section 280F of the Internal Revenue Code of 1986 (Code). The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains these proposed regulations.

Special Analyses

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

Comments and Requests for a Public Hearing

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

Drafting Information

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

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.280F–6 also issued under 26 U.S.C. 280F. * * *

Par. 2. Section 1.280F–6 is amended as follows:

§1.280F–6 Special rules and definitions.

[The text of this proposed section is the same as the text of the amendments to §1.280F–6T published elsewhere in this issue of the Bulletin.]

Robert E. Wenzel,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 3, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 7, 2003, 68 F.R. 40224)

Notice of Proposed Rulemaking and Notice of Public Hearing

Changes in Use Under Section 168(i)(5)

REG–138499–02

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the depreciation of property subject to section 168 of the Internal Revenue Code (MACRS property). Specifically, these proposed regulations provide guidance on how to depreciate MACRS property for which the use changes in the hands of the same taxpayer. The proposed regulations reflect changes to the law made by the Tax Reform Act of 1986. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by October 20, 2003. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for Wednesday, December 3, 2003, at 10 a.m., must be received by November 12, 2003.

ADDRESSES: Send submissions to: CC:PA:RU (REG–138499–02), room 5226, Internal Revenue Service, P. O. Box 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (REG–138499–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at: *www.irs.gov/regs*.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Sara Logan, (202) 622–3110; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Treena Garrett, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 to provide regulations under section 168(i)(5) of the Internal Revenue Code (Code). In addition, these proposed amendments provide change-in-use rules for assets in a general asset account under section 168(i)(4). Sections 168(i)(4) and 168(i)(5) were amended by section 201 of the Tax Reform Act of 1986 (Public Law 99–514, 100 Stat. 2121).

Explanation of Provisions

Scope

The proposed regulations provide the rules for determining the annual depreciation allowance under section 168 for property for which the use changes in the hands of the taxpayer. Changes in use include a conversion of personal use property to a business or income-producing use, a conversion of MACRS property to personal use, or a change in use of MACRS property that results in a different recovery period, depreciation method, or both.

Conversion to Business or Personal Use

The proposed regulations provide that personal use property converted to business or income-producing use is treated as being placed in service by the taxpayer on the date of the conversion. Thus, the property is depreciated by using the applicable depreciation method, recovery period, and convention prescribed under section 168 for the property beginning in the taxable year the change of use ("year of change") occurs. The depreciable basis of the property for the year of change is the lesser of its fair market value or adjusted depreciable basis at the time of the conversion.

A conversion of MACRS property from business or income-producing use to personal use is treated as a disposition of the property. Depreciation for the year of change is computed by taking into account the applicable convention. No gain, loss, or depreciation recapture is recognized upon the conversion. See Rev. Rul. 69–487, 1969–2 C.B. 165.

MACRS Property

Use Changes After Placed-in-service Year

The proposed regulations provide rules for MACRS property if a taxpayer changes the use of the property after the property's placed-in-service year but the property continues to be MACRS property in the hands of the taxpayer.

In general, the proposed regulations provide that a change in the use of MACRS property occurs when the primary use of the MACRS property in the taxable year is different from its primary use in the immediately preceding taxable year. A change in the use of MACRS property also occurs when a taxpayer begins or ceases to use MACRS property predominantly outside the United States, when the property changes to tax-exempt bond financed property, or when the property changes to or from tax-exempt use property or imported property covered by an Executive order, during the taxable year. If a change in the use of MACRS property has occurred, the depreciation allowance for the MACRS property for the year of change is determined as though the change in the use of the MACRS property occurred on the first day of the year of change. The IRS and Treasury Department believe that this rule will help to simplify the computation of depreciation allowances in the year of change and subsequent taxable years. The IRS and Treasury Department invite comments on this rule and on a potential alternative rule that would treat a change in the use of MACRS property as occurring on the first day of the month in which the use changes and would allocate the depreciation allowance for that MACRS property for the year of change based on the number of full months of the old use and of the new use of the MACRS property during the year of change.

The proposed regulations also provide rules for determining the applicable depreciation method, recovery period, and convention used to determine the depreciation allowances for the MACRS property for the year of change and subsequent taxable years. If a change in the use of MACRS property results in a shorter recovery period and/or a more accelerated depreciation method (for example, MACRS property ceases to be used predominantly outside the United States), the adjusted depreciable basis of the property as of the beginning of the year of change is depreciated over the shorter recovery period and/or by the more accelerated depreciation method beginning with the year of change as though the MACRS property is first placed in service in the year of change. Under certain circumstances, this rule may adversely affect taxpayers. For example, under this rule, if a change in the use of

MACRS property results in a shorter recovery period, a taxpayer must depreciate that MACRS property over the new shorter recovery period even if the remaining portion of the original longer recovery period is less than the new shorter recovery period. To avoid this adverse effect, the proposed regulations allow a taxpayer to elect to continue to depreciate the MACRS property for which the new recovery period is shorter or a more accelerated method is allowed as though the change in use had not occurred.

If a change in the use of MACRS property results in a longer recovery period and/or slower depreciation method (for example, MACRS property begins to be used predominantly outside the United States), the adjusted depreciable basis of the property is depreciated over the longer recovery period and/or by the slower depreciation method beginning with the year of change as though the taxpayer originally placed the MACRS property in service with the longer recovery period and/or slower depreciation method. Accordingly, the adjusted depreciable basis of the MACRS property as of the beginning of the year of change is depreciated over the remaining portion of the new, longer recovery period as of the beginning of the year of change.

For MACRS property depreciated under the optional depreciation tables in Rev. Proc. 87–57, 1987–2 C.B. 687, before the change in use, the taxpayer may continue to depreciate the property under the tables after the change in use. However, the taxpayer is not required to do so. If the taxpayer desires to use the optional depreciation tables after a change in the use instead of the formulas (for example, see section 6 of Rev. Proc. 87–57, 1987–2 C. B. at 692), the proposed regulations provide guidance on choosing the applicable optional depreciation table. If the change in use results in a longer recovery period and/or a slower depreciation method, the proposed regulations also provide guidance on how to modify the calculation involved to compute the depreciation allowances beginning in the year of change.

If a change in the use of MACRS property results in a shorter recovery period and/or more accelerated depreciation method, the taxpayer may use the optional depreciation table that corresponds to the applicable depreciation method, recovery period, and convention, determined as though the property is placed in service in the year of change. Taxpayers should be aware that using this table will result in less depreciation than using the formulas, because the convention is factored into the optional depreciation tables, and taken into account in determining depreciation in the year of change. However, if the formulas are used, the convention is not taken into account in the year of change. The IRS and Treasury Department invite comments on this matter.

Use Changes During Placed-in-service Year

The proposed regulations provide rules for MACRS property if a change in the use occurs during the taxable year the property is placed-in-service and the property continues to be MACRS property in the hands of the taxpayer. If the use of MACRS property changes during its placed-in-service year, the depreciation allowance generally is determined by the primary use of the property during that taxable year. However, in determining whether MACRS property is used within or outside the United States during the placed-in-service year, the predominant use, instead of the primary use, of the MACRS property governs. Further, in determining whether MACRS property is tax-exempt use property or imported property covered by an Executive order during the placed-in-service year, the use of the property at the end of the placed-in-service year governs. Moreover, MACRS property is tax-exempt bond financed property during the placed-in-service year if a tax-exempt bond for the MACRS property is issued during that year.

General Asset Accounts

Finally, the proposed regulations amend the final regulations under section 168(i)(4) (T.D. 8566, 1994–2 C.B. 20 [59 FR 51369]) for property accounted for in a general asset account for which the use changes, resulting in a different recovery period and/or depreciation method. While this change in use does not cause or permit the revocation of the election to account for the property in a general asset account, the property generally is removed from its existing general asset account and placed in a separate general asset account. Because this rule would require taxpayers to track each property in a general asset account, the IRS and Treasury Department request comments on whether the IRS and Treasury should adopt a rule that disregards any change in the use of any MACRS property accounted for in a general asset account, except for a conversion to personal use.

Proposed Effective Date

These regulations are proposed to be applicable for any changes in the use of MACRS property in taxable years ending on or after the date of publication of the final regulations in the **Federal Register**. For any changes in use of MACRS property after December 31, 1986, in taxable years ending before the date of publication of the final regulations in the **Federal Register**, the IRS will allow any reasonable method of depreciating the property under section 168 in the year of change and the subsequent taxable years that is consistently applied to the MACRS property that changed use in the hands of the taxpayer.

Special Analyses

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

Comments and Public Hearing

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

rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for December 3, 2003, beginning at 10:00 a.m., in room number 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by November 12, 2003. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

§1.168(i)–1 also issued under 26 U.S.C. 168(i)(4).

§1.168(i)–4 also issued under 26 U.S.C. 168(i)(5).

Par. 2. Sections 1.168(a)–1 and 1.168(b)–1 are added to read as follows:

§1.168(a)–1 Modified accelerated cost recovery system.

Section 168 determines the depreciation allowance for tangible property that is of a character subject to the allowance for depreciation provided in section 167(a) and that is placed in service after December 31, 1986 (or after July 31, 1986, if the taxpayer made an election under section 203(a)(1)(B) of the Tax Reform Act of 1986; 100 Stat. 2143). Except for property excluded from the application of section 168 as a result of section 168(f) or as a result of a transitional rule, the provisions of section 168 are mandatory for all eligible property. The allowance for depreciation under section 168 constitutes the amount of depreciation allowable under section 167(a). The determination of whether tangible property is property of a character subject to the allowance for depreciation is made under section 167 and the regulations thereunder. This section is effective as of the date of publication of the final regulations in the **Federal Register**.

§1.168(b)–1 Definitions.

(a) *Definitions*. For purposes of section 168 and the regulations thereunder, the following definitions apply:

(1) *Depreciable property* is property that is of a character subject to the allowance for depreciation as determined under section 167 and the regulations thereunder.

(2) *MACRS property* is tangible, depreciable property that is placed in service after December 31, 1986 (or after July 31, 1986, if the taxpayer made an election under section 203(a)(1)(B) of the Tax Reform Act of 1986; 100 Stat. 2143), and subject to section 168, except for property excluded from the application of section 168 as a result of section 168(f) or as a result of a transitional rule.

(3) *Unadjusted depreciable basis* is the basis of property for purposes of section 1011 without regard to any adjustments described in section 1016(a)(2) and (3). This basis reflects the reduction in basis for the percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income), for any portion of the basis the taxpayer properly elects to treat as an expense under section 179, and for any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations thereunder (other than section 1016(a)(2) and (3)) (for example, a reduction in basis by the amount of the disabled access credit pursuant to section 44(d)(7)). For property subject to a lease, see section 167(c)(2).

(4) *Adjusted depreciable basis* is the unadjusted depreciable basis of the property less the adjustments described in section 1016(a)(2) and (3).

(b) *Effective date*. This section applies as of the date of publication of the final regulations in the **Federal Register**.

Par. 3. Section 1.168(i)–0 is amended by revising the entry for §1.168(i)–1(h)(2) to read as follows:

§1.168(i)–0 Table of contents for the general asset account rules.

* * * * *

§1.168(i)–1

(h) * * *

(2) Change in use results in a different recovery period and/or depreciation method.

* * * * *

Par. 4. Section 1.168(i)–1 is amended by:

1. Revising paragraph (b)(1).

2. Amending paragraph (c)(2)(ii) by:

a. Removing the language "and" from the end of paragraph (c)(2)(ii)(C).

b. Removing the period "." from the end of paragraph (c)(2)(ii)(D) and adding "; and" in its place.

c. Adding paragraph (c)(2)(ii)(E).

3. Removing the language "(h)(1) (conversion to personal use)" from paragraphs (d)(2) and (i) and adding "(h) (changes in use)" in its place.

4. Removing the language "the change in use occurs and" from the last sentence of paragraph (h)(1) and adding "the change in use occurs (the year of change) and" in its place.

5. Revising paragraph (h)(2).

6. Removing the language "(h)(1)" from paragraph (j) and adding "(h)" in its place.

7. Removing the language "(h)(1)" from paragraph (k)(1) and adding "(h)" in its place.

8. Revising paragraph (l).

The addition and revisions read as follows:

§1.168(i)–1 General asset accounts.

* * * * *

(b) * * *

(1) *Unadjusted depreciable basis* is the basis of an asset for purposes of section 1011 without regard to any adjustments described in section 1016(a)(2) and (3). This basis reflects the reduction in basis for the percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income), for any portion of the basis the taxpayer properly elects to treat as an expense under section 179, and for any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations thereunder (other than section 1016(a)(2) and (3)) (for example, a reduction in basis by the amount of the disabled access credit pursuant to section 44(d)(7)). For property subject to a lease, see section 167(c)(2).

* * * * *

(c) * * *

(2) * * *

(ii) * * *

(E) Assets subject to paragraph (h)(2)(iii)(A) of this section (change in use results in a shorter recovery period and/or a more accelerated depreciation method) for which the depreciation allowance for the year of change is not determined by using an optional depreciation table must be grouped into a separate general asset account.

* * * * *

(h) * * *

(2) *Change in use results in a different recovery period and/or depreciation method*—(i) *No effect on general asset account election*. A change in the use described in §1.168(i)–4(d) (change in use results in a different recovery period and/or depreciation method) of an asset in a general asset account shall not cause or permit the revocation of the election made under this section.

(ii) *Asset is removed from the general asset account*. Upon a change in the use described in §1.168(i)–4(d), the taxpayer must remove the asset from the general asset account as of the first day of the year of change and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(*C*)(*2*) through (4) of this section. If, however, the result of the change in use is described in §1.168(i)–4(d)(3) (change in use results in a shorter recovery period and/or a more accelerated depreciation method) and the taxpayer elects to treat the asset as though the change in use had not occurred pursuant to §1.168(i)–4(d)(3)(ii), no adjustment is made to the general asset account upon the change in use.

(iii) *New general asset account is established*—(A) *Change in use results in a shorter recovery period and/or a more accelerated depreciation method*. If the result of the change in use is described in §1.168(i)–4(d)(3) (change in use results in a shorter recovery period and/or a more accelerated depreciation method) and adjustments to the general asset account are made pursuant to paragraph (h)(2)(ii) of this section, the taxpayer must establish a new general asset account for the asset in the year of change in accordance with the rules in paragraph (c) of this section, except that the adjusted depreciable basis of the asset as of the first day of the year of change is included in the general asset account. For purposes of paragraph (c)(2) of this section, the applicable depreciation method, recovery period, and convention are determined under §1.168(i)–4(d)(3)(i).

(B) *Change in use results in a longer recovery period and/or a slower depreciation method*. If the result of the change in use is described in §1.168(i)–4(d)(4) (change in use results in a longer recovery period and/or a slower depreciation method), the taxpayer must establish a separate general asset account for the asset in the year of change in accordance with the rules in paragraph (c) of this section, except that the unadjusted depreciable basis of the asset, and the greater of the depreciation of the asset allowed or allowable in accordance with section 1016(a)(2), as of the first day of the year of change are included in the newly established general asset account. Consequently, this general asset account as of the first day of the year of change will have a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the general asset account. For purposes of paragraph (c)(2) of this section, the applicable depreciation method, recovery period, and convention are determined under §1.168(i)–4(d)(4)(ii).

* * * * *

(l) *Effective date*—(1) *In general*. Except as provided in paragraph (l)(2) of this section, this section applies to depreciable assets placed in service in taxable years ending on or after October 11, 1994. For depreciable assets placed in service after December 31, 1986, in taxable years ending before October 11, 1994, the Internal Revenue Service will allow any reasonable method that is consistently applied to the taxpayer's general asset accounts.

(2) *Exceptions*—(i) *In general*. Paragraphs (c)(2)(ii)(E) and (h)(2) of this section apply to any changes in the use of depreciable assets pursuant to §1.168(i)–4(d) in taxable years ending on or after the date of publication of the final regulations in the **Federal Register**. For any changes in the use of depreciable assets as described in §1.168(i)–4(d) after December 31, 1986, in taxable years ending before the date of publication of the final regulations in the **Federal Register**, the Internal Revenue Service will allow any reasonable method that is consistently applied to the taxpayer's general asset accounts.

(ii) *Change in method of accounting*. If a taxpayer adopted a method of accounting for general asset account treatment due to a change in the use of depreciable assets and the method is not in accordance with the method of accounting provided in paragraphs (c)(2)(ii)(E) and (h)(2) of this section, a change to the method of accounting provided in paragraphs (c)(2)(ii)(E) and (h)(2) of this section is a change in method of accounting to which the provisions of sections 446(e) and 481 apply. For any taxable year ending on or after the date of publication of the final regulations in the **Federal Register**, a taxpayer changing its method of accounting in accordance with this paragraph (l)(2)(ii) must follow the applicable administrative procedures issued under §1.446–1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, for example, see Rev. Proc. 2002–9, 2002–1 C.B. 327, and §601.601(d)(2)(ii)(*b*) of this chapter). Because this change does not change the

adjusted depreciable basis of the asset, the method change is made on a cut-off basis and, therefore, no adjustment under section 481(a) is required or allowed.

* * * * *

Par. 5. Section 1.168(i)–4 is added to read as follows:

§1.168(i)–4 Changes in use.

(a) *Scope*. This section provides the rules for determining the depreciation allowance for MACRS property for which the use changes in the hands of the same taxpayer. The allowance for depreciation under this section constitutes the amount of depreciation allowable under section 167(a) for the year of change and any subsequent taxable year. For purposes of this section, the year of change is the taxable year in which a change in the use occurs.

(b) *Conversion to business or income-producing use*—(1) *Depreciation deduction allowable*. This paragraph (b) applies to property that is converted from personal use to use in a taxpayer's trade or business, or for the production of income, during a taxable year. This conversion includes property that was previously used by the taxpayer for personal purposes, including real property (other than land) that is acquired before 1987 and converted from personal use to business or income-producing use after 1986, and depreciable property that was previously used by a tax-exempt entity before it changed to a taxable entity. Upon a conversion to business or income-producing use, the depreciation allowance for the year of change and any subsequent taxable year is determined as though the property is placed in service by the taxpayer on the date on which the conversion occurs. Thus, the taxpayer may choose any applicable depreciation method, recovery period, and convention prescribed under section 168 for the property in the year of change, consistent with any election made under section 168 by the taxpayer for that year (see, for example, section 168(b)(5)). The depreciable basis of the property for the year of change is the lesser of its fair market value or its adjusted depreciable basis, as applicable, at the time of the conversion to business or income-producing use.

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

Example. *A*, a calendar-year taxpayer, purchases a house in 1985 that she occupies as her principal residence. In February 2003, *A* ceases to occupy the house and converts it to residential rental property. At the time of the conversion to residential rental property, the house's fair market value (excluding land) is $130,000 and adjusted depreciable basis attributable to the house (excluding land) is $150,000. Pursuant to this paragraph (b), *A* is considered to have placed in service residential rental property in February 2003 with a depreciable basis of $130,000. *A* depreciates the residential rental property under the general depreciation system by using the straight-line method, a 27.5-year recovery period, and the mid-month convention. This property is not eligible for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). Thus, the depreciation allowance for the house for 2003 is $4,137, after taking into account the mid-month convention (($130,000 adjusted depreciable basis multiplied by the applicable depreciation rate of 3.636% (1/27.5)) multiplied by the mid-month convention fraction of 10.5/12). The amount of depreciation computed under section 168, however, may be limited under other provisions of the Internal Revenue Code, such as, section 280A.

(c) *Conversion to personal use*. The conversion of MACRS property from business or income-producing use to personal use during a taxable year is treated as a disposition of the property in that taxable year. The depreciation allowance for MACRS property for the year of change in which the property is treated as being disposed of is determined by first multiplying the adjusted depreciable basis of the property as of the first day of the year of change by the applicable depreciation rate for that taxable year (for further guidance, for example, see section 6 of Rev. Proc. 87–57, 1987–2 C. B. 687, 692, and §601.601(d)(2)(ii)(*b*) of this chapter). This amount is then multiplied by a fraction, the numerator of which is the number of months (including fractions of months) the property is deemed to be placed in service during the year of change (taking into account the applicable convention) and the denominator of which is 12. No depreciation deduction is allowable for MACRS property placed in service and disposed of in the same taxable year. Upon the conversion to personal use, no gain, loss, or depreciation recapture under section 1245 or section 1250 is recognized. However, the provisions of section 1245 or section 1250 apply to any disposition of the converted property by the taxpayer at a later date.

(d) *Change in use results in a different recovery period and/or depreciation method*—(1) *In general*. This paragraph (d) applies to a change in the use of MACRS property during a taxable year subsequent to the placed-in-service year, if the property continues to be MACRS property owned by the same taxpayer and, as a result of the change in use, has a different recovery period, a different depreciation method, or both. For example, this paragraph (d) applies to MACRS property that—

(i) Begins or ceases to be used predominantly outside the United States;

(ii) Results in a reclassification of the property under section 168(e) due to a change in the use of the property; or

(iii) Begins or ceases to be tax-exempt use property (as defined in section 168(h)).

(2) *Determination of change in use*—(i) *In general*. Except as provided in paragraph (d)(2)(ii) of this section, a change in the use of MACRS property occurs when the primary use of the MACRS property in the taxable year is different from its primary use in the immediately preceding taxable year. The primary use of MACRS property may be determined in any reasonable manner that is consistently applied to the taxpayer's MACRS property.

(ii) *Alternative depreciation system property*—(A) *Property used within or outside the United States*. A change in the use of MACRS property occurs when a taxpayer begins or ceases to use MACRS property predominantly outside the United States during the taxable year. The determination of whether MACRS property is used predominantly outside the United States is made in accordance with the test in §1.48–1(g)(1)(i) for determining predominant use.

(B) *Tax-exempt bond financed property*. A change in the use of MACRS property occurs when the property changes to tax-exempt bond financed property, as described in section 168(g)(1)(C) and (g)(5), during the taxable year. For purposes of this paragraph (d), MACRS property changes to tax-exempt bond financed property when a tax-exempt bond is first issued after the MACRS property is placed in service. MACRS property continues to be tax-exempt bond financed property in the hands of the taxpayer even if the tax-exempt bond (including any refunding issue) is no longer outstanding or is redeemed.

(C) *Other mandatory alternative depreciation system property*. A change in

the use of MACRS property occurs when the property changes to, or changes from, property described in section 168(g)(1)(B) (tax-exempt use property) or (D) (imported property covered by an Executive order) during the taxable year.

(iii) *Change in use deemed to occur on first day of year*. If a change in the use of MACRS property occurs under this paragraph (d)(2), the depreciation allowance for that MACRS property for the year of change is determined as though the use of the MACRS property changed on the first day of the year of change.

(3) *Change in use results in a shorter recovery period and/or a more accelerated depreciation method*—(i) *Treated as placed in service in year of change*—(A) *In general*. If the change in use results in the MACRS property changing to a shorter recovery period and/or a depreciation method that is more accelerated than the method used for the MACRS property before the change in use, the depreciation allowances beginning in the year of change are determined as though the MACRS property is placed in service by the taxpayer in the year of the change in use.

(B) *Computation of depreciation allowance*. The depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined by multiplying the adjusted depreciable basis of the MACRS property as of the first day of each taxable year by the applicable depreciation rate for each taxable year. In determining the applicable depreciation rate for the year of change and subsequent taxable years, the taxpayer may choose any applicable depreciation method and recovery period prescribed under section 168 for the MACRS property in the year of change, consistent with any election made under section 168 by the taxpayer for that year (see, for example, section 168(b)(5)). If there is a change in the use of MACRS property, the applicable convention that applies to the MACRS property is the same as the convention that applied before the change in the use of the MACRS property. However, the depreciation allowance for the year of change for the MACRS property is determined without applying the applicable convention, unless the MACRS property is disposed of during the year of change. See paragraph (d)(5) of this section for the rules relating to the computation of the depreciation allowance under the optional depreciation tables. If the year of change or any subsequent taxable year is less than 12 months, the depreciation allowance determined under this paragraph (d)(3)(i) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15, 1989–1 C.B. 816, and §601.601(d)(2)(ii)(*b*) of this chapter).

(C) *Special rules*. MACRS property affected by this paragraph (d)(3)(i) is not eligible in the year of change for the election provided under section 168(f)(1), 179, or 1400L(f), or for the additional first-year depreciation deduction provided in section 168(k) or 1400L(b). For purposes of determining whether the mid-quarter convention applies to other MACRS property placed in service during the year of change, the unadjusted depreciable basis or the adjusted depreciable basis of MACRS property affected by this paragraph (d)(3)(i) is not taken into account.

(ii) *Option to disregard change in use*. In lieu of applying paragraph (d)(3)(i) of this section, the taxpayer may elect to determine the depreciation allowance as though the change in use had not occurred. The taxpayer elects this option by claiming on the taxpayer's timely filed (including extensions) income tax return for the year of change the depreciation allowance for the property as though the change in use had not occurred. See paragraph (g)(2) of this section for the manner for revoking this election.

(4) *Change in use results in a longer recovery period and/or a slower depreciation method*—(i) *Treated as originally placed in service with longer recovery period and/or slower depreciation method*. If the change in use results in a longer recovery period and/or a depreciation method for the MACRS property that is less accelerated than the method used for the MACRS property before the change in use, the depreciation allowances beginning with the year of change are determined as though the MACRS property had been originally placed in service by the taxpayer with the longer recovery period and/or the slower depreciation method.

(ii) *Computation of the depreciation allowance*. The depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined by multiplying the adjusted depreciable basis of the MACRS property as of the first day of each taxable year by the applicable depreciation rate for each taxable year. If there is a change in the use of MACRS property, the applicable convention that applies to the MACRS property is the same as the convention that applied before the change in the use of the MACRS property. If the year of change or any subsequent taxable year is less than 12 months, the depreciation allowance determined under this paragraph (d)(4)(ii) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15, 1989–1 C.B. 816, and §601.601(d)(2)(ii)(*b*) of this chapter). See paragraph (d)(5) of this section for the rules relating to the computation of the depreciation allowance under the optional depreciation tables. In determining the applicable depreciation rate for the year of change and any subsequent taxable year—

(A) The applicable depreciation method is the depreciation method that would apply in the year of change and any subsequent taxable year for the MACRS property had the taxpayer used the longer recovery period and/or the slower depreciation method in the placed-in-service year of the property. If the 200- or 150-percent declining balance method would have applied in the placed-in-service year but the method would have switched to the straight line method in the year of change or any prior taxable year, the applicable depreciation method beginning with the year of change is the straight line method; and

(B) The applicable recovery period is either—

(*1*) The longer recovery period resulting from the change in use if the applicable depreciation method is the 200- or 150-percent declining balance method (as determined under paragraph (d)(4)(ii)(A) of this section) unless the recovery period did not change as a result of the change in use, in which case the applicable recovery period is the same recovery period that applied before the change in use; or

(*2*) The number of years remaining as of the beginning of each taxable year (taking into account the applicable convention) had the taxpayer used the longer recovery period in the placed-in-service year of the property if the applicable depreciation

method is the straight line method (as determined under paragraph (d)(4)(ii)(A) of this section) unless the recovery period did not change as a result of the change in use, in which case the applicable recovery period is the number of years remaining as of the beginning of each taxable year (taking into account the applicable convention) based on the recovery period that applied before the change in use.

(5) *Using optional depreciation tables*—(i) *Taxpayer not bound by prior use of table*. If a taxpayer used an optional depreciation table for the MACRS property before a change in the use, the taxpayer is not bound to use the appropriate new table for that MACRS property after the change in use (for further guidance, for example, see section 8 of Rev. Proc. 87–57, 1987–2 C.B. 687, 693, and §601.601(d)(2)(ii)(*b*) of this chapter). If the taxpayer chooses not to continue to use the optional depreciation table, the depreciation allowances for the MACRS property beginning in the year of change are determined under paragraph (d)(3)(i) or (4) of this section, as applicable.

(ii) *Taxpayer chooses to use optional depreciation table after change in use*. If the taxpayer chooses to continue to use an optional depreciation table for the MACRS property after a change in the use, the depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined as follows:

(A) *Change in use results in a shorter recovery period and/or a more accelerated depreciation method*. If the change in use results in a shorter recovery period and/or a more accelerated depreciation method (as described in paragraph (d)(3)(i) of this section), the depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined by multiplying the adjusted depreciable basis of the MACRS property as of the first day of the year of change by the annual depreciation rate for each recovery year (expressed as a decimal equivalent) specified in the appropriate optional depreciation table. The appropriate optional depreciation table for the MACRS property is based on the depreciation system, depreciation method, recovery period, and convention applicable to the MACRS property in the year of change as determined under paragraph (d)(3)(i) of this section. The depreciation allowance for the year of change for the MACRS property is determined by taking into account the applicable convention (which is already factored into the optional depreciation tables). If the year of change or any subsequent taxable year is less than 12 months, the depreciation allowance determined under this paragraph (d)(5)(ii)(A) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15, 1989–1 C.B. 816, and §601.601(d)(2)(ii)(*b*) of this chapter).

(B) *Change in use results in a longer recovery period and/or a slower depreciation method*—(*1*) *Determination of the appropriate optional depreciation table*. If the change in use results in a longer recovery period and/or a slower depreciation method (as described in paragraph (d)(4)(i) of this section), the depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined by choosing the optional depreciation table that corresponds to the depreciation system, depreciation method, recovery period, and convention that would have applied to the MACRS property in the placed-in-service year had that property been originally placed in service by the taxpayer with the longer recovery period and/or the slower depreciation method. If there is a change in the use of MACRS property, the applicable convention that applies to the MACRS property is the same as the convention that applied before the change in the use of the MACRS property. If the year of change or any subsequent taxable year is less than 12 months, the depreciation allowance determined under this paragraph (d)(5)(ii)(B) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15, 1989–1 C.B. 816, and §601.601(d)(2)(ii)(*b*) of this chapter).

(*2*) *Computation of the depreciation allowance*. The depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are computed by first determining the appropriate recovery year in the table identified under paragraph (d)(5)(ii)(B)(*1*) of this section. The appropriate recovery year for the year of change is the year that corresponds to the year of change. For example, if the recovery year for the year of change would have been Year 4 in the table that applied before the change in the use of the MACRS property, then the recovery year for the year of change is Year 4 in the table identified under paragraph (d)(5)(ii)(B)(*1*) of this section. Next, the annual depreciation rate (expressed as a decimal equivalent) for each recovery year is multiplied by a transaction coefficient. The transaction coefficient is the formula (1 / (1 – x)) where x equals the sum of the annual depreciation rates from the table identified under paragraph (d)(5)(ii)(B)(*1*) of this section (expressed as a decimal equivalent) for the taxable years beginning with the placed-in-service year of the MACRS property through the taxable year immediately prior to the year of change. The product of the annual depreciation rate and the transaction coefficient is multiplied by the adjusted depreciable basis of the MACRS property as of the beginning of the year of change.

(6) *Examples*. The application of this paragraph (d) is illustrated by the following examples:

Example 1. Change in use results in a shorter recovery period and/or a more accelerated depreciation method and optional depreciation table is not used—(i) *X*, a calendar-year corporation, places in service in 1998 equipment at a cost of $100,000 and uses this equipment from 1998 through 2002 primarily in its *A* business. *X* depreciates the equipment for 1998 through 2002 under the general depreciation system as 7-year property by using the 200-percent declining balance method (which switched to the straight-line method in 2002), a 7-year recovery period, and a half-year convention. Beginning in 2003, *X* primarily uses the equipment in its *B* business. As a result, the classification of the equipment under section 168(e) changes from 7-year property to 5-year property and the recovery period of the equipment under the general depreciation system changes from 7 years to 5 years. The depreciation method does not change. On January 1, 2003, the adjusted depreciable basis of the equipment is $22,311. *X* depreciates its 5-year recovery property placed in service in 2003 under the general depreciation system by using the 200-percent declining balance method and a 5-year recovery period. *X* does not use the optional depreciation tables.

(ii) Under paragraph (d)(3)(i) of this section, *X*'s allowable depreciation deduction for the equipment for 2003 and subsequent taxable years is determined as though *X* placed the equipment in service in 2003 for use primarily in its *B* business. The depreciable basis of the equipment as of January 1, 2003, is $22,311 (the adjusted depreciable basis at January 1, 2003). Because *X* does not use the optional depreciation tables, the depreciation allowance for 2003 (the deemed placed-in-service year) for this equipment only is computed without taking into account

the half-year convention. This equipment is not eligible for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). Thus, *X*'s allowable depreciation deduction for the equipment for 2003 is $8,924 ($22,311 adjusted depreciable basis at January 1, 2003, multiplied by the applicable depreciation rate of 40% (200/5)). *X*'s allowable depreciation deduction for the equipment for 2004 is $5,355 ($13,387 adjusted depreciable basis at January 1, 2004, multiplied by the applicable depreciation rate of 40% (200/5)).

(iii) Alternatively, under paragraph (d)(3)(ii) of this section, *X* may elect to disregard the change in use and, as a result, may continue to treat the equipment as though it is used primarily in its *A* business. If the election is made, *X*'s allowable depreciation deduction for the equipment for 2003 is $8,924 ($22,311 adjusted depreciable basis at January 1, 2003, multiplied by the applicable depreciation rate of 40% (1/2.5 years remaining at January 1, 2003)). *X*'s allowable depreciation deduction for the equipment for 2004 is $8,925 ($13,387 adjusted depreciable basis at January 1, 2004, multiplied by the applicable depreciation rate of 66.67% (1/1.5 years remaining at January 1, 2004)).

Example 2. Change in use results in a shorter recovery period and/or a more accelerated depreciation method and optional depreciation table is used—(i) Same facts as in *Example 1*, except that *X* used the optional depreciation tables for computing depreciation for 1998 through 2002. Pursuant to paragraph (d)(5) of this section, *X* chooses to continue to use the optional depreciation table for the equipment. *X* does not make the election provided in paragraph (d)(3)(ii) of this section to disregard the change in use.

(ii) In accordance with paragraph (d)(5)(ii)(A) of this section, *X* must first identify the appropriate optional depreciation table for the equipment. This table is table 1 in Rev. Proc. 87–57 because the equipment will be depreciated in the year of change (2003) under the general depreciation system using the 200-percent declining balance method, a 5-year recovery period, and the half-year convention (which is the convention that applied to the equipment in 1998). This equipment is not eligible for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). For 2003, *X* multiplies its adjusted depreciable basis in the equipment as of January 1, 2003, of $22,311, by the annual depreciation rate in table 1 for recovery year 1 for a 5-year recovery period (.20), to determine the depreciation allowance of $4,462. For 2004, *X* multiplies its adjusted depreciable basis in the equipment as of January 1, 2003, of $22,311, by the annual depreciation rate in table 1 for recovery year 2 for a 5-year recovery period (.32), to determine the depreciation allowance of $7,140.

Example 3. Change in use results in a longer recovery period and/or a slower depreciation method—(i) *Y*, a calendar-year corporation, places in service in January 2001, equipment at a cost of $100,000 and uses this equipment in 2001 and 2002 only within the United States. *Y* depreciates the equipment for 2001 and 2002 under the general depreciation system by using the 200-percent declining balance method, a 5-year recovery period, and a half-year convention. Beginning in 2003, *Y* uses the equipment predominantly outside the United States. As a result of this change in use, the equipment is subject to the alternative depreciation system beginning in 2003. Under the alternative depreciation system, the equipment is depreciated by using the straight-line method and a 9-year recovery period. The adjusted depreciable basis of the equipment at January 1, 2003, is $48,000.

(ii) Pursuant to paragraph (d)(4) of this section, *Y*'s allowable depreciation deduction for 2003 and subsequent taxable years is determined as though the equipment had been placed in service in January 2001, as property used predominantly outside the United States. In determining the applicable depreciation rate for 2003, the applicable depreciation method is the straight-line method and the applicable recovery period is 7.5 years, which is the number of years remaining at January 1, 2003, for property placed in service in 2001 with a 9-year recovery period (taking into account the half-year convention). Thus, the depreciation allowance for 2003 is $6,398 ($48,000 adjusted depreciable basis at January 1, 2003, multiplied by the applicable depreciation rate of 13.33% (1/7.5 years)). The depreciation allowance for 2004 is $6,398 ($41,602 adjusted depreciable basis at January 1, 2004, multiplied by the applicable depreciation rate of 15.38% (1/6.5 years remaining at January 1, 2004)).

Example 4. Change in use results in a longer recovery period and/or a slower depreciation method and optional depreciation table is used—(i) Same facts as in *Example 3*, except that *Y* used the optional depreciation tables for computing depreciation in 2001 and 2002. Pursuant to paragraph (d)(5) of this section, *Y* chooses to continue to use the optional depreciation table for the equipment.

(ii) In accordance with paragraph (d)(5)(ii)(B) of this section, *Y* must first determine the appropriate optional depreciation table for the equipment pursuant to paragraph (d)(5)(ii)(B)(*1*) of this section. This table is table 8 in Rev. Proc. 87–57, which corresponds to the alternative depreciation system, the straight-line method, a 9-year recovery period, and the half-year convention (because *Y* depreciated 5-year property in 2001 using a half-year convention). Next, *Y* must determine the appropriate recovery year in table 8. Because the year of change is 2003, the depreciation allowance for the equipment for 2003 is determined using recovery year 3 of table 8. For 2003, *Y* multiplies its adjusted depreciable basis in the equipment as of January 1, 2003, of $48,000, by the product of the annual depreciation rate in table 8 for recovery year 3 for a 9-year recovery period (.1111) and the transaction coefficient [1/(1–(.0556+.1111)), which equals 1.200], to determine the depreciation allowance of $6,399. For 2004, *Y* multiplies its adjusted depreciable basis in the equipment as of January 1, 2003, of $48,000, by the product of the annual depreciation rate in table 8 for recovery year 4 for a 9-year recovery period (.1111) and the transaction coefficient (1.200), to determine the depreciation allowance of $6,399.

(e) *Change in the use of MACRS property during the placed-in-service year*—(1) *In general*. Except as provided in paragraph (e)(2) of this section, if a change in the use of MACRS property occurs during the placed-in-service year and the property continues to be MACRS property owned by the same taxpayer, the depreciation allowance for that property for the placed-in-service year is determined by its primary use during that year. The primary use of MACRS property may be determined in any reasonable manner that is consistently applied to the taxpayer's MACRS property. For purposes of this paragraph (e), the determination of whether the mid-quarter convention applies to any MACRS property placed in service during the year of change is made in accordance with §1.168(d)–1.

(2) *Alternative depreciation system property*—(i) *Property used within and outside the United States*. The depreciation allowance for the placed-in-service year for MACRS property that is used within and outside the United States is determined by its predominant use during that year. The determination of whether MACRS property is used predominantly outside the United States during the placed-in-service year shall be made in accordance with the test in §1.48–1(g)(1)(i) for determining predominant use.

(ii) *Tax-exempt bond financed property*. The depreciation allowance for the placed-in-service year for MACRS property that changes to tax-exempt bond financed property, as described in section 168(g)(1)(C) and (g)(5), during that taxable year is determined under the alternative depreciation system. For purposes of this paragraph (e), MACRS property changes to tax-exempt bond financed property when a tax-exempt bond is first issued after the MACRS property is placed in service. MACRS property continues to be tax-exempt bond financed property in the hands of the taxpayer even if the tax-exempt bond (including any refunding issue) is not outstanding at, or is redeemed by, the end of the placed-in-service year.

(iii) *Other mandatory alternative depreciation system property*. The depreciation allowance for the placed-in-service year for MACRS property that changes to, or changes from, property described in section 168(g)(1)(B) (tax-exempt use property) or (D) (imported property covered by an Executive order) during that taxable year is determined under—

(A) The alternative depreciation system if the MACRS property is described in section 168(g)(1)(B) or (D) at the end of the placed-in-service year; or

(B) The general depreciation system if the MACRS property is not described in section 168(g)(1)(B) or (D) at the end of the placed-in-service year.

(3) *Examples*. The application of this paragraph (e) is illustrated by the following examples:

Example 1. (i) *Z*, a utility and calendar-year corporation, places in service on January 1, 2003, equipment at a cost of $100,000. *Z* uses this equipment in its combustion turbine production plant for 4 months and then uses the equipment in its steam production plant for the remainder of 2003. *Z*'s combustion turbine production plant assets are classified as 15-year property and are depreciated by *Z* under the general depreciation system using a 15-year recovery period and the 150-percent declining balance method of depreciation. *Z*'s steam production plant assets are classified as 20-year property and are depreciated by *Z* under the general depreciation system using a 20-year recovery period and the 150-percent declining balance method of depreciation. *Z* uses the optional depreciation tables. The equipment is qualified property for purposes of section 168(k)(1).

(ii) Pursuant to this paragraph (e), *Z* must determine depreciation based on the primary use of the equipment during the placed-in-service year. *Z* has consistently determined the primary use of all of its MACRS property by comparing the number of full months in the taxable year during which a MACRS property is used in one manner with the number of full months in that taxable year during which that MACRS property is used in another manner. Applying this approach, *Z* determines the depreciation allowance for the equipment for 2003 is based on the equipment being classified as 20-year property because the equipment was used by *Z* in its steam production plant for 8 months in 2003. If the half-year convention applies in 2003, the appropriate optional depreciation table is table 1 in Rev. Proc. 87–57, which is the table for MACRS property subject to the general depreciation system, the 150-percent declining balance method, a 20-year recovery period, and the half-year convention. Thus, the depreciation allowance for the equipment for 2003 is $32,625, which is the total of $30,000 for the additional 30-percent first-year depreciation deduction allowable (the unadjusted depreciable basis of $100,000 multiplied by .30), plus $2,625 for the 2003 depreciation allowance on the remaining basis of $70,000 [(the unadjusted depreciable basis of $100,000 less the additional first-year depreciation deduction of $30,000) multiplied by the annual depreciation rate of .0375 in table 1 for recovery year 1 for a 20-year recovery period].

Example 2. *T*, a calendar year corporation, places in service on January 1, 2003, several computers at a total cost of $100,000. *T* uses these computers within the United States for 3 months in 2003 and then moves and uses the computers outside the United States for the remainder of 2003. Pursuant to §1.48–1(g)(1)(i), the computers are considered as used predominantly outside the United States in 2003. As a result, for 2003, the computers are required to be depreciated under the alternative depreciation system of section 168(g) with a recovery period of 5 years pursuant to section 168(g)(3)(C). *T* uses the optional depreciation tables. If the half-year convention applies in 2003, the appropriate optional depreciation table is table 8 in Rev. Proc. 87–57, which is the table for MACRS property subject to the alternative depreciation system, the straight-line method, a 5-year recovery period, and the half-year convention. Thus, the depreciation allowance for the computers for 2003 is $10,000, which is equal to the unadjusted depreciable basis of $100,000 multiplied by the annual depreciation rate of .10 in table 8 for recovery year 1 for a 5-year recovery period. Because the computers are required to be depreciated under the alternative depreciation system in their placed-in-service year, the computers are not eligible for the additional first year depreciation deduction provided by section 168(k).

(f) *No change in accounting method*. A change in computing the depreciation allowance in the year of change for property subject to this section results from a change in underlying facts and, thus, is not a change in method of accounting under section 446(e).

(g) *Effective date*—(1) *In general*. This section applies to changes in the use of MACRS property in taxable years ending on or after the date of publication of the final regulations in the **Federal Register**. For changes in the use of MACRS property after December 31, 1986, in taxable years ending before the date of publication of the final regulations in the **Federal Register**, the Internal Revenue Service will allow any reasonable method of depreciating the property under section 168 in the year of change and the subsequent taxable years that is consistently applied to any property that changed use in the hands of the taxpayer.

(2) *Change in method of accounting*—(i) *In general*. If a taxpayer adopted a method of accounting for depreciation due to a change in the use of MACRS property and the method is not in accordance with the method of accounting for depreciation provided in this section, a change to the method of accounting for depreciation provided in this section is a change in method of accounting to which the provisions of sections 446(e) and 481 and the regulations thereunder apply. Also, a revocation of the election provided in paragraph (d)(3)(ii) of this section to disregard a change in the use is a change in method of accounting to which the provisions of sections 446(e) and 481 and the regulations thereunder apply.

(ii) *Automatic consent to change method of accounting*. For any taxable year ending on or after the date of publication of the final regulations in the **Federal Register**, a taxpayer changing its method of accounting in accordance with this paragraph (g)(2) must follow the applicable administrative procedures issued under §1.446–1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, for example, see Rev. Proc. 2002–9, 2002–1 C.B. 327, and §601.601(d)(2)(ii)(*b*) of this chapter). Any change in method of accounting made under this paragraph (g)(2) must be made using an adjustment under section 481(a).

Robert E. Wenzel,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 18, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 21, 2003, 68 F.R. 43047)

Notice of Proposed Rulemaking

Notarized Statements of Purchase Under Section 1042

REG–121122–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the temporary regulations under section 1042 of the Internal Revenue Code of 1986. The proposed regulations would affect taxpayers making an election to defer the recognition of gain under section 1042 on the sale of stock to an employee stock ownership plan. The proposed regulations provide guidance on the notarization requirements of the temporary regulations.

DATES: Written and electronic comments and requests for a public hearing must be received by October 7, 2003.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–121122–03), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (REG–121122–03), Courier's Desk, Internal Revenue Service, 1111

Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *www.irs.gov/regs*.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, John T. Ricotta at (202) 622–6060 (not a toll-free number); concerning submissions or hearing requests, Sonya Cruse, (202) 622–7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the requirement of §1.1042–1T, A–3(b) of the Temporary Income Tax regulations that a statement of purchase for qualified replacement property be notarized within 30 days of the date of purchase of the property (30-day notarization requirement).

The temporary regulations under section 1042 were published in T.D. 8073, 1986–1 C.B. 45, on February 4, 1986 (EE–63–84) (51 FR 4312) as part of a package of temporary regulations addressing effective dates and other issues under the Tax Reform Act of 1984. The text of the temporary regulations also served as a notice of proposed rulemaking (EE–96–85, 1986–1 C.B. 697 [51 FR 4391]). A public hearing was held on June 26, 1986, concerning the proposed regulations.

Explanation of Provisions

Overview

Section 1042(a) provides that a taxpayer or executor may elect in certain cases not to recognize long-term capital gain on the sale of *qualified securities* to an employee stock ownership plan (ESOP) (as defined in section 4975(e)(7)) or eligible worker owned cooperative (as defined in section 1042(c)(2)) if the taxpayer purchases *qualified replacement property* (as defined in section 1042(c)(4)) within the replacement period of section 1042(c)(3) and the requirements of section 1042(b) and §1.1042–1T of the Temporary Income Tax Regulations are satisfied.

Section 1042(c)(1) provides that the term *qualified securities* means employer securities (as defined in section 409(l)) which are issued by a domestic C corporation that has no stock outstanding that is readily tradable on an established securities market and which were not received by the taxpayer in a distribution from a plan described in section 401(a) or in a transfer pursuant to an option or other right to acquire stock to which section 83, 422, or 423 applied.

A sale of *qualified securities* meets the requirements of section 1042(b) if: (1) the qualified securities are sold to an ESOP (as defined in section 4975(e)(7)), or an eligible worker owned cooperative; (2) the plan or cooperative owns (after application of section 318(a)(4)), immediately after the sale, at least 30 percent of (a) each class of outstanding stock of the corporation (other than stock described in section 1504(a)(4)) which issued the securities or (b) the total value of all outstanding stock of the corporation (other than stock described in section 1504(a)(4)); (3) the taxpayer files with the Secretary a verified written statement of the employer whose employees are covered by the ESOP or an authorized officer of the cooperative consenting to the application of sections 4978 and 4979A (which provide for excise taxes on certain dispositions or allocations of securities acquired in a sale to which section 1042 applies) with respect to such employer or cooperative; and (4) the taxpayer's holding period with respect to the qualified securities is at least three years (determined as of the time of the sale).

The taxpayer must purchase *qualified replacement property* within the *replacement period*, which is defined in section 1042(c)(3) as the period which begins three months before the date on which the sale of qualified securities occurs and ends 12 months after the date of such sale.

Section 1042(c)(4)(A) defines *qualified replacement property* as any security issued by a domestic operating corporation which did not, for the taxable year preceding the taxable year in which such security was purchased, have passive investment income (as defined in section 1362(d)(3)(C)) in excess of 25 percent of the gross receipts of such corporation for such preceding taxable year, and is not the corporation which issued the qualified securities which such security is replacing or a member of the same controlled group of corporations (within the meaning of section 1563(a)(1)) as such corporation.

Section 1042(c)(4)(B) defines an *operating corporation* as a corporation more than 50 percent of the assets of which, at the time the security was purchased or before the close of the replacement period, were used in the active conduct of a trade or business.

Section 1.1042–1T A–3(a) of the Temporary Income Tax Regulations states that the election is to be made in a *statement of election* attached to the taxpayer's income tax return filed on or before the due date (including extensions of time) for the taxable year in which the sale occurs.

Section 1.1042–1T A–3(b) states that the *statement of election* must provide that the taxpayer elects to treat the sale of securities as a sale of qualified securities under section 1042(a) and must contain the following information: (1) A description of the qualified securities sold, including the type and number of shares; (2) The date of the sale of the qualified securities; (3) The adjusted basis of the qualified securities; (4) The amount realized upon the sale of the qualified securities; (5) The identity of the ESOP or eligible worker-owned cooperative to which the qualified securities were sold; and (6) If the sale was part of a single interrelated transaction under a prearranged agreement between taxpayers involving other sales of qualified securities, the names and taxpayer identification numbers of the other taxpayers under the agreement and the number of shares sold by the other taxpayers.

Section 1.1042–1T, A–3(b) further provides that, if the taxpayer has purchased qualified replacement property at the time of the election, the taxpayer must attach as part of the statement of election a *statement of purchase* describing the qualified replacement property, the date of the purchase, and the cost of the property, and declaring such property to be qualified replacement property with respect to the sale of qualified securities.

The statement of purchase must be notarized no later than 30 days after the purchase. The purpose of the statement of purchase is to identify qualified replacement property with respect to a sale of qualified securities. The qualified replacement property will have its cost basis reduced under section 1042(d) to reflect

the gain on the sale of qualified securities that is being deferred by the taxpayer. Upon subsequent disposition of the qualified replacement property by the taxpayer, the deferred gain will be recognized by the taxpayer under section 1042(e). Under section 1042(f), the filing of the statement of purchase of qualified replacement property (or a statement of the taxpayer's intention not to purchase replacement property) will begin the statutory period for assessment of any deficiency with respect to gain arising from the sale of the qualified securities. The purpose of the 30-day notarization requirement is to provide a contemporaneous identification of replacement property.

However, the 30-day notarization requirement leads to frequent mistakes by taxpayers and their advisors. Taxpayers are often unaware of this requirement and become aware of it only when they prepare their tax returns for the year of sale to the ESOP. By this time, the 30-day period is typically past because purchases of replacement property may have been made up to one year before. A number of private letter rulings have been issued granting relief to taxpayers in these situations as long as the statements were notarized shortly after the taxpayer became aware of the requirement and it was represented that the property listed was the only replacement property purchased for this sale.

A number of commentators on the temporary and proposed regulations criticized this requirement as without statutory authority, a trap for the unwary, and inconsistent with the definition of the qualified replacement period in section 1042(c)(3).

Proposed Amendment to the Regulations

In order to facilitate taxpayer compliance with the temporary regulations concerning identification of qualified replacement property through notarization of the statements of purchase, the proposed amendment to the temporary regulations would modify §1.1042–1T, A–3(b) to provide that the notarization requirements for the *statement of purchase* are satisfied if the taxpayer's statement of purchase is notarized not later than the time the taxpayer files the income tax return for the taxable year in which the sale of qualified securities occurred in any case in which any qualified replacement property was purchased by such time and during the qualified replacement period. If qualified replacement property was purchased after such filing date and during the qualified replacement period, the statement of purchase must be notarized not later than the time the taxpayer's income tax return is filed for the taxable year following the year for which the election under section 1042(a) was made.

Proposed Effective Date

The proposed amendments to the temporary regulations would apply to taxable years of sellers ending on or after the date of publication of the Treasury decision adopting these amendments as final regulations in the **Federal Register**. However, taxpayers may rely upon these proposed regulations for guidance with respect to all open taxable years pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

Special Analyses

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

Comments and Public Hearing

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

Drafting Information

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

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Proposed Amendments to The Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. In §1.1042–1T, A–3, in the undesignated paragraph following paragraph (b)(6), the penultimate sentence is removed and three sentences added in its place to read as follows:

§1.1042–1T Questions and Answers relating to the sales of stock to employee stock ownership plans or certain cooperatives (temporary).

* * * * *

Q–3. * * *

A–3. * * * Such statement of purchase must be notarized not later than the time the taxpayer files the income tax return for the taxable year in which the sale of qualified securities occurred in any case in which any qualified replacement property was purchased by such time and during the qualified replacement period. If qualified replacement property is purchased after such filing date but during the qualified replacement period, the statement of purchase must be notarized not later than the time the taxpayer's income tax return is filed for the taxable year following the year for which the election under section

1042(a) was made. The previous two sentences apply to taxable years of sellers ending on or after the date final regulations are published in the **Federal Register**. * * *

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Robert E. Wenzel,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 9, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 10, 2003, 68 F.R. 41087)

Notice of Proposed Rulemaking

Guidance Under Section 1502; Stock Basis After a Group Structure Change

REG–130262–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 1502 that relate to stock basis after a group structure change. These proposed regulations affect corporations filing consolidated returns.

DATES: Written or electronic comments and requests for a public hearing must be received by October 6, 2003.

ADDRESSES: Send submissions to: CC:PA:RU (REG–130262–03), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:RU (REG–130262–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *www.irs.gov/regs*.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Marlene Oppenheim or Ross Poulsen, (202) 622–7770; concerning submission of comments and/or requests for a public hearing, Sonya Cruse, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Section 1.1502–31 applies if one corporation (P) succeeds another corporation (T) under the principles of §1.1502–75(d)(2) or (3) as the common parent of a consolidated group in a group structure change. If a corporation acquires stock of the former common parent in a group structure change, the basis of the members in the former common parent's stock immediately after the group structure change is generally redetermined to reflect the former common parent's net asset basis. In general, the group structure change regulations were designed to prevent disparate basis consequences resulting from different forms of transactions that effect a restructuring of a consolidated group that continues to exist following the restructuring.

The IRS and Treasury are concerned that the application of the net asset basis rule may produce inappropriate results on the disposition of stock acquired in a transaction in which, under generally applicable rules, the basis of the acquired stock would otherwise be determined by reference to the acquiror's cost for the stock. Accordingly, this document proposes to modify the application of the provisions of §1.1502–31 to permit the basis of stock acquired in a recognition transaction to reflect the cost of the acquired stock.

In particular, this document excepts from the application of the net asset basis rule stock acquired in a transaction in which gain or loss was recognized in whole. These regulations are proposed to apply to group structure changes that occur after the date these regulations are published as temporary or final regulations in the **Federal Register**. With respect to group structure changes that occur on or before the date these regulations are published as temporary or final regulations in the **Federal Register** and during consolidated return years beginning on or after January 1, 1995, these regulations are proposed to apply at the election of the group.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily will affect affiliated groups of corporations, which tend to be larger businesses. Moreover, the number of taxpayers affected is minimal and the regulations will simplify basis determinations. Pursuant to section 7805(f) of the Internal Revenue Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

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

Drafting Information

The principal authors of these regulations are Marlene Oppenheim and Ross Poulsen, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1502–31 is amended by revising paragraphs (b)(2), (d)(2)(ii), (g), and (h) to read as follows:

§1.1502–31 Stock basis after a group structure change.

* * * * *

(b) * * *

(2) *Stock acquisitions*. If a corporation acquires stock of the former common parent in a transaction that is a group structure change, the basis of the members in the former common parent's stock immediately after the group structure change (including any stock of the former common parent owned before the group structure change) that has, or would otherwise have, a basis determined in whole or in part by reference to the basis of the property exchanged for such stock is redetermined in accordance with the results for an asset acquisition described in paragraph (b)(1) of this section. For example, if all of T's stock is contributed to P in a group structure change to which section 351 applies, P's basis in T's stock is T's net asset basis, rather than the amount determined under section 362. Similarly, if S merges into T in a group structure change described in section 368(a)(2)(E) and P acquires all of the T stock, P's basis in T's stock is the basis that P would have in S's stock under paragraph (b)(1) of this section if T had merged into S in a group structure change described in section 368(a)(2)(D).

* * * * *

(d) * * *

(2) * * *

(ii) *Stock acquisitions*. If less than all of the former common parent's stock is subject to the redetermination described in paragraph (b)(2) of this section, the percentage of the former common parent's net asset basis taken into account in the redetermination equals the percentage (by fair market value) of the former common parent's stock subject to the redetermination. For example, if P owns less than all of the former common parent's stock immediately after the group structure change and the basis of such stock would otherwise be determined in whole or in part by reference to the basis of the property exchanged for such stock, only an allocable part of the basis determined under this section is reflected in the shares owned by P (and the amount allocable to shares owned by nonmembers has no effect on the basis of their shares). Alternatively, if P acquired 10 percent of the former common parent's stock in a transaction in which the stock basis was determined by P's cost, and P later acquires the remaining 90 percent of the former common parent's stock in a separate transaction that is described in paragraph (b)(2) of this section, P retains it cost basis in its original stock and the basis of P's newly acquired shares reflects only an allocable part of the former common parent's net asset basis.

* * * * *

(g) *Examples*. For purposes of the examples in this section, unless otherwise stated, all corporations have only one class of stock outstanding, the tax year of all persons is the calendar year, all persons use the accrual method of accounting, the facts set forth the only corporate activity, all transactions are between unrelated persons, and tax liabilities are disregarded. The principles of this section are illustrated by the following examples:

Example 1. Forward triangular merger. (i) *Facts*. P is the common parent of one group and T is the common parent of another. T has assets with an aggregate basis of $60 and fair market value of $100 and no liabilities. T's shareholders have an aggregate basis of $50 in T's stock. In Year 1, pursuant to a plan, P forms S and T merges into S with the T shareholders receiving $100 of P stock in exchange for their T stock. The transaction is a reorganization described in section 368(a)(2)(D). The transaction is also a reverse acquisition under §1.1502–75(d)(3) because the T shareholders, as a result of owning T's stock, own more than 50% of the value of P's stock immediately after the transaction. Thus, the transaction is a group structure change under §1.1502–33(f)(1), and P's earnings and profits are adjusted to reflect T's earnings and profits immediately before T ceases to be the common parent of the T group.

(ii) *Analysis*. Under paragraph (b)(1) of this section, P's basis in S's stock is adjusted to reflect T's net asset basis. Under paragraph (c) of this section, T's net asset basis is $60, the basis T would have in the stock of a subsidiary under section 358 if T had transferred all of its assets and liabilities to the subsidiary in a transaction to which section 351 applies. Thus, P has a $60 basis in S's stock.

(iii) *Pre-existing S*. The facts are the same as in paragraph (i) of this *Example 1*, except that P has owned the stock of S for several years and P has a $50 basis in the S stock before the merger with T. Under paragraph (b)(1) of this section, P's $50 basis in S's stock is adjusted to reflect T's net asset basis. Thus, P's basis in S's stock is $110 ($50 plus $60).

(iv) *Excess loss account included in former common parent's net asset basis*. The facts are the same as in paragraph (i) of this *Example 1*, except that T has two assets, an operating asset with an $80 basis and $90 fair market value, and stock of a subsidiary with a $20 excess loss account and $10 fair market value. Under paragraph (c) of this section, T's net asset basis is $60 ($80 minus $20). See sections 351 and 358, and §1.1502–19. Consequently, P has a $60 basis in S's stock. Under section 362 and §1.1502–19, S has an $80 basis in the operating asset and a $20 excess loss account in the stock of the subsidiary.

(v) *Liabilities in excess of basis*. The facts are the same as in paragraph (i) of this *Example 1*, except that T's assets have a fair market value of $170 (and $60 basis) and are subject to $70 of liabilities. Under paragraph (c) of this section, T's net asset basis is negative $10 ($60 minus $70). See sections 351 and 358, and §§1.1502–19 and 1.1502–80(d). Thus, P has a $10 excess loss account in S's stock. Under section 362, S has a $60 basis in its assets (which are subject to $70 of liabilities). (Under paragraph (a)(2) of this section, because the liabilities are taken into account in determining net asset basis under paragraph (c) of this section, the liabilities are not also taken into account as consideration not provided by P under paragraph (d)(1) of this section.)

(vi) *Consideration provided by S*. The facts are the same as in paragraph (i) of this *Example 1*, except that P forms S with a $100 contribution at the beginning of Year 1, and during Year 6, pursuant to a plan, S purchases $100 of P stock and T merges into S with the T shareholders receiving P stock in exchange for their T stock. Under paragraph (b)(1) of this section, P's $100 basis in S's stock is increased by $60 to reflect T's net asset basis. Under paragraph (d)(1) of this section, P's basis in S's stock is decreased by $100 (the fair market value of the P stock) because the P stock purchased by S and used in the transaction is consideration not provided by P.

(vii) *Appreciated asset provided by S*. The facts are the same as in paragraph (i) of this *Example 1*, except that P has owned the stock of S for several years, and the shareholders of T receive $60 of P stock and an asset of S with a $30 adjusted basis and $40 fair market value. S recognizes a $10 gain from the asset under section 1001. Under paragraph (b)(1) of this section, P's basis in S's stock is increased by $60 to reflect T's net asset basis. Under paragraph (d)(1) of this section, P's basis in S's stock is decreased by $40 (the fair market value of the asset provided by S). In addition, P's basis in S's stock is increased under §1.1502–32(b) by S's $10 gain.

(viii) *Depreciated asset provided by S*. The facts are the same as in paragraph (i) of this *Example 1*, except that P has owned the stock of S for several years, and the shareholders of T receive $60 of P stock and an asset of S with a $50 adjusted basis and $40 fair market value. S recognizes a $10 loss from the asset under section 1001. Under paragraph (b)(1) of this section, P's basis in S's stock is increased by $60 to reflect T's net asset basis. Under paragraph (d)(1) of this section, P's basis in S's stock is decreased by $40 (the fair market value of the asset provided by S). In addition, S's $10 loss is taken into account under §1.1502–32(b) in determining P's basis adjustments under that section.

Example 2. Stock acquisition. (i) *Facts*. P is the common parent of one group and T is the common parent of another. T has assets with an aggregate basis of $60 and fair market value of $100 and no liabilities. T's shareholders have an aggregate basis of $50 in T's stock. Pursuant to a plan, P forms S and S acquires all of T's stock in exchange for P stock in a transaction described in section 368(a)(1)(B). The transaction is

also a reverse acquisition under §1.1502–75(d)(3). Thus, the transaction is a group structure change under §1.1502–33(f)(1), and the earnings and profits of P and S are adjusted to reflect T's earnings and profits immediately before T ceases to be the common parent of the T group.

(ii) *Analysis*. Under paragraph (d)(4) of this section, although S is not the new common parent of the T group, adjustments must be made to S's basis in T's stock in accordance with the principles of this section. Although S's basis in T's stock would ordinarily be determined under section 362 by reference to the basis of T's shareholders in T's stock immediately before the group structure change, under the principles of paragraph (b)(2) of this section, S's basis in T's stock is determined by reference to T's net asset basis. Thus, S's basis in T's stock is $60.

(iii) *Higher-tier adjustments*. Under paragraph (d)(4) of this section, P's basis in S's stock is increased by $60 (to be consistent with the adjustment to S's basis in T's stock).

(iv) *Cross ownership*. The facts are the same as in paragraph (i) of this *Example 2*, except that several years ago S purchased 10% of T's stock from an unrelated person for cash and, pursuant to the plan, S acquires the remaining 90% of T's stock in exchange for P stock. S's basis in the initial 10% of T's stock is not redetermined under this section. However, S's basis in the additional 90% of T's stock is redetermined under this section. S's basis in that stock is adjusted to $54 (90% of T's net asset basis).

(v) *Allocable share*. The facts are the same as in paragraph (i) of this *Example 2*, except that P owns only 90% of S's stock immediately after the group structure change. S's basis in T's stock is the same as in paragraph (ii) of this *Example 2*. Under paragraph (d)(2) of this section, P's basis in its S stock is increased by $54 (90% of S's $60 adjustment).

Example 3. *Taxable stock acquisition*. (i) *Facts*. P is the common parent of one group and T is the common parent of another. T has assets with an aggregate basis of $60 and fair market value of $100 and no liabilities. T's shareholders have an aggregate basis of $50 in T's stock. Pursuant to a plan, P acquires all of T's stock in exchange for $70 of P's stock and $30 in a transaction that is a group structure change under §1.1502–33(f)(1). P's basis in its acquired T stock is not determined in whole or in part by reference to the basis of the property exchanged for such stock. (Because of P's use of cash, the acquisition is not a transaction described in section 368(a)(1)(B).)

(ii) *Analysis*. The rules of this section do not apply to determine P's basis in T's stock. Therefore, P's basis in T's stock is $100.

(h) *Effective dates* — (1) *General rule*. This section applies to group structure changes that occur after the date these regulations are published as temporary or final regulations in the **Federal Register**. However, after the date these regulations are published as temporary or final regulations in the **Federal Register**, a group may apply this section to group structure changes that occur on or before the date these regulations are published as temporary or final regulations in the **Federal Register** and in consolidated return years beginning on or after January 1, 1995.

(2) *Prior law*. For group structure changes that occur on or before the date these regulations are published as temporary or final regulations in the **Federal Register** and in consolidated return years beginning on or after January 1, 1995, with respect to which the group does not elect to apply the provisions of this section, see §1.1502–31 as contained in the 26 CFR part 1 edition revised as of April 1, 2003. For group structure changes that occur in consolidated return years beginning before January 1, 1995, see §1.1502–31T as contained in the 26 CFR part 1 edition revised as of April 1, 1994.

Robert E. Wenzel,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 7, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 8, 2003, 68 F.R. 40579)

New Revision of Publication 971, *Innocent Spouse Relief (And Separation of Liability and Equitable Relief)* (Revised July 2003.)

Announcement 2003–51

Publication 971 discusses the innocent spouse relief provisions available to taxpayers whose spouses improperly report items or omit items on their tax returns.

A new revision of Publication 971 is now available on the IRS website at *www.irs.gov*. This revision dated July 2003 replaces the June 2002 revision.

This version covers final regulations under Internal Revenue Code section 6015 (relating to guidance for taxpayers requesting relief from joint and several liability).

Paper copies will not be issued for the July 2003 revision. The next revision, which should be out in the fall of 2003, will be available both on the IRS website and in paper copies. That revision will cover part of the final regulations under Internal Revenue Code section 66 (relating to relief from liability arising from community property law) and Revenue Procedure 2003–61 (relating to guidance for taxpayers seeking equitable relief).

Foundations Status of Certain Organizations

Announcement 2003–57

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

7th Precinct Community Council, Inc., New York, NY
A & A Foundation for Children, Stockton, CA
Aging Awareness Institute, Inc., Long Beach, NY
Airship Research in Science and Education, Inc., Terra Ceia, FL
Albanian American Advisory Council, Inc., Yonkers, NY
Allen Temple Development Corporation, Inc., Tampa, FL
Amateur Radio Experimenters Assn., Fairlawn, OH
American Charities Fund, Inc., Indianapolis, IN
American Chelation Association, a Public Education Service Organization, Anaheim, CA
American Friends of the Restoration of the Kuwait Museum of Islamic Art, Inc., Boston, MA
Americas Future Leaders, Denham Springs, LA
Angel Center, Goodman, MS
Appec, Inc., Brick, NJ
A R C Action Recovery Cry International Christian Assistance, Memphis, TN

Art2Facts, New York, NY
Arthur A. Monday Jr., Community Development Corporation, New Orleans, LA
Asianwired Information Services, Inc., Rowland Heights, CA
Atlanta Technology Library and Museum, Inc., Atlanta, GA
B Team, New York, NY
Bangladesh Social & Community Development Institute USA, Jackson Heights, NY
Barsimchap Foundation, Inc., Brooklyn, NY
Beatrice Foundation for Homeless & Needy People, Denver, CO
Been There-Done That Counseling, Inc., Orlando, FL
Bells Volunteer Fire Fighters Association, Bells, TX
Belmont Boulevard II Housing Development Corporation, Bronx, NY
Bluesprings Youth Soccer Association, Inc., Loganville, GA
Bronx School for Quality Education, Inc., Bronx, NY
Brown Youth Development, Harbor City, CA
Calvary Community Development Center, Inc., Garfield, NJ
CASK – Creative Art Space for Kids, Inc., Lynbrook, NY
Center for Housing & Economic Opportunities Corporation, Austin, TX
Center for National Software Studies, Reston, VA
Cerro Gordo Historical Society, Keeler, CA
Charm and Fteley Neighborhood Block Association, Bronx, NY
Children Counseling Services, Inc., Cincinnati, OH
Children's Museum of Buffalo, Buffalo, NY
Chora Ethiopian Center for Educational & Sports Information, Boston, MA
Christian Alliance for Community Development, Inc., Tucson, AZ
Christian Law Enforcement Officers & Associates Foundation, Inc., Pompano Beach, FL
Cincinnati Christian Taekwondo Association, Cincinnati, OH
C L A R A Foundation, Topeka, KS
Coachella Valley Public Education Foundation Spooktacular, La Quinta, CA
Cobb Health Partners, Inc., Marietta, GA
Commercial Recycling Council, Philadelphia, PA
Committee for the Fourth R, Lakewood, OH
Commodity Resource Exchange, Inc., Rocky Mount, NC
Community Consultants, Portsmouth, VA
Community in Action Foundation, Inc., Thetford, VT
Community Outreach for Youth into the 21st Century, Medford, OR
Community Roundtable for Family Preservation, Inc., Mt. Vernon, NY
Comprehensive Action Network, Inc., Oakland, CA
Conservacion de Vivienda en Zones Historicas, Inc., San Juan, PR
Creatures Great and Small, Inc., Callicoon Ctr, NY
Daru Hijra Modification Halfway House of New Jersey, Inc., Newark, NJ
DAY Cancer Foundation, Long Beach, CA
Development Enterprises of Central Oklahoma, Incorporated, Shawnee, OK
Diakonia Prison Ministries, Corpus Christi, TX
Discover Your Dreams Therapeutic Riding Center, Inc., Fort Fairfield, ME
Dobrowolski Family Foundation, Exton, PA
Earth Ed, Brookfield, VT
Educational Vision Services-Parent Advocates, New York, NY
El Barrio Broadcasting Corporation, New York, NY
Ethopian Art Heritage Project, Santa Barbara, CA
Fannie Flowers, Inc., Baltimore, MD
Fetal IQ Enhancement Studies, Carmel, CA
Fettersville Restoration and Development Association, Inc., Camden, NJ
Finbar Devine Memorial Dinner Corp., Brooklyn, NY
Firemen's Relief Benevolent Association, Fort Worth, TX
Fleet Ministries, Inc., Bedford, IN
Footprints Day Care Center, Inc., Wanakena, NY
Foundation for the Preservation of the Individual, Prairie Grove, AR
Foundation of Fresno, Pinedale, CA
Foundation to Provide Opportunity for the Differently Abled, Inc., Cleveland, OH
Free Range Theater Company, New York, NY
Friends of the San Fernando Valley Fair, Burbank, CA
Fruits From the Vine, Inc., North Canton, OH
Gemach Yafehana, New York, NY
Global Cultural Link, Inc., Jamaica, NY
Global Marketplace Ministries, Inc., Woodstock, GA
God Is Moving, Inc., Houston, TX
God's True Ministry Outreach, Inc., College Park, GA
Greater Kelly Development Foundation, Inc., Kelly Air Force Base, TX
Guidance-Hall, Inc., Miami, FL
Harris E & I Corporation, Chino, CA
Healingworks Institute, Inc., Scottsdale, AZ
Heartland Homes for Seniors, Inc., St. Paul, MN
Helen Palmer Enneagram Archive Project, Berkeley, CA
Help for Africa Foundation, Inc., North Royalton, OH
Helping the Under Privileged Foundation, Norwalk, CA
Higher Bound Company, Harrah, OK
Hillcrest ASA Softball Association, Inc., Tuscaloosa, AL
Holistic Advocates Institute, Mount Hermon, CA
Holy Grounds, Inc., Brookwood, AL
Home Away From Home Family Life and Educational Center, Inc., Hampton, VA
Home Delaware County, Inc., Boothwyn, PA
Homeward Bound Program, Bronx, NY
HOPE, Inc., Hollywood, FL
Houston Innovation Center, Inc., Houston, TX
Hudson Foundation for Human Development, Inc., Bronx, NY
Hyperbaric Research Foundation, Inc., Boca Raton, FL
IAMA Family Life and Educational Center, Inc., Baltimore, MD
Idaho High School Hall of Fame Foundation, Inc., Meridian, ID
Idyllwild Institute, Inc., Sandpoint, ID
Independence 1st Owner Corp., Kew Gardens, NY
Independence 2nd Owner Corp., Kew Gardens, NY
Information Resources Center, Inc., Kissimmee, FL
Institute for the Study of Long Term Economic Trends, Forest Hills, NY
Intercommunity Good Shepherd Association, Whitewater, CA
International Children's Medical Foundation, Johnson City, TN

International Handicapped Service, Inc., Las Vegas, NV
IOOF Fellows Terrace, Inc., Springfield, OH
Janus Foundation USA, Inc., Miami, FL
Jericho Educational Foundation, Inc., Jericho, NY
Jewish Deaf Resource Center, Inc., New York, NY
John and Mildred Medic Wuchenich Foundation, Redlands, CA
John Wesley Village II, Inc., Riverhead, NY
Joseph Ching Memorial Scholarship Fund, Hicksville, NY
JSKWIC Foundation, W. Richland, WA
Judge Harold A. Stevens Law Services Fund, Inc., New York, NY
Jungle Habitat, Inc., Coral Gables, FL
Kennedy Danse Ensemble, White Plains, NY
Latino Coalition for Fair Media, Inc., Brooklyn, NY
Leadership International Women for Pharmacy, Richmond, VA
Legal Ministries, Inc., Carrollton, TX
Lincoln Beach Community Revitalization Project, New Kennsington, PA
Lo Society Branch of North Carolina, Inc., Connelly Springs, NC
Lokahi E Hawaii 1, Waimanlo, HI
Los Angeles Theatre Arts Community Youth Academy, Inglewood, CA
Lucille Clark Housing Development Fund Co., Inc., New York, NY
M. W. El-Nanchef Foundation, Grand Blanc, MI
Margaret A. Nebel Charitable Trust, Clinton, MO
Media Heritage Group, Inc., Rockford, TN
Memphis Uptown Alliance, Inc., Memphis, TN
Mesopatamia Museum, Prospect Heights, IL
Michael E. & Carol B. Dantley Ministries Foundation, Inc., Cincinnati, OH
Millennium Community Housing Corp., Rye, NY
Ministerio Accion En Cristo, Inc., Tarrytown, NY
Monroe County School Music Association, Inc., Pittsford, NY
More Communities in Action, Fort Worth, TX
Mrs. Music, Chicago, IL
Mt. Vernon Enrichment Programs, Inc., Mt. Vernon, NY
Muscatine Public Library Endowment Foundation, Muscatine, IA
Music at Greenlawn, Ltd., E. Northport, NY
Nandi House, Inc., Oakland, CA
Narrow Way Community Development, Inc., Elmsford, NY
National Affordable Housing Center, Inc., Columbus, OH
National Council of Supervisors of Mathematics Charitable Trust, Highlands Ranch, CO
National Sorority of Phi Delta Beta Omicron Chapter Early, Jamaica, NY
New Center Community Development Corporation, Detroit, MI
New Hope Youth Coalition Project, Magee, MS
New Jersey Health Care Quality Inst., Inc., Edison, NJ
New Light Development Corporation Establishment, Irvington, NJ
New York School for Quality Education, Inc., New York, NY
Newton Film Foundation, Inc., New York, NY
NHA Properties, Inc., Newton, NJ
North Carolina Assisted Living Foundation, Cary, NC
Oak Park Community Assistance Network, Sacramento, CA
Oakleaf Forest Youth Council, Inc., Norfolk, VA
Oh Ottawa, Inc., Port Clinton, OH
Opportunities and Enrichment Services, Inc., Miami, FL
OTSS Youth Program – OTSS Gospel Entertainment, Lancaster, TX
Parent Hood, Hawthorne, CA
Parents of Murdered Children Outreach Prog. for Secondary Victim, Shirley, NY
Peachtree Christian Church Foundation, Inc., Atlanta, GA
People for Improvements, Inc., Pittsburg, CA
Perseverence in Space Plus Mass Foundation, Oakland, CA
Pilgrim Rest Charitable Association, Memphis, TN
Pioneers West Historical Society, Oaklawn, IL
Pittsburgh Rebels Girls Softball, Munhall, PA
Plays the Thing Theatre Company, Inc., Brooklyn, NY
Positive Community Images, Inc., New York, NY
Presque Isle Psychiatric Associates, Erie, PA
Project New Beginnings, Chicago, IL
Promised Land Community Development Corporation, Newark, NJ
Pyramids, Inc., Richland, WA
Rainbow, R P Llc, St. Paul, MN
Ralph Country Brown Scholarship, Inc., Summerville, GA
Reach for the Sky, Inc., South Boston, MA
Right Step Home Care Services, Inc., Brooklyn, NY
Riverhead Development Corporation, Riverhead, NY
Rocky H. Aoki Foundation, New York, NY
Room Two Grow Program, Covina, CA
Sacramento Community Clinic Association, Inc., West Sacramento, CA
Self Accountable Children's Society, Moreno Valley, CA
Servcorps, Inc., Farmington, CT
Servicing Homeless Adults Released on Parole, Inc., Yonkers, NY
Sisters Society Ministries, Inc., Brooklyn, NY
Solid Rock Foundation of South Florida, Inc., Miami, FL
Spine & Scoliosis Research Associates, Inc., Summit, NJ
Spiritual Society of Seekers, Inc., Long Beach, NY
St. James Self-Help Program, Detroit, MI
St. Michaels Housing Corporation, Paterson, NJ
Steven Starr Memorial Fund, Acworth, GA
Tabernacle Community Development, Inc., Pompano Beach, FL
Tecolotes of San Diego, San Diego, CA
Teenwork Force, Leon, KS
Tell It Like It is Ministries, Thomaston, GA
Temple of Praise Ministries, Arlington, TX
Tobe Foundation, Jefferson City, MO
Toma Foundation, Austin, TX
Transformation Association, Altadena, CA
Under Renovation Family Counseling Center, Denver, CO
Universal Missions, New Orleans, LA
Vietnamese Interfaith Council of Northern California, San Jose, CA
Vineland Housing Development Corporation, Vineland, NJ
Vision Manor Assisted Living, (Young/Elderly), Inc., Atlanta, GA

Visions of the Soul V O T S, Inc., San Francisco, CA
Voices for the Future, Inc., Jamesville, NY
Westchester Theater Arts Association, Inc., Hastings Hdsn, NY
Western Pequot Mohegan, Inc., East Hartford, CT
Williams's Reach Advance Program, Inc., Jersey City, NJ
Winterset Fire Fighters Association, Inc., Winterset, IA
Womens Peace Land, Inc., Romulus, NY
World Dynamics, Inc., Arlington, VA
World Foundation for Smart Communities, La Jolla, CA
World Hall of Fame, Chicago, IL
World Law Institute, Inc., Cleveland, OH
World Outreach Ministries, Inc., Newark, CA
World Wide Harvest Ministries, Inc., Greenville, SC
Yad Shaul Yehuda, Inc., New York, NY
Yeshiva Yordim Volim, Brooklyn, NY
Yonkers Partnership Housing Development Fund Corporation, Yonkers, NY
Youth Center for Cultural Enrichment, Incorporation, Holly Springs, MS
Yu Hwa Chinese School, San Francisco, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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96-30
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96-38
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2000-12
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2000-15
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Rev. Proc. 2003-61, 2003-32 I.R.B. *296*

2002-9
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Amplified and modified by
Rev. Proc. 2003-50, 2003-29 I.R.B. *119*
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Rev. Proc. 2003-63, 2003-32 I.R.B. *304*
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2002-13
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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2003-1 through 2003-26 is in Internal Revenue Bulletin 2003-27, dated July 7, 2003.

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2002-45
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2003-15
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54-396
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56-160
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57-116
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57-296
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59-120
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Rev. Rul. 2003-99, 2003-34 I.R.B. *388*

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65-110
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65-260
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Rev. Rul. 2003-99, 2003-34 I.R.B. *388*

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Rev. Rul. 2003-99, 2003-34 I.R.B. *388*

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*U.S. G.P.O.: 2003—496–919/60100