Internal Revenue
bulletin

Bulletin No. 2003–3
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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. 2003–1, page 291.
Constructive sales; reestablished positions. This ruling provides guidance on the interaction between section 1259(c)(3)(A) of the Code (exception for certain closed transactions) and section 1259(c)(3)(B) (treatment of positions which are reestablished).

Rev. Rul. 2003–8, page 290.
Costa Rican income tax law; withholding taxes. This ruling holds that certain Costa Rican taxes are noncreditable soak-up taxes under sections 901 and 903 of the Code. The ruling also serves as an official confirmation to the Costa Rican Tax Administration that these taxes are noncreditable in the United States.

Rev. Rul. 2003–10, page 288.
Accrual of income. This ruling addresses the accrual of gross income when a taxpayer's customer disputes its liability to the taxpayer because of (1) a clerical mistake in a sales invoice, (2) the shipment of the wrong goods, or (3) the shipment of more items than the customer ordered.

Rev. Rul. 2003–12, page 283.
Gross income; general welfare; gifts; disaster relief payments. This ruling holds that amounts paid to an individual by a state agency, a charity, or an employer to reimburse the individual for certain expenses the individual incurs as a result of a Presidentially declared disaster are excluded from the individual's gross income under the administrative general welfare exclusion, sections 102 and 139 of the Code, respectively. Rev. Rul. 53–131 modified.

REG–151043–02, page 300.
Proposed regulations under section 61 of the Code authorize the Commissioner to provide, through administrative guidance, rules for deferring inclusion of advance rentals in gross income to a taxable year other than the year of receipt.

Notice 2003–4, page 294.
LIFO recapture installment payments. This document informs taxpayers of the federal income tax consequences of a failure to timely make an installment payment attributable to the LIFO recapture requirement of section 1363(d) of the Code.

Notice 2003–5, page 294.
This notice provides guidance relating to the application of separate foreign tax credit limitations under section 904 of the Code to dividends from a noncontrolled section 902 corporation (10/50 corporation) in taxable years beginning after December 31, 2002.

EMPLOYEE PLANS

Rev. Rul. 2003–6, page 286.
Employee stock ownership plans; delayed effective date; abuse. This ruling states that where the intent of section 409(p) of the Code to limit the establishment of ESOPs by S corporations to those that provide broad-based employee coverage and that benefit rank-and-file employees (as well as highly compensated employees and historical owners) is not present, the delayed effective date in section 656(d)(2) of EGTRRA is not available and that such transactions are listed transactions.

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Finding List begins on page ii.

Department of the Treasury
Internal Revenue Service

Rev. Rul. 2003–11, page 285.
Limitation on annual compensation; section 611(c) of EGTRRA. This ruling pertains to whether the allowable compensation limit enacted by section 611(c) of EGTRRA may be applied to former employees and meet the nondiscrimination and coverage requirements of the Code.

Notice 2003–6, page 298.
Nondiscrimination rules; certain governmental plans. This document announces that the Service intends to issue regulations regarding how, and the extent to which, the nondiscrimination rules apply to governmental plans under section 414(d) of the Code other than those maintained by a state or local government, political subdivision, agency, or instrumentality thereof. Comments are requested regarding the content of these regulations. Notice 2001–46 modified.

ADMINISTRATIVE

Announcement 2003–2, page 301.
New Form 8883, *Asset Allocation Statement Under Section 338*, is now available. This form is used to report information about transactions involving the deemed sale of corporate assets under section 338 of the Code.

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.

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

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

Section 61.—Gross Income Defined

26 CFR 1.61–1(a): Gross income
(Also §§ 102; 139; 7805; 1.102–1; 301.7805–1.)

Gross income; general welfare; gifts; disaster relief payments. This ruling holds that amounts paid to an individual by a state agency, a charity, or an employer to reimburse the individual for certain expenses the individual incurs as a result of a Presidentially declared disaster are excluded from the individual's gross income under the administrative general welfare exclusion, sections 102 and 139 of the Code, respectively.

Rev. Rul. 2003–12

ISSUES

(1) Are grants individuals receive under a state's program to pay or reimburse certain reasonable and necessary medical, temporary housing, or transportation expenses they incur as a result of a flood includible in gross income?

(2) Are grants individuals receive under a charitable organization's program to pay or reimburse certain medical, temporary housing, or transportation expenses they incur as a result of a flood includible in gross income?

(3) Are grants employees receive under an employer's program to pay or reimburse certain reasonable and necessary medical, temporary housing, or transportation expenses they incur as a result of a flood includible in gross income?

FACTS

Situation 1. An area within state *ST* was affected by a flood that was a Presidentially declared disaster as defined in § 1033(h)(3) of the Internal Revenue Code. *ST* enacted emergency legislation appropriating funds for grants to pay or reimburse medical, temporary housing, and transportation expenses individuals incur as a result of the flood that are not compensated for by insurance or otherwise. *ST* will not require individuals to provide proof of actual expenses to receive a grant payment. *ST* 's program, however, contains requirements (which are described in the program documents) to ensure that the grant amounts are reasonably expected to be commensurate with the amount of unreimbursed reasonable and necessary medical, temporary housing, and transportation expenses individuals incur as a result of the flood. The grants are not intended to indemnify all flood-related losses or to reimburse the cost of nonessential, luxury, or decorative items and services.

Situation 2. O, a charitable organization described in § 501(c)(3) that is exempt from tax under § 501(a), whose purpose is to provide assistance to individuals who are affected by disasters, also makes grants to distressed individuals affected by the flood described in *Situation 1*. The grants will pay or reimburse individuals for medical, temporary housing, and transportation expenses they incur as a result of the flood that are not compensated for by insurance or otherwise.

Situation 3. Employer *R* makes grants to its employees who are affected by the flood described in *Situation 1*. The grants will pay or reimburse employees for medical, temporary housing, and transportation expenses they incur as a result of the flood that are not compensated for by insurance or otherwise. *R* will not require individuals to provide proof of actual expenses to receive a grant payment. *R*'s program, however, contains requirements (which are described in the program documents) to ensure that the grant amounts are reasonably expected to be commensurate with the amount of unreimbursed reasonable and necessary medical, temporary housing, and transportation expenses *R*'s employees incur as a result of the flood. The grants are not intended to indemnify all flood-related losses or to reimburse the cost of nonessential, luxury, or decorative items and services. The grants are available to all employees regardless of length or type of service with *R*.

LAW AND ANALYSIS

Section 61(a) provides that, except as otherwise provided by law, gross income means all income from whatever source derived. Rev. Rul. 131, 1953–2 C.B. 112, concludes, in part, that certain payments by an employer to its employees for the purpose of helping the employees defray costs they incurred from personal injury and property loss resulting from a tornado do not come within the concept of gross income to the employees under the predecessor of § 61 because the payments are gratuitous, measured solely by need, not related to services rendered, and designed to place the employees in about the same economic position as they were before the tornado. In 1955, the Supreme Court of the United States held that Congress intended under § 61 to tax all gains or undeniable accessions to wealth, clearly realized, over which taxpayers have complete dominion. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), 1955–1 C.B. 207.

The Internal Revenue Service has concluded that payments made by governmental units under legislatively provided social benefit programs for the promotion of the general welfare (*i.e.*, based on need) are not includible in the gross income of the recipients of the payments ("general welfare exclusion"). For example, Rev. Rul. 98–19, 1998–1 C.B. 840, concludes that a relocation payment, authorized by the Housing and Community Development Act of 1974 and funded under the 1997 Emergency Supplemental Appropriations Act for Recovery From Natural Disasters, made by a local jurisdiction to an individual moving from a flood-damaged residence to another residence, is not includible in the individual's gross income. Likewise, Rev. Rul. 76–144, 1976–1 C.B. 17, concludes that grants received under the Disaster Relief Act of 1974 by individuals unable to meet necessary expenses or serious needs as a result of a disaster are in the interest of general welfare and are not includible in the recipients' gross income.

Section 102(a) provides that the value of property acquired by gift is excluded from gross income. Under § 102(a) a gift "must proceed from a 'detached and disinterested generosity,' ... 'out of affection, respect, admiration, charity or like impulses.'" *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960), 1960–2 C.B. 428, 431. In general, a payment made by a charity to an individual that responds to the individual's needs, and does not proceed from any moral or legal duty, is motivated by detached and disinterested generosity. Rev. Rul. 99–44, 1999–2 C.B. 549. Section 102(c) provides that § 102(a) shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee. Governmental grants in response to a disaster generally do not qualify as gifts because the govern-

ment's intent in making the payments proceeds from its duty to relieve the hardship caused by the disaster. *Kroon v. United States*, Civ. No. A–90–71 (D. Alaska 1974).

The Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107–134, 115 Stat. 2427 (2001), added § 139 to the Code. Section 139(a) provides that gross income does not include any amount received by an individual as a qualified disaster relief payment.

Section 139(b) provides, in part, that the term "qualified disaster relief payment" means any amount paid to or for the benefit of an individual:

(1) to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster (§ 139(b)(1));

(2) to reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement, is attributable to a qualified disaster (§ 139(b)(2)); or

(3) by a Federal, State, or local government, or agency or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare (§ 139(b)(4)).

Thus, § 139(b)(4) codifies (but does not supplant) the administrative general welfare exclusion with respect to certain disaster relief payments to individuals. Section 139(b) also provides that the exclusion from income applies only to the extent any expense compensated by such payment is not otherwise compensated for by insurance or otherwise.

Section 139(c) provides that the term "qualified disaster" means:

(1) a disaster that results from a terroristic or military action (as defined in § 692(c)(2));

(2) a Presidentially declared disaster as defined in § 1033(h)(3) (generally, a disaster in an area that has been subsequently determined by the President to warrant federal assistance under the Disaster Relief and Emergency Assistance Act);

(3) a disaster resulting from any event that the Secretary determines to be of a catastrophic nature; or

(4) with respect to amounts described in § 139(b)(4), a disaster that is determined by an applicable Federal, State, or local authority (as determined by the Secretary) to warrant assistance from the Federal, State, or local government or an agency or instrumentality thereof.

Because "of the extraordinary circumstances surrounding a qualified disaster, it is anticipated that individuals will not be required to account for actual expenses in order to qualify for the [§ 139] exclusion, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred." Joint Committee on Taxation Staff, *Technical Explanation of the "Victims of Terrorism Tax Relief Act of 2001," as Passed by the House and Senate on December 20, 2001*, 107th Cong., 1st Sess. 16 (2001). As under § 139, the Service will not require individuals to account for actual disaster-related expenses for governmental payments to qualify under the administrative general welfare exclusion if the amount of the payments is reasonably expected to be commensurate with the expenses incurred.

The grants that individuals receive from *ST*, *O*, and *R*, and the payments that the employees receive from their employer in Rev. Rul. 131, are accessions to wealth clearly realized over which the recipients have complete dominion, and therefore come within the concept of gross income under § 61 as described in *Glenshaw Glass*. Thus, these amounts are included in gross income unless specifically excluded by another provision of law. Accordingly, Rev. Rul. 131 is modified to the extent that it holds that the payments received by the employees from their employer do not come within the concept of gross income.

In *Situation 1*, the grants made by *ST* are reasonably expected to be commensurate with the unreimbursed reasonable and necessary medical, temporary housing, or transportation expenses individuals incur as a result of the flood. These expenses are personal, living, or family expenses within the meaning of § 139. Moreover, they are paid to compensate individuals for expenses that are not compensated for by insurance or otherwise. Thus, the grants are in the nature of general welfare and are, therefore, excluded from the recipients' gross income under the general welfare exclusion. The payments also qualify for exclusion from gross income under § 139. Because *ST* 's intent in making the grants proceeds from its duty to relieve the hardship caused by the disaster, not from a detached and disinterested generosity, the grants made by *ST* do not qualify for exclusion from income as gifts under § 102.

In *Situation 2*, the grants made by *O* are designed to help distressed individuals with unreimbursed medical, temporary housing, or transportation expenses they incur as a result of the flood. Under these facts, *O*'s grants are made out of detached and disinterested generosity rather than to fulfill any moral or legal duty. Thus, the grants are excluded from the gross income of the recipients as gifts under § 102. Because payments by non-governmental entities are not considered payments for the general welfare, the grants made by O are not excluded from the recipients' gross income under the general welfare exclusion. Rev. Rul. 82–106, 1982–1 C.B. 16. It is not necessary to reach the question of whether § 139 applies to the grants.

In *Situation 3*, the grants made by *R* to its employees do not qualify as gifts under § 102. Also, because payments by non-governmental entities are not considered payments for the general welfare, the grants made by *R* are not excluded from the recipients' gross income under the general welfare exclusion. The grants, however, are reasonably expected to be commensurate with the unreimbursed reasonable and necessary personal, living, or family expenses that *R*'s employees incur as a result of a flood that is a qualified disaster as defined in § 139(c). Moreover, they are paid to compensate individuals for expenses that are not compensated for by insurance or otherwise. Therefore, *R*'s grants are qualified disaster relief payments that are excluded from the gross income of *R*'s employees under § 139. Similar to the grants in *Situation 3*, the payments made by the employer described in Rev. Rul. 131 do not qualify as gifts under § 102 and are not excluded from the employees' gross income under the general welfare exclusion. Whether the payments described in Rev. Rul. 131 are included in an employee's gross income depends on whether the payments qualify for exclusion under § 139.

HOLDINGS

Under the facts of this ruling:

(1) Payments individuals receive under a state's program to pay or reimburse unreimbursed reasonable and necessary medical, temporary housing, or transportation expenses they incur as a result of a

flood are excluded from gross income under the general welfare exclusion. Such payments also qualify for exclusion under § 139.

(2) Payments that individuals receive under a charitable organization's program to pay or reimburse unreimbursed medical, temporary housing, or transportation expenses they incur as a result of a flood are excluded from gross income under § 102.

(3) Payments that employees receive under an employer's program to pay or reimburse unreimbursed reasonable and necessary medical, temporary housing, or transportation expenses they incur as a result of a flood are excluded from gross income under § 139.

Amounts that are excluded from gross income under this revenue ruling are not subject to information reporting under § 6041.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 131 is modified.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in § 7805(b), this revenue ruling will not apply adversely to payments received on or before January 21, 2003.

DRAFTING INFORMATION

The principal author of this revenue ruling is Sheldon A. Iskow of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Iskow at (202) 622–4920 (not a toll-free call).

Section 401.—Qualified Pension, Profit-Sharing and Stock Bonus Plans

26 CFR 1.401–1: Qualified pension, profit-sharing and stock bonus plans.

Whether an S corporation ESOP is eligible for the delayed effective date of section 409(p) of the Internal Revenue Code as added by section 656(d)(2) of the Economic Growth and Tax Relief Reconciliation Act of 2001. See Rev. Rul. 2003–6, page 286.

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26 CFR 1.401(a)(17)–1: Limitation on annual compensation.

Limitation on annual compensation; section 611(c) of EGTRRA. This ruling pertains to whether the allowable compensation limit enacted by section 611(c) of EGTRRA may be applied to former employees and meet the nondiscrimination and coverage requirements of the Code.

Rev. Rul. 2003–11

ISSUE

Whether a plan amendment that reflects the increase in the allowable compensation limit contained in section 611(c) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107–16, and applies that increase to former employees, will satisfy the nondiscrimination rules of § 401(a)(4) and the minimum coverage requirements of § 410(b) of the Internal Revenue Code (Code).

FACTS

Plan A is a nongovernmental defined benefit plan with a calendar year plan year and a benefit formula that provides for all participants an annual benefit at normal retirement age equal to the product of: (years of service) x (1 percent) x (high 3-year average compensation). For this purpose, high 3-year average compensation is the average of the compensation over the 3 consecutive plan years for which the average is the highest, and compensation for each year is limited to $150,000, as adjusted for cost-of-living increases (the limit under § 401(a)(17) of the Code prior to the effective date of the EGTRRA amendments to that section). B is a former participant in Plan A who retired as of December 31, 2001. As of December 31, 2001, B has 10 years of service and compensation of $250,000 for each of the 3 years 1999, 2000, and 2001. B's high 3-year average compensation of $166,667 is determined as the average of annual compensation (as limited by § 401(a)(17) of the Code) of $160,000 for 1999, $170,000 for 2000, and $170,000 for 2001. B's annual benefit under the plan formula as of December 31, 2001, is $16,667, calculated as (10) x (.01) x ($166,667). As of December 31, 2001, B is a "highly compensated former employee," as defined in § 1.410(b)–9, and a "former HCE," as defined in § 1.401(a)(4)–12, for purposes of applying the nondiscrimination rules under §§ 410(b) and 401(a)(4) respectively.

In 2002, Plan A is amended (1) to use the $200,000 compensation limit for compensation paid in years beginning after December 31, 2001, (2) to use the $200,000 compensation limit for compensation paid in years beginning prior to January 1, 2002, in determining benefit accruals in years beginning after December 31, 2001, and (3) to use the $200,000 compensation limit in determining retirement benefits to be paid after December 31, 2001, to employees who retired on or before December 31, 2001. A high 3-year average compensation of $200,000 is determined for B as of December 31, 2002, as the average of annual compensation (as limited by § 401(a)(17) of the Code, as amended by EGTRRA) of $200,000 for 1999, $200,000 for 2000, and $200,000 for 2001. As of December 31, 2002, B's annual benefit under the plan formula is $20,000, calculated as (10) x (.01) x ($200,000).

LAW AND ANALYSIS

Section 401(a)(17) limits the annual compensation that may be taken into account for purposes of determining a participant's benefit accruals under a defined benefit plan or a participant's allocations under a defined contribution plan. Section 401(a)(17) also limits the annual compensation that may be taken into account for purposes of certain nondiscrimination requirements, including those in §§ 401(a)(4), 401(a)(5), 401(l), 401(k), 401(m), 403(b)(12), 404(a)(2), and 410(b)(2), and for purposes of determining whether a definition of compensation is nondiscriminatory under § 414(s)(3). Under § 401(a)(17), as in effect prior to the effective date of the EGTRRA amendment, the compensation limit was $150,000, indexed in $10,000 increments for cost-of-living adjustments. For 2001, the compensation limit was $170,000. A higher compensation limit applies to eligible participants in certain governmental plans. See § 1.401(a)(17)–1(d)(4)(ii) of the Income Tax Regulations.

Section 611(c) of EGTRRA amended § 401(a)(17) of the Code by increasing the $150,000 limit (as adjusted) to $200,000, and changing the method used for cost-of-living adjustments. Section 611(c) of EGTRRA made similar amendments to

§§ 404(l), 408(k), and 505(b)(7) of the Code.

Section 611(i)(1) of EGTRRA provides that the increase in the compensation limit under § 401(a)(17) of the Code applies to years beginning after December 31, 2001. Thus, for purposes of determining benefit accruals or the amount of allocations for plan years beginning on or after January 1, 2002, compensation taken into account may not exceed the compensation limit under § 401(a)(17), as amended by section 611(c) of EGTRRA.

Notice 2001–56, 2001–2 C.B. 277, provides that in the case of a plan that uses annual compensation for periods prior to the first plan year beginning on or after January 1, 2002, to determine accruals or allocations for a plan year beginning on or after January 1, 2002, the plan is permitted to provide that the $200,000 compensation limit applies to annual compensation for such prior periods in determining such accruals or allocations.

Section 1.401(a)(4)–5 provides general rules for determining whether the timing of a plan amendment has the effect of discriminating significantly in favor of highly compensated employees. Section 1.401(a)(4)–5(a) provides that whether the timing of a plan amendment has the effect of discriminating significantly in favor of HCEs or former HCEs is determined at the time the plan amendment first becomes effective for purposes of § 401(a), and is based on all of the relevant facts and circumstances.

Section 1.401(a)(4)–10 provides rules for determining whether a plan satisfies the nondiscrimination requirements of § 401(a)(4) with respect to benefits provided to former employees, generally in the form of a plan amendment. Section 1.401(a)(4)–10(b)(1) provides that a plan is nondiscriminatory with respect to the amount of benefits provided to former employees if, under all of the relevant facts and circumstances, the amount of benefits provided to former employees does not discriminate significantly in favor of former employees who are highly compensated employees (HCEs). For this purpose, § 1.401(a)(4)–10(b)(1) specifies that benefits provided to former employees include all benefits provided to former employees or, at the employer's option, only those benefits arising out of the amendment providing the benefits.

Section 1.410(b)–2(c) provides rules for determining whether the group of former employees benefiting under a plan for a year satisfies the coverage requirements of § 410(b) with respect to former employees. Section 1.410(b)–2(c)(2) provides that a plan satisfies § 410(b) with respect to former employees if, under all of the relevant facts and circumstances, a group of former employees benefiting under the plan does not discriminate significantly in favor of highly compensated former employees. Section 1.410(b)–3(b) provides that for this purpose, a former employee is treated as benefiting for a plan year if and only if the plan provides a benefit increase to the former employee for the plan year.

Based on all the relevant facts and circumstances, the amendment to Plan A satisfies the requirements of § 401(a)(4) and § 410(b).

HOLDING

A plan amendment to apply the increased compensation limits under section 611(c) of EGTRRA to all former employees (or all former employees who retain accrued benefits under the plan) that is effective as of the first plan year beginning after December 31, 2001, satisfies the requirements of § 401(a)(4) and § 410(b) of the Code.

DRAFTING INFORMATION

The principal drafters of this revenue ruling are Steven Linder of the Employee Plans, Tax Exempt and Government Entities Division and Linda Phillips of the Office of the Associate Chief Counsel/Division Counsel (TEGE). For further information rearding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number) between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday. Mr. Linder may be reached at (202) 283–9888; Ms. Phillips may be reached at (202) 622–6090. The telephone numbers in the preceding sentence are not toll-free.

Section 409(p).—Prohibited Allocations of Securities in an S Corporation

(Also, §§ 401, 4975, 4979A, 6011, 6111 and 6112; 1.401–1, 54.4975–11, 1.6011–4T, 301.6111–2T and 301.6112–1T.)

Employee stock ownership plans; delayed effective date, abuse. This ruling states that where the intent of section 409(p) of the Code to limit the establishment of ESOPs by S corporations to those that provide broad-based employee coverage and that benefit rank-and-file employees (as well as highly compensated employees and historical owners) is not present, the delayed effective date in section 656(d)(2) of the EGTRRA is not available and that such transactions are listed transactions.

Rev. Rul. 2003–6

PURPOSE

The Internal Revenue Service and the Treasury Department understand that certain arrangements involving employee stock ownership plans (ESOPs) that hold employer securities in an S corporation are being used for the purpose of claiming eligibility for the delayed effective date of § 409(p) of the Internal Revenue Code, under section 656(d)(2) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (Pub. L. 107–16). This revenue ruling alerts taxpayers and their representatives that the tax benefits purportedly generated by these transactions are not allowable for federal income tax purposes. This revenue ruling also alerts taxpayers, their representatives, and organizers or sellers of these transactions to certain responsibilities that may arise from participating in these transactions.

ISSUE

Is an S corporation ESOP described below eligible for the delayed effective date under § 409(p) of the Code provided under section 656(d)(2) of EGTRRA?

FACTS

On or before March 14, 2001, A, a person in the business of providing advice to other companies or individuals, arranges for the establishment of a number of S corpo-

rations that have no substantial assets or business, and forms an ESOP for each of those corporations. A takes the position that some or all of the employees of A are eligible to participate under the terms of the ESOP sponsored by each S corporation, but there is no reasonable expectation that these individuals will accrue more than insubstantial benefits under the plans or more than an insubstantial share in the ownership of the S corporations. After March 14, 2001, A markets these S corporations and the associated ESOPs to other taxpayers, including individuals or companies.

After one of the S corporations (and its ESOP) are transferred to one or more taxpayers, the taxpayers restructure their businesses so that the S corporation receives income from those businesses. After the restructuring, the S corporation is wholly or substantially owned by the ESOP. In addition, there are one or more individual taxpayers who are disqualified persons, within the meaning of § 409(p) of the Code (relating to prohibited allocations under an ESOP that holds stock in an S corporation), who are deemed to own in the aggregate at least 50% of the number of shares of the S corporation.

LAW

Section 4975(e)(7) provides that an ESOP is a defined contribution plan which is (1) either a stock bonus plan which is qualified or a stock bonus plan and money purchase pension plan both of which are qualified under § 401(a), and (2) designed to invest primarily in qualifying employer securities. A plan is not treated as an ESOP unless it meets the following requirements, to the extent applicable: § 409(h) (relating to participants' right to receive employer securities and put options); § 409(o) (relating to participants' distribution rights and payment requirements); § 409(n) (relating to securities received in transactions to which § 1042 applies); § 409(p) (relating to prohibited allocations of securities in an S corporation); § 664(g) (relating to qualified gratuitous transfers of qualified employer securities); and § 409(e) (relating to participants' voting rights), if the employer has a registration-type class of securities (as defined in § 409(e)(4)). As authorized by § 4975(e)(7), additional requirements are imposed under § 54.4975–11 of the Excise Tax Regulations.

The legislative history to the Tax Reform Act of 1976 (TRA '76) (Pub.L. 94–455) states that an ESOP "is a technique of corporate finance designed to build beneficial equity ownership of shares in the employer corporation into its employees . . . ." (See S. Rep. 94–938 at 180 and 1976–3 C.B. Vol. 3, 218.)

Section 1.401–1(a)(2)(ii) of the Income Tax Regulations provides that a qualified profit-sharing plan is established and maintained by an employer to enable employees or their beneficiaries to participate in the profits of the employer's trade or business. However, § 401(a)(27) permits contributions to be made without regard to profits if the plan is designated as a profit-sharing plan. Under § 1.401–1(a)(2)(iii), a stock bonus plan is a plan that provides employees or their beneficiaries benefits similar to those of a profit-sharing plan, except that benefits are distributable in stock of the employer.

Section 409(p) requires that an ESOP that holds employer securities consisting of stock in an S corporation provide that no portion of the assets of the plan attributable to such employer securities may, during a nonallocation year, accrue (or be allocated directly or indirectly under any plan of the employer meeting the requirements of § 401(a)) for the benefit of any disqualified person. Indirect allocations include allocations of income on S corporation stock held in the account of a disqualified person. H.R. Conf. Rep. 107–84 at 276.

Any prohibited allocations in a nonallocation year are treated as distributions and are currently taxable to the disqualified person. Section 409(p)(3) provides that a "nonallocation year" means a plan year during which, at any time, disqualified persons own at least 50 percent of the number of shares of the S corporation. Section 409(p)(4) provides, in general, that a "disqualified person" means a person for whom (1) the aggregate number of deemed-owned shares of such person and the members of such person's family is at least 20 percent of the number of deemed-owned shares of stock in the S corporation or (2) the number of such deemed-owned shares is at least 10 percent of the number of deemed-owned shares of stock in the S corporation. If an ESOP fails § 409(p), prohibited allocations are treated as currently taxable to the disqualified person under § 409(p)(2), and an excise tax equal to 50 percent of the allocations is imposed on the S corporation under § 4979A.

Section 409(p) is effective for plan years beginning after December 31, 2004. However, pursuant to section 656(d)(2) of EGTRRA, § 409(p) of the Code is effective for plan years ending after March 14, 2001, for an ESOP that is established after that date, or if the employer securities held by the plan consist of stock in an S corporation that did not have an S election in effect on that date. Notice 2002–2, Q & A–15, 2002–2 I.R.B. 285, provides that an S corporation does not have an election in effect on March 14, 2001, unless a valid election was actually filed on or before that date and is effective with respect to such corporation on or before that date.

The legislative history to section 656 of EGTRRA, which added § 409(p) to the Code, states that § 409(p) is intended to limit the establishment of ESOPs by S corporations to those that provide broad-based employee coverage and that benefit rank-and-file employees as well as highly compensated employees and historical owners. (See H.R. Rep. 107–51, pt. 1, at 100, and H.R. Conf. Rep. 107–84, at 274 (2001).) In addition, Congress has expressed concern regarding techniques to avoid or evade the requirements of § 409(p). (See § 409(p)(7)(B), which provides that the Secretary may, by regulation or other guidance of general applicability, provide that a nonallocation year occurs in any case in which the principal purpose of the ownership structure of an S corporation constitutes an avoidance or evasion of the nonallocation requirements of § 409(p).)

ANALYSIS

In these transactions, A has not formed the ESOPs to provide substantial benefits, or substantial participation in the ownership of the S corporations, to the initial purported participants in the ESOPs. The initial employees of the entity forming the ESOP do not receive more than insubstantial benefits or more than insubstantial ownership interests through the ESOP. For purposes of the effective date of § 409(p), an ESOP is not established until it is adopted by an employer for the purpose of enabling its employees to participate in a more than insubstantial manner in the ownership of the employer's business and to

provide its employees with more than insubstantial benefits under the ESOP.

For the foregoing reasons, an ESOP adopted by an S corporation under the facts provided above will not be treated as having been established on or before March 14, 2001, and is not entitled to the delayed 2005 effective date for purposes of the nonallocation rules of § 409(p).

Accordingly, because there is a nonallocation year under § 409(p), the disqualified persons under § 409(p)(4) are treated as receiving deemed distributions to the extent of any allocation to their account, pursuant to § 409(p)(2)(A). In addition, excise taxes under § 4979A apply to any nonallocation year.

HOLDING

An S corporation ESOP described in this ruling is not eligible for the delayed effective date under § 409(p) of the Code provided under section 656(d)(2) of EGTRRA, and thus is subject to the nonallocation rules of § 409(p) of the Code effective for plan years ending after March 14, 2001. Any taxpayer who is a disqualified person with respect to the S corporation ESOP is treated as receiving a deemed distribution of stock allocated to the taxpayer's account and income with respect to that account. In addition, excise taxes under § 4979A apply to any nonallocation year.

LISTED TRANSACTIONS

Transactions that are the same as, or substantially similar to, the transaction described in this revenue ruling are identified as "listed transactions" for purposes of § 1.6011–4T(b)(2) of the temporary Income Tax Regulations and § 301.6111–2T(b)(2) of the temporary Procedure and Administration Regulations with respect to each disqualified person for plan years beginning prior to January 1, 2005. See also § 301.6112–1T, A–4. Further, it should be noted that, independent of their classification as "listed transactions" for purposes of §§ 1.6011–4T(b)(2) and 301.6111–2T(b)(2), transactions that are the same as, or substantially similar to, the transaction described in this revenue ruling may already be subject to the disclosure requirements of § 6011, the tax shelter registration requirements of § 6111 or the list maintenance requirements of § 6112 (§§ 1.6011–4T, 301.6111–1T, 301.6111–2T, and 301.6112–1T, A-3 and A–4).

Persons who are required to satisfy the registration requirement of § 6111 with respect to the transaction described in this revenue ruling and who fail to do so may be subject to the penalty under § 6707(a). Persons who are required to satisfy the list-keeping requirement of § 6112 with respect to the transaction and who fail to do so may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on participants in this transaction or substantially similar transactions, or, as applicable, on persons who participate in the reporting of this transaction or substantially similar transactions, including the accuracy-related penalty under § 6662, and the return preparer penalty under § 6694.

FURTHER GUIDANCE

The Service is developing further guidance to address other abusive arrangements involving S corporation ESOPs.

DRAFTING INFORMATION

The principal drafters of this revenue ruling are Steven Linder of the Employee Plans, Tax Exempt and Government Entities Division and John Ricotta of the Office of the Associate Chief Counsel/ Division Counsel (TEGE). For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number) between the hours of 8:00 a.m. and 6.30 p.m. Eastern Time, Monday through Friday. Mr. Linder may be reached at (202) 283–9888; Mr. Ricotta may be reached at (202) 622–6060. The telephone numbers in the preceding sentence are not toll-free.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451–1: General rule for taxable year of inclusion.

Accrual of income. This ruling addresses the accrual of gross income when a taxpayer's customer disputes its liability to the taxpayer because of (1) a clerical mistake in a sales invoice, (2) the shipment of the wrong goods, or (3) the shipment of more items than the customer ordered.

Rev. Rul. 2003–10

ISSUES

(1) Under the all events test of § 451 of the Internal Revenue Code, when does a taxpayer using an accrual method of accounting accrue gross income if the taxpayer ships goods and the customer disputes its liability to the taxpayer because of a clerical mistake in the sales invoice discovered in the next taxable year?

(2) Under the all events test of § 451, when does a taxpayer using an accrual method of accounting accrue gross income if the taxpayer ships the wrong goods and the customer disputes its liability during the taxable year of sale?

(3) Under the all events test of § 451, when does a taxpayer using an accrual method of accounting accrue gross income if the taxpayer ships more items than the customer ordered, the excess quantity is discovered by the customer in the next taxable year, and, in accordance with an agreement with the customer, the taxpayer reduces the quantity that would otherwise have been included in the next shipment?

FACTS

Taxpayer *P* manufactures products *H* and *M* and sells them to retailers for resale. *P* uses an accrual method of accounting and a calendar taxable year. For federal income tax purposes, *P* recognizes gross income from sales of products *H* and *M* when it ships the product to the retailer.

Situation 1. In October 2002, *X*, a retailer, orders 1,000 cases of product *M* from *P* at a price of $15 per case. In November 2002, *P* ships 1,000 cases of *M* to *X* and sends *X* an invoice for the 1,000 cases of *M*. As the result of a data entry mistake, the amount of the invoice is improperly stated as $16,000 rather than $15,000. In January 2003, *X* notifies *P* of the erroneous invoice and P acknowledges that it is entitled to receive only $15,000 for the 1,000 cases of *M*. *X* subsequently pays the $15,000 to P.

Situation 2. *Y* is a retailer that purchases product *M* from P. In September 2002, *Y* orders 600 cases of *M* from *P* at a price of $15 per case. In October 2002, P ships 600 cases of *H* to *Y* and sends *Y* an invoice for $9,000. In November 2002, *Y* discovers that *P* shipped *H* rather than *M* and notifies *P* that it will not pay for the *H*. In January

2003, *P* and *Y* settle the dispute by agreeing that *Y* will pay *P* $4,500 for the *H*.

Situation 3. *Z* is a retailer that purchases products *H* and *M* from *P*. Each month *P* ships *Z* 300 cases of *H* at a price of $10 per case and 700 cases of *M* at a price of $15 per case. On December 28, 2002, *P* mistakenly ships 400 cases of *H* and 600 cases of *M* to *Z* and sends *Z* an invoice for $13,000. On January 3, 2003, *Z* discovers that *P* shipped the wrong amount of *H* and *M* and notifies *P*. *Z* asks *P* to correct the situation by adjusting the amount of *H* and *M* it ships to *Z* in January's monthly shipment. On January 28, 2003, *P* ships 200 cases of *H* and 800 cases of *M* to *Z* to adjust for the amount of *H* and *M* mistakenly shipped to *Z* in December 2002. In February 2003, *Z* pays *P* $13,000 for the *H* and *M* it received in December 2002 and in March 2003, *Z* pays *P* $14,000 for the *H* and *M* it received in January 2003.

LAW AND ANALYSIS

Section 61(a) provides that, except as otherwise provided, gross income means all income from whatever source derived. Section 1.61–3(a) of the Income Tax Regulations provides that in a manufacturing, merchandising, or mining business, "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources.

Section 451 provides rules for determining the taxable year of inclusion for items of gross income. Sections 1.446–1(c)(1)(ii)(A) and 1.451–1(a) provide that under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive the income and the amount thereof can be determined with reasonable accuracy. All the events that fix the right to receive income occur when (1) the required performance takes place, (2) payment is due, or (3) payment is made, whichever happens first. *Schlude v. Commissioner*, 372 U.S. 128, 133 (1963); Rev. Rul. 84–31, 1984–1 C.B. 127; Rev. Rul. 80–308, 1980–2 C.B. 162.

Section 1.446–1(e)(2)(ii)(b) provides that a change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of a tax liability.

Section 1.451–1(a) provides that if an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made. Additionally, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, the taxpayer should, if within the period of limitation, file a claim for credit or refund of any overpayment of tax arising therefrom. *Gould-Mersereau Co. v. Commissioner*, 21 B.T.A. 1316 (1931) *acq.* 1931–2 C.B. 27. If the right to an amount of income is substantially in controversy the income may not be accrued until the controversy is resolved. *North American Oil Consolidated v. Burnet*, 286 U.S. 417 (1932); *Jamaica Water Co. v. Commissioner*, 125 F.2d 512 (2d Cir. 1942); Rev. Rul. 60–237, 1960–2 C.B. 164.

In *Situation 1*, *P*'s invoice to *X* was for an improper amount as a result of a clerical mistake. P may not accrue $16,000 of gross sales in gross income in 2002 because *P* does not have a fixed right to that amount. Rather, *P* accrues $15,000 of gross sales and includes $15,000, the correct amount, less the corresponding cost of goods sold, in gross income in 2002. Generally, if *P* has already filed its income tax return for 2002 when the mistake is discovered, *P* should, if within the period of limitation, file a claim for refund of any overpayment of tax arising from reporting an improper amount of income on that return. If, however, *P* has regularly and consistently for a period of two or more taxable years treated invoice amounts as a reasonable estimate of accrued income and, if the exact amount is subsequently determined to be different, has taken the difference into account for the taxable year in which the determination is made, *P* should seek consent for a change in method of accounting if it wants to begin taking such differences into account in the year of sale.

In *Situation 2*, the dispute arises in the taxable year of sale. Accordingly, because under § 451 *P* does not have a fixed right to the income *P* may not include any amount from that transaction, including the corresponding cost of goods sold, in gross income in 2002. *P* accrues $4,500 of gross sales and includes $4,500, less the corresponding cost of goods sold, in gross income in 2003, when *P* and *Y* settle their dispute by agreeing that *Y* will pay *P* the amount of $4,500 for the *H*.

In *Situation 3*, *P* mistakenly ships the wrong amount of *H* and *M* to *Z* in December 2002 and sends an invoice for $13,000 to *Z*. However, because *Z* does not dispute the shipment *P* has a fixed right to income relating to the shipment in 2002. Accordingly, *P* accrues $13,000 of gross sales and includes $13,000, less the corresponding cost of goods sold, in gross income in 2002 because the all events test of § 451 is satisfied.

HOLDINGS

(1) Under the all events test of § 451, if a taxpayer using an accrual method of accounting overbills a customer due to a clerical mistake in an invoice and the customer discovers the error and, in the following taxable year, disputes its liability for the overbilled amount, then the taxpayer accrues gross income in the taxable year of sale for the correct amount.

(2) Under the all events test of § 451, a taxpayer using an accrual method of accounting does not accrue gross income in the taxable year of sale if, during the taxable year of sale, the customer disputes its liability to the taxpayer because the taxpayer shipped incorrect goods.

(3) Under the all events test of § 451, a taxpayer using an accrual method of accounting accrues gross income in the taxable year of sale if the taxpayer ships excess quantities of goods and the customer agrees to pay for the excess quantities of goods.

REQUEST FOR COMMENTS

The Service requests comment on the application of § 451 to a situation in which *P* ships defective products to a customer that discovers the defect in the next taxable year and disputes its liability to *P*. In particular, the Service requests comments concerning: (1) whether *P* has a fixed right to income within the meaning of § 451 in the taxable year of sale (compare *Hallmark Cards, Inc. v. Commissioner*, 90 T.C. 26 (1988), with *Celluloid Co. v. Commissioner*, 9 B.T.A. 989 (1927) *acq.* VII–1 C.B. 6); (2) whether the taxable year concept of accounting requires *P* to accrue gross income in the taxable year of sale because the dispute did not arise until the next taxable year; (3) examples of situations that should be treated as shipments of defective products (*e.g.*, shipments of damaged goods, shipments of incorrect goods); and

(4) whether the analysis is affected by the course of dealing between *P* and its customer.

Comments should be submitted by April 21, 2003, either to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
Attn: CC:PA:T:CRU (CC:ITA:7)
Room 5529

or electronically at: *Notice.Comments@irscounsel.treas.gov* (the Service's comments e-mail address). All comments are available for public inspection and copying. During its review of the comments, the Service will continue to process private letter ruling requests, including requests for consent to change a method of accounting.

DRAFTING INFORMATION

The principal author of this revenue ruling is John P. Moriarty of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Moriarty at (202) 622–4930 (not a toll-free call).

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 1.901–2: Income, war profits or excess profits tax paid or accrued.
(Also sections 903; 1.903–1.)

Costa Rican income tax law; withholding taxes. This ruling holds that certain Costa Rican taxes are noncreditable soak-up taxes under sections 901 and 903 of the Code. The ruling also serves as an official confirmation to the Costa Rican Tax Administration that these taxes are noncreditable in the United States.

Rev. Rul. 2003–8

ISSUE

Are the withholding taxes specified in Article 61 of the Costa Rican Income Tax Law creditable taxes under sections 901 and 903 of the Internal Revenue Code of 1986?

FACTS

Costa Rica's income tax law imposes a withholding tax on various types of income paid to persons operating or residing outside of Costa Rica at rates specified in Costa Rican Income Tax Law Article 59. The Costa Rican Tax Administration has authority to grant a total or partial exemption from liability for withholding taxes on profits, dividends, social participation, interest, commissions, financial expenses, patents, royalties, reinsurance, consolidation and insurance premiums of all types referred to in Article 59. Costa Rican Income Tax Law art. 61. The exemption can be given if the persons who act as withholding or receiving agents, or the interested parties, prove, to the satisfaction of the Costa Rican Tax Administration, that the recipient of such income is not granted in the country in which it operates or resides any credit against its tax liability for the withholding tax that was paid to Costa Rica. *Id.* In order to claim an exemption under Article 61, the Costa Rican Tax Administration requires the foreign recipient or its withholding agent to provide certification from the tax authorities of the country in which the recipient operates or resides verifying that the tax is not creditable in that country. Costa Rican Income Tax Regulation art. 65.

LAW AND ANALYSIS

Section 901 of the Code allows a credit against United States income tax for the amount of any income, war profits, and excess profits taxes paid or accrued to any foreign country. Section 1.901–2(a)(1) of the Income Tax Regulations provides that a foreign levy is an income tax only if it is a tax, and if the predominant character of that tax is an income tax in the United States sense. Section 1.901–2(a)(3)(ii) provides that the predominant character of a foreign tax is that of an income tax in the United States sense only to the extent that liability for the tax is not dependent, by its terms or otherwise, on the availability of a credit for the tax against income tax liability to another country. Section 1.901–2(c)(1) provides that liability for foreign tax is dependent on the availability of a credit for the foreign tax against income tax liability to another country only if and to the extent that the foreign tax would not be imposed on the taxpayer but for the availability of such a credit.

Section 903 of the Code allows a credit against United States income tax for an amount of tax paid or accrued "in lieu of" an income, war profits or excess profits tax otherwise generally imposed by any foreign country. Section 1.903–1(a) of the regulations provides that a foreign levy is a tax in lieu of an income tax only if it is a tax, and it meets the "substitution requirement" of section 1.903–1(b). Section 1.903–1(b)(2) provides that a foreign tax meets the substitution requirement only to the extent that the liability for the foreign tax is not dependent (by its terms or otherwise) on the availability of a credit for the foreign tax against the income tax liability to another country.

Therefore, if a foreign country imposes a withholding tax only in the event that a credit for the tax is available from the recipient's country of domicile, the tax is not creditable under section 901 or 903.

HOLDING

The withholding taxes referred to in Article 61 of the Costa Rican Income Tax Law are not creditable taxes under section 901 or 903 of the Code since they are imposed only in the event that a credit for the tax is available from the country in which the recipient operates or resides. This ruling is an official confirmation by the Internal Revenue Service that the withholding taxes referred to in Article 61 are not creditable in the United States.

DRAFTING INFORMATION

The principal author of this revenue ruling is Margaret A. Hogan of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Ms. Hogan at 202–622–3850 (not a toll-free call).

Section 1259.—Constructive Sales Treatment for Appreciated Financial Positions

Constructive sales; reestablished positions. This ruling provides guidance on the interaction between section 1259(c)(3)(A) of the Code (exception for certain closed transactions) and section 1259(c)(3)(B) (treatment of positions which are reestablished).

Rev. Rul. 2003–1

ISSUE

If a taxpayer enters into successive short sales of its entire appreciated financial position, must the taxpayer recognize gain pursuant to § 1259(a)(1) of the Internal Revenue Code if all of the short sales are closed before the 30th day after the end of the taxpayer's taxable year and the entire appreciated financial position is held unhedged for a 60-day period beginning on the date on which the last of the short sales is closed?

FACTS

A is a calendar year taxpayer. On January 1, 2002, *A* owns 100 shares of stock in *X* Corporation (*X* stock). On February 1, 2002, *A* enters into a short sale of 100 shares of *X* stock (Short Sale 1). In March of 2002, *A* purchases an additional 100 shares of *X* stock and delivers those shares to close Short Sale 1. On April 1, 2002, *A* enters into a second short sale of 100 shares of *X* stock (Short Sale 2). In May of 2002, *A* purchases an additional 100 shares of *X* stock and delivers those shares to close Short Sale 2. On June 3, 2002, *A* enters into a third short sale of 100 shares of *X* stock (Short Sale 3). On January 15, 2003, *A* purchases an additional 100 shares of *X* stock. Prior to the deadline contained in § 1259(c)(3)(B)(ii)(II), *A* delivers those shares to close Short Sale 3. *A* continues to hold the 100 shares of *X* stock during the 60-day period beginning on the date Short Sale 3 is closed. At all relevant times during that period, *A*'s risk of loss with respect to the 100 shares of *X* stock is not reduced by reason of a circumstance described in § 1259(c)(3)(A)(iii). That is, the 100 shares of *X* stock are held "unhedged" during the 60-day period. At all relevant times, the 100 shares of *X* stock are appreciated.

LAW

Section 1259(a)(1) provides that if there is a constructive sale of an appreciated financial position (AFP), the taxpayer must recognize gain as if the position were sold, assigned, or otherwise terminated at its fair market value on the date of the constructive sale. "Appreciated financial position" is defined in § 1259(b)(1) to include a position with respect to stock if there would be gain were the position sold, assigned, or otherwise terminated at its fair market value. Section 1259(c)(1)(A) treats a taxpayer as having made a constructive sale of an AFP if the taxpayer enters into a short sale of the same or substantially identical property.

Section 1259(c)(3)(A) provides an exception (closed transaction exception) to § 1259(a)(1) for certain closed transactions. The closed transaction exception disregards any transaction that would otherwise be treated as a constructive sale during the taxable year if: (i) the transaction is closed before the end of the 30th day after the close of the taxable year; (ii) the taxpayer holds the AFP throughout the 60-day period beginning on the date the transaction is closed; and (iii) at no time during the 60-day period is the taxpayer's risk of loss with respect to the position reduced by reason of a circumstance that would be described in § 246(c)(4) if references to stock included references to the position. That is, the taxpayer must hold the AFP "unhedged" for a 60-day period beginning on the date of the closing of the transaction that would otherwise be treated as a constructive sale.

If certain requirements are met, even though a subsequent risk-reducing transaction would otherwise prevent the closed transaction exception from applying to some prior transaction, § 1259(c)(3)(B) may cause the subsequent transaction to be disregarded for this purpose. In general, this rule (the reestablished positions exception) applies when a taxpayer closes out a transaction (the prior transaction) that would otherwise cause a constructive sale of an AFP and, during the 60-day period following the closing of the prior transaction, the taxpayer enters into a substantially similar transaction (the subsequent transaction) that, if not disregarded, would violate the "unhedged" 60-day period requirement with respect to the prior transaction. The requirements are: (i) the prior transaction is closed during the taxable year or during the 30 days thereafter; (ii) the subsequent transaction is substantially similar to the prior transaction and would otherwise cause a constructive sale of the AFP; (iii) the subsequent transaction is closed before the 30th day after the close of the taxable year in which the prior transaction occurs; and (iv) the 60-day unhedged requirements of § 1259(c)(3)(A)(ii) and (iii) are met with respect to the subsequent transaction.

ANALYSIS

Short Sale 1

Short Sale 1 is described in § 1259(c)(1) and is closed before the end of the 30th day after 2002. In addition, *A* holds the 100 shares of *X* stock for the 60-day period beginning on the date Short Sale 1 is closed. During part of the 60-day period beginning on the date Short Sale 1 is closed, however, *A*'s risk of loss with respect to *X* stock is reduced because *A* entered into Short Sale 2. Thus, Short Sale 1 fails the closed transaction exception unless the reestablished position exception causes Short Sale 2 to be disregarded.

Short Sale 2 is substantially similar to Short Sale 1, is entered into during the 60-day period beginning on the date Short Sale 1 is closed, is described in § 1259(c)(1) and is closed by the deadline contained in § 1259(c)(3)(B)(ii)(II). In addition, *A* holds the 100 shares of *X* stock for the 60-day period beginning on the date Short Sale 2 is closed. During the 60-day period beginning on the date Short Sale 2 is closed, however, *A*'s risk of loss with respect to *X* stock is reduced because *A* entered into Short Sale 3. Thus, the reestablished position exception does not cause Short Sale 2 to be disregarded unless the reestablished position exception also causes Short Sale 3 to be disregarded.

Short Sale 3 is substantially similar to Short Sale 2, is entered into during the 60-day period beginning on the date Short Sale 2 is closed, is described in § 1259(c)(1) and is closed by the deadline contained in § 1259(c)(3)(B)(ii)(II). In addition, *A* holds the 100 shares of *X* stock for the 60-day period beginning on the date Short Sale 3 is closed, and during the 60-day period beginning on the date Short Sale 3 is closed,

A's risk of loss with respect to *X* stock is not reduced. Accordingly, Short Sale 3 is disregarded as a reestablished position with respect to Short Sale 2, Short Sale 2 in turn is disregarded as a reestablished position with respect to Short Sale 1, and Short Sale 1, therefore, is treated as a closed transaction under § 1259(c)(3)(A).

Short Sale 2

The next question is whether Short Sale 2 causes a constructive sale or whether it too is disregarded for this purpose on the grounds that it is a closed transaction. The analysis supporting the application of that exception is similar to that for Short Sale 1. Short Sale 2 is described in § 1259(c)(1) and is closed before the end of the 30th day after 2002. In addition, *A* holds the 100 shares of *X* stock for the 60-day period beginning on the date Short Sale 2 is closed. During part of the 60-day period beginning on the date Short Sale 2 is closed, however, *A*'s risk of loss with respect to *X* stock is reduced because *A* entered into Short Sale 3. Thus, Short Sale 2 fails the closed transaction exception unless Short Sale 3 is disregarded as a reestablished position. As noted above, Short Sale 3 is disregarded as a reestablished position with respect to Short Sale 2. Therefore, Short Sale 2 is also a closed transaction under § 1259(c)(3)(A).

Short Sale 3

Short Sale 3 is described in § 1259(c)(1) and is closed before the end of the 30th day after 2002. In addition, *A* holds the 100 shares of *X* stock for the 60-day period beginning on the date Short Sale 3 is closed. During the 60-day period beginning on the date Short Sale 3 is closed, *A*'s risk of loss with respect to *X* stock is not reduced. Therefore, Short Sale 3 is a closed transaction under § 1259(c)(3)(A).

Rapid Series of Transactions

A entered into Short Sale 3 on June 3, 2002, more than 60 days after the date on which Short Sale 1 closed. If Short Sale 3 had occurred within that 60-day period, the analysis of Short Sale 1 would remain the same except that, for Short Sale 1 to be a closed transaction, Short Sale 3 would have to be a reestablished position not only with respect to Short Sale 2 but also with respect to Short Sale 1 directly. Thus, if *A* had entered into Short Sale 2 on March 15, 2002, closed Short Sale 2 on March 18, 2002, entered into Short Sale 3 on March 20, 2002, and closed Short Sale 3 on March 25, 2002, Short Sale 3 would qualify to be disregarded as a reestablished position with respect to Short Sale 1 as well as with respect to Short Sale 2.

Decline in Value of the AFP

Section 1259(c)(3)(B)(ii)(I) describes a subsequent transaction that may be disregarded as one "which also would otherwise be treated as a constructive sale of [the AFP]." For the reasons explained below, this provision requires only that the subsequent transaction be a transaction described in § 1259(c)(1) that would cause a constructive sale of the AFP if the subsequent transaction occurred on the date of entering into the prior transaction. This provision does not require that the subsequent transaction independently would cause a constructive sale based on appreciation in the position at the time the subsequent transaction occurs. Thus, the conclusion in this ruling that Short Sale 1 is a closed transaction under § 1259(c)(3)(A) would apply even if the 100 shares of *X* stock had declined in value below *A*'s basis at the time *A* entered into each subsequent transaction.

Requiring appreciation of the 100 shares of *X* stock owned by *A* at the time *A* enters into each subsequent transaction could cause Short Sale 1 to fail the closed transaction exception. For example, assume that on the date that *A* entered into Short Sale 3, the 100 shares of *X* stock still owned by *A* had declined in value below *A*'s basis. If § 1259(c)(3)(B)(ii)(I) required that the *X* stock be appreciated at that time, Short Sale 3 would fail to be a disregarded, reestablished position with respect to Short Sale 2. If Short Sale 3 were not disregarded, then Short Sale 2 would fail the no-risk-reduction requirement in § 1259(c)(3)(A)(iii), which would then cause Short Sale 2 to fail as a disregarded, reestablished position with respect to Short Sale 1.

Requiring appreciation when *A* enters into subsequent transactions would create several unwarranted results. First, in certain circumstances it would treat more favorably a taxpayer, *B*, who has a lower tax basis and, therefore, a larger amount of unrealized appreciation. Thus, if *B* holds appreciated *X* stock with a basis lower than that of *A* and enters into a series of transactions identical to those of *A*, and if the value of the 100 shares of *X* stock at the time of Short Sale 3 is higher than *B*'s basis but lower than *A*'s basis, then *A* would realize gain because of Short Sale 1 but *B* would not. Nothing in the statute or legislative history indicates that Congress intended this dissimilar treatment.

Second, requiring appreciation when *A* enters into subsequent transactions would treat *A* differently from a taxpayer, *C*, who enters into only Short Sale 1 and holds that short position open until the date Short Sale 3 is closed. Although *C* would have reduced risk for a longer period of time than *A*, Short Sale 1 would be a closed transaction that is not subject to § 1259(a) for *C* but would be subject to § 1259(a) for *A*. There also is nothing in the statute or legislative history indicating that Congress intended this dissimilar treatment.

Third, requiring appreciation when *A* enters into subsequent transactions would create circularity problems if the value of the AFP at the time of the later short sale is between the taxpayer's original basis in the AFP and the value of the AFP at the time of the first short sale. In these cases, whether the later short sale is a disregarded transaction would depend on whether the first short sale produced a basis increase as a result of causing a constructive sale to occur, which would depend, in turn, on whether the later short sale is disregarded. As a consequence, many reestablished positions would fail to meet the requirement that they would otherwise be treated as a constructive sale if the existence of unrealized appreciation in the position were tested on the date of the subsequent transaction and, for this purpose, the prior transaction were treated, at least provisionally, as causing a constructive sale. Failure to treat the prior transaction as causing a constructive sale, at least provisionally, would result in the reestablished position failing to meet the requirement that the prior transaction "would otherwise be treated as a constructive sale."

Consequently, ignoring changes in value of the AFP after the initial transaction occurs avoids unwarranted, differential application of the closed transaction exception and also avoids a potential circularity problem in the interpretation of the exception. When there is a series of more than two transactions, the foregoing analysis also ap-

plies to any of the intermediate transactions for purposes of determining whether the reestablished positions exception allows the intermediate transaction to benefit from the closed transaction exception.

HOLDING

Section 1259(c)(3)(A) applies to Short Sale 1, Short Sale 2, and Short Sale 3. Therefore, *A* does not recognize gain pursuant to § 1259(a)(1).

DRAFTING INFORMATION

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

Section 4975.—Tax on Prohibited Transactions

26 CFR 54–4975–11: "ESOP" requirements.

Whether an S corporation ESOP is eligible for the delayed effective date of section 409(p) of the Internal Revenue Code as added by section 656(d)(2) of the Economic Growth and Tax Relief Reconciliation Act of 2001. See Rev. Rul. 2003–6, page 286.

Section 4979A.—Tax on Certain Prohibited Allocations of Qualified Securities

Whether transactions involving an S corporation ESOP and the delayed effective date of section 409(p) of the Internal Revenue Code, as added by section 656(d)(2) of the Economic Growth and Tax Relief Reconciliation Act of 2001, may give rise to the excise tax on the prohibited allocation of qualified securities. See Rev. Rul. 2003–6, page 286.

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 1.6011–4T: Requirement of statement disclosing participation in certain transactions by corporate taxpayers.

Whether transactions involving an S corporation ESOP and the delayed effective date of section 409(p) of the Internal Revenue Code, as added by section 656(d)(2) of the Economic Growth and Tax Relief Reconciliation Act of 2001, are listed transactions. See Rev. Rul. 2003–6, page 286.

Section 6111.—Registration of Tax Shelters

26 CFR 301.6111–2T: Confidential corporate tax shelters.

Whether transactions involving an S corporation ESOP and the delayed effective date of section 409(p) of the Internal Revenue Code, as added by section 656(d)(2) of the Economic Growth and Tax Relief Reconciliation Act of 2001, are listed transactions. See Rev. Rul. 2003–6, page 286.

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

26 CFR 301.6112–1T: Questions and answers relating to the requirement to maintain a list of investors in potentially abusive tax shelters.

Whether a list must be maintained identifying each person who was sold an interest in transactions involving an S corporation ESOP and the delayed effective date of section 409(p) of the Internal Revenue Code, as added by section 656(d)(2) of the Economic Growth and Tax Relief Reconciliation Act of 2001. See Rev. Rul. 2003–6, page 286.

Part III. Administrative, Procedural, and Miscellaneous

LIFO Recapture

Notice 2003–4

This notice provides information concerning the federal income tax consequences of a taxpayer's failure to timely make an installment payment attributable to the last-in, first-out (LIFO) recapture requirement of § 1363(d) of the Internal Revenue Code.

Section 1363(d)(1) provides that a C corporation that accounts for its inventory using the LIFO method and elects S corporation status must include a "LIFO recapture amount" in gross income for the last taxable year before its S election becomes effective. Under § 1363(d)(3), the LIFO recapture amount is the excess of the inventory amount of the inventory assets under the first-in, first-out method over the inventory amount of the assets under the LIFO method. The inventory amounts are determined as of the close of the taxable year prior to the taxable year in which the taxpayer's S election becomes effective.

Section 1363(d)(2) requires payment of the additional tax that is attributable to the inclusion of the LIFO recapture amount in gross income in four equal installments. The first installment payment must be made on or before the due date of the electing corporation's last income tax return as a C corporation. An additional installment must be paid on or before the due date of the corporation's return for each of the 3 succeeding taxable years. No interest is payable with regard to any installment payment that is paid on or before the due date. Due dates are determined without regard to extensions.

A C corporation that accounts for its inventory using the LIFO method that elects S status but fails to include a LIFO recapture amount in gross income for the last taxable year before its S election becomes effective may be liable for a 20 percent accuracy-related penalty pursuant to § 6662. A corporation that fails to make a LIFO recapture installment payment by its required due date may be liable for a failure to pay penalty under § 6651.

A corporation that fails to make a LIFO recapture installment payment by its required due date is liable for interest under § 6601, which requires payment of interest on the unpaid amount from the last date prescribed for payment to the date paid. When determining interest on underpayments, the "last date prescribed for payment" is generally ascertained without regard to any extension of time for payment or filing. However, under § 1363(d)(2)(C), no interest is payable with regard to a LIFO recapture installment payment that is paid by its due date.

Failure to pay, or late payment of, a LIFO recapture installment payment due under § 1363(d) does not cause any remaining unpaid installments to become due immediately. The authority in § 6159(b)(4) to alter or modify an installment agreement if the taxpayer fails to timely make an installment payment is limited to the specific installment payments described in that section and does not apply to installment payments under § 1363(d).

DRAFTING INFORMATION

The principal author of this notice is Scott Rabinowitz of the Office of the Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Mr. Rabinowitz at (202) 622–4970 (not a toll-free call).

Application of Separate Limitations to Dividends From Noncontrolled Section 902 Corporations

Notice 2003–5

I. *PURPOSE*

This notice provides guidance relating to the application of section 904 to dividends paid by a foreign corporation that is a noncontrolled section 902 corporation as defined in section 904(d)(2)(E) (10/50 corporation).[1] This guidance is necessary to reflect the provisions of the Taxpayer Relief Act of 1997 that modified the treatment of dividends from 10/50 corporations in taxable years beginning after December 31, 2002 (post-2002 taxable years). Treasury and the Service intend to issue regulations concerning the treatment of dividends paid by a 10/50 corporation that incorporate the guidance set forth in this notice.

II. *BACKGROUND*

Prior to the Taxpayer Relief Act of 1997 (Public Law 105–34, 111 Stat. 788 (the 1997 Act)), section 904(d)(1)(E) required a domestic corporation meeting the stock ownership requirements of section 902(a) (qualifying shareholder) to compute a separate foreign tax credit limitation for dividends received from each 10/50 corporation. The 1997 Act eliminated the requirement that the foreign tax credit limitation be computed on the basis of a separate category (basket) for dividends from each 10/50 corporation, and instead provided that dividends paid by a 10/50 corporation out of earnings and profits accumulated in post-2002 taxable years (post-2002 earnings) generally will be treated as income in a separate basket based on the separate basket of the underlying earnings and profits being distributed (look-through treatment). Section 904(d)(4). Dividends paid by 10/50 corporations that are not passive foreign investment companies (PFICs) out of earnings and profits accumulated in taxable years beginning before January 1, 2003 (pre-2003 taxable years, and pre-2003 earnings), will be assigned to a single 10/50 dividend basket. Dividends paid by each 10/50 corporation that is a PFIC out of pre-2003 earnings will be assigned to a separate 10/50 dividend basket. Sections 904(d)(1)(E) and 904(d)(2)(E)(iv).

The 1997 Act amendments provide look-through treatment to qualifying shareholders for dividends paid by a 10/50 corporation in a manner similar to the treatment of dividends paid by a controlled foreign corporation (CFC). Dividends paid by a CFC to a U.S. shareholder (as defined in section 951(b)) are entitled to look-through treatment if the distribution is out of earnings and profits accumulated during periods in which the CFC was a CFC. Sections 904(d)(2)(E)(i) and 904(d)(3). A dividend paid by a CFC out of earnings accumulated when the CFC was not a CFC but was a 10/50 corporation is treated as a dividend from a 10/50 corporation. Accord-

[1]Unless otherwise noted, references to section 904 in this notice are to the Internal Revenue Code of 1986 (Code), as in effect for taxable years beginning after December 31, 2002.

ingly, such a dividend receives look-through treatment if paid out of post-2002 earnings, but is treated as income in the single 10/50 dividend basket if paid out of pre-2003 earnings. Section 904(d)(3) extends look-through treatment to interest, rents, and royalties paid to a U.S. shareholder by a CFC as well as to inclusions of income under section 951(a)(1)(A) (subpart F inclusions). In the case of a 10/50 corporation, however, only dividends paid out of post-2002 earnings are eligible for look-through treatment.

III. *APPLICATION OF LOOK-THROUGH RULES TO DIVIDENDS PAID BY 10/50 CORPORATIONS IN POST-2002 TAXABLE YEARS*

A. *In general*

Under section 904(d)(4), dividends paid by a 10/50 corporation out of post-2002 earnings generally will be eligible for look-through treatment. Dividends paid by a 10/50 corporation out of pre-2003 earnings will be treated as income in the single 10/50 dividend basket (or, in the case of dividends from a PFIC, in a separate 10/50 dividend basket). Sections 904(d)(1)(E) and 904(d)(2)(E)(iv). Look-through treatment also applies to dividends paid by a CFC out of earnings accumulated during periods when it was a CFC. Section 904(d)(2)(E)(i). In light of this rule, Treasury and the Service believe that it is appropriate to provide comparable treatment for dividends paid by a 10/50 corporation out of such earnings. Accordingly, the regulations will apply look-through treatment to dividends paid by a 10/50 corporation out of pre-2003 earnings that were accumulated in periods during which the 10/50 corporation was a CFC, except as discussed below.

Proposed § 1.904–4(g)(3)(i)(C)(1) would not provide look-through treatment in the case of earnings accumulated while the distributing corporation was a CFC but distributed after a pre-2003 intervening period during which the distributing corporation was a 10/50 corporation. *See also* Proposed § 1.904–4(g)(3)(i)(C)(2) (providing the same result more generally where a look-through corporation has an intervening period during which such corporation was not a look-through corporation). Treasury and the Service are considering modifying the proposed regulations when they are finalized to provide for look-through treatment in such cases.

B. *Distributions by 10/50 corporations out of pre-acquisition earnings and profits*

The Secretary is authorized to prescribe regulations regarding the treatment of distributions by a 10/50 corporation out of earnings and profits accumulated in periods prior to the taxpayer's acquisition of the stock. *See* section 904(d)(4)(C)(ii)(II). Pursuant to this authority, the regulations will apply look-through treatment to dividends paid to a new qualifying shareholder by a 10/50 corporation out of post-2002 earnings accumulated during periods when the foreign corporation was either a 10/50 corporation with respect to any qualifying shareholder or a CFC but before the recipient became a shareholder of the corporation. The regulations also will provide that dividends paid by a 10/50 corporation out of post-2002 earnings accumulated in periods when the 10/50 corporation was neither a 10/50 corporation with respect to any qualifying shareholder nor a CFC are assigned to the single 10/50 dividend basket in the case of a distribution from a 10/50 corporation that is not a PFIC, and to a separate 10/50 dividend basket in the case of a 10/50 corporation that is a PFIC. Consistent with § 1.904–4(g)(3)(iii) (concerning earnings accumulated in the taxable year in which a corporation becomes a CFC), the regulations also will provide that earnings and profits accumulated in the taxable year in which the corporation became a 10/50 corporation will be considered earnings and profits accumulated after the corporation became a 10/50 corporation.

C. *Ordering rule for post-2002 distributions from 10/50 corporations*

Under section 902(c)(3), the multi-year pools of post-1986 undistributed earnings (as defined in section 902(c)(1)) and post-1986 foreign income taxes (as defined in section 902(c)(2)) of a foreign corporation are determined by taking into account only periods beginning on and after the first day of the foreign corporation's first taxable year in which a domestic corporation owns 10 percent or more of its voting stock, or in the case of a lower-tier foreign corporation, such corporation is a member of a "qualified group" (as defined in section 902(b)(2)).

Under section 902(c)(6)(B)(i), dividends are treated as paid first out of the post-1986 undistributed earnings. Pre-1987 accumulated profits (defined in section 902(c)(6)(A) and § 1.902–1(a)(10) to include both earnings accumulated in pre-1987 taxable years and earnings accumulated in post-1986 taxable years preceding the first year in which the foreign corporation has a qualifying shareholder) are treated as distributed only after the pools of post-1986 undistributed earnings are exhausted, and then out of annual layers of earnings and taxes on a last-in, first-out (LIFO) basis. Distributions out of pre-1987 accumulated profits are governed by the section 902 rules in effect under pre-1987 law. Section 902(c)(6)(A).

Section 1.904–4(g)(3)(i)(B) sets forth a LIFO ordering rule for determining the earnings to which a dividend paid by a CFC is attributable. The dividend is deemed made first from the pools of post-1986 undistributed earnings attributable to the period after the corporation was a CFC (look-through pools), next from the non-look-through pool of post-1986 undistributed earnings (as defined in § 1.904–4(g)(3)(iv)(B)), if any, and finally on a LIFO basis from the annual layers of pre-1987 accumulated profits. Since 10/50 corporations will be considered look-through entities beginning in post-2002 taxable years, the regulations will provide a similar LIFO ordering rule for dividends from a 10/50 corporation. Specifically, a dividend from a 10/50 corporation will be deemed made first from post-1986 undistributed earnings attributable to the post-2002 period when the corporation was eligible for look-through; second, from the non-look-through pool of post-1986 undistributed earnings; and finally, on a LIFO basis from pre-1987 accumulated profits. Treasury and the IRS request comments on the allocation of deficits in the look-through pools or the non-look-through pool in determining the earnings to which a dividend from a 10/50 corporation is attributable, consistent with the rules of § 1.902–2.

IV. *ALLOCATING AND APPORTIONING EXPENSES OF 10/50 CORPORATIONS; DIVIDENDS PAID BY LOWER-TIER CORPORATIONS*

A. *Expense allocation*

Because 10/50 corporations will be treated as look-through entities with respect to certain dividends paid in post-2002 taxable years, deductible expenses of a 10/50 corporation will reduce the corporation's pools of post-1986 undistributed earnings. The regulations will generally provide that expenses of a 10/50 look-through corporation will be allocated and apportioned in the same manner as expenses of a CFC. *See, e.g.*, section 954(b)(5); § 1.904–5(c)(2)(ii).

However, the regulations will not extend the special allocation rule for related person interest expense under section 954(b)(5) and § 1.904–5(c)(2)(ii) (providing that interest paid by a CFC to a U.S. shareholder or any related look-through entity is first allocated to reduce foreign personal holding company income which is passive income) to interest paid by 10/50 corporations, since such corporations are not look-through entities with respect to interest payments and are not subject to subpart F. Accordingly, all interest paid by a 10/50 corporation will be apportioned to reduce the payor's pools of post-1986 undistributed earnings under the rules applicable to unrelated person interest expense.

B. *Look-through treatment of dividends paid by certain lower-tier corporations*

In order for a taxpayer to qualify for look-through treatment with respect to a dividend from a 10/50 corporation, the taxpayer must be a qualifying shareholder with respect to the 10/50 corporation. Sections 904(d)(2)(E) and 904(d)(4). Because a shareholder's eligibility for look-through treatment under section 904(d)(4) is based on the eligibility requirements under section 902, the regulations will apply look-through treatment to a dividend paid by a 10/50 corporation to another foreign corporation where the recipient is eligible to compute foreign taxes deemed paid under section 902(b)(1), (*i.e.*, where both the payor and payee corporations are members of the same qualified group as defined in section 902(b)(2)).

A taxpayer's eligibility for look-through treatment of a dividend paid by a 10/50 corporation is based on eligibility requirements under section 902. In contrast, a taxpayer's eligibility for look-through treatment of a dividend from a CFC is based on whether the taxpayer is a U.S. shareholder with respect to the CFC. *See* sections 904(d)(3)(A) and 904(d)(3)(D). Treasury and the Service believe that the eligibility requirements for look-through treatment for 10/50 corporations and CFCs should be conformed to the extent possible, taking into account the differing eligibility requirements under the Code for look-through treatment of dividends from CFCs and 10/50 corporations. Accordingly, the regulations will apply look-through treatment to any dividend paid by a CFC to another member of the same qualified group (as defined in section 902(b)). Finally, the regulations will retain the current rule of § 1.904–5(i)(3), to the extent it applies look-through treatment to dividends between CFCs that have a common 10 percent U.S. shareholder but do not meet the qualified group test.

C. *Tax accounting elections*

Section 1.964–1(c)(3) permits "controlling U.S. shareholders" of a CFC to make or change tax accounting elections on behalf of the CFC. The controlling U.S. shareholders must meet several requirements before an election is deemed made on behalf of the CFC. *See* § 1.964–1(c)(3). Section 1.861–9T(f)(3)(ii) provides similar rules to allow the controlling U.S. shareholders to elect the asset method or modified gross income method for purposes of apportioning interest expense.

The regulations will apply similar rules in order to provide a mechanism for shareholders of a 10/50 corporation to make or change tax elections on behalf of the corporation for purposes of computing the 10/50 corporation's earnings and profits for U.S. tax purposes. Specifically, the regulations will permit the majority domestic corporate shareholders of a 10/50 corporation to make or change tax elections on behalf of the corporation (subject to generally applicable restrictions, such as elections requiring the consent of the Commissioner). The term "majority domestic corporate shareholders" means those domestic corporations that meet the ownership requirements of section 902(a) with respect to the 10/50 corporation (or to a first-tier foreign corporation that is a member of the same qualified group as the 10/50 corporation), that, in the aggregate, own directly or indirectly more than 50 percent of the combined voting power of all of the voting stock of the 10/50 corporation that is owned directly or indirectly by all domestic corporations that meet the ownership requirements of section 902(a) with respect to the 10/50 corporation (or a relevant first-tier foreign corporation). *See* § 1.985–2(c)(3)(i).

V. *CARRYOVERS AND CARRYBACKS OF EXCESS FOREIGN TAXES UNDER SECTION 904(c)*

Section 904(c) provides that to the extent a taxpayer's foreign income taxes paid or accrued in any taxable year exceed the limitation under section 904 for that year, the excess is carried back first to the second taxable year preceding the taxable year, and then to the first taxable year preceding the taxable year, and finally is carried forward to the five taxable years following the taxable year. As discussed below, regulations will provide transition rules for the carryover and carryback of excess foreign income taxes (excess credits) between pre-2003 taxable years (when pre-2003 distributions from 10/50 corporations are treated as income in separate 10/50 dividend baskets) and post-2002 taxable years (when distributions out of post-2002 earnings are subject to look-through treatment, and distributions out of pre-2003 earnings are treated as income in the single 10/50 dividend basket or, in the case of a PFIC, a separate 10/50 dividend basket).

Except as discussed below in Part VI.A, to the extent a taxpayer has pre-2003 excess credits in any non-PFIC separate 10/50 dividend basket and these credits are carried forward to post-2002 taxable years, the regulations will provide that such credits may be used to the extent that the single 10/50 dividend basket has excess foreign tax credit limitation. This treatment is consistent with consolidating in the single 10/50 dividend basket dividends paid by all non-PFIC 10/50 corporations out of pre-2003 accumulated earnings. Treasury and the Service do not believe that it is consistent with the statute to carry forward excess credits in the separate 10/50 dividend baskets, on a look-through basis, to the baskets to which dividends paid by a 10/50

corporation out of post-2003 earnings are assigned. Excess credits in separate 10/50 dividend baskets should be carried forward to the single 10/50 dividend basket and not the look-through baskets because such excess credits are most appropriately associated with pre-2003 earnings, dividends out of which are allocated to the single 10/50 dividend basket.

With respect to carrybacks of excess credits from post-2002 taxable years to pre-2003 taxable years, the regulations will apply a rule similar to the carryforward rule discussed above: to the extent a taxpayer has post-2002 excess credits in the single 10/50 dividend basket and these credits are carried back to pre-2003 taxable years, the credits will reduce excess limitation in separate 10/50 dividend baskets (other than 10/50 dividend baskets with respect to PFICs). If the amount of credits carried back to the 2001 or 2002 taxable year is smaller than the aggregate excess limitation in all of the taxpayer's separate 10/50 dividend baskets for the year, the regulations will provide that the amount will be allocated *pro rata* among the non-PFIC separate 10/50 dividend baskets based on the relative amount of excess limitation in each such basket. The regulations will provide that to the extent a taxpayer has post-2002 excess credits in a look-through basket and these credits are carried back to pre-2003 taxable years, the credits will be carried back within the same look-through basket and not to the separate 10/50 dividend baskets. Excess credits in one separate 10/50 dividend basket carried forward from taxable years beginning in 1998–2002 cannot then be carried back to reduce excess limitation in a different separate 10/50 dividend basket with excess limitation in taxable years beginning in 2001 or 2002. Under section 904(c), only foreign taxes that are paid or accrued in a taxable year (and not taxes that are carried forward from a prior taxable year) are eligible to be carried back to prior taxable years.

VI. *SEPARATE LIMITATION LOSSES AND OVERALL FOREIGN LOSSES*

Section 904(f) contains rules for allocating and recapturing foreign losses. To the extent a loss in a separate basket (separate limitation loss or SLL) exceeds income in the same basket, the SLL is allocated to and reduces income in other baskets on a proportionate basis. Section 904(f)(5)(B). The SLL is subject to recapture in subsequent years to the extent income is earned in the loss basket. Section 904(f)(5)(C). An overall foreign loss (OFL) arises where there is a loss in all of a taxpayer's baskets combined. To the extent an OFL reduces U.S. source taxable income, it is subject to recapture in subsequent years at a rate of 50 percent (or such larger percent as the taxpayer may choose) of any foreign source income earned. Section 904(f)(1); § 1.904(f)–1(d)(1). Since all the non-PFIC separate 10/50 dividend baskets will be replaced by a single 10/50 dividend basket in post-2002 taxable years, the regulations will provide transition rules, as described below, for recapture in a post-2002 taxable year of (1) an OFL or SLL in a separate 10/50 dividend basket that offset U.S. source income or foreign source income in other baskets in a pre-2003 taxable year, and (2) an SLL in another basket (*e.g.*, the general or passive basket) that offset income in a separate 10/50 dividend basket in a pre-2003 taxable year.

A. *Recapture of an OFL or SLL arising in a separate 10/50 dividend basket*

The regulations will provide that a taxpayer consolidates OFL and SLL accounts of non-PFIC separate 10/50 dividend baskets (*i.e.*, OFLs and SLLs arising in non-PFIC separate 10/50 dividend baskets that offset U.S. source income or foreign source income in other baskets, respectively) into one set of OFL and SLL accounts of the single 10/50 dividend basket beginning in the taxpayer's first post-2002 taxable year. Thus, for example, where a taxpayer had OFLs and SLLs in non-PFIC separate 10/50 dividend baskets that offset U.S. source income and foreign source income in the general and passive baskets, the OFL and SLL recapture accounts will be consolidated in the single 10/50 dividend basket, and income subsequently earned in the single 10/50 dividend basket will be recaptured as U.S. source income and foreign source income in the general and passive baskets to the extent of the respective OFL and SLL combined accounts. Any SLL recapture account in a non-PFIC separate 10/50 dividend basket with respect to another non-PFIC separate 10/50 dividend basket will be eliminated since "recapture" to and from the single 10/50 dividend basket would be meaningless.

Treasury and the Service recognize that requiring taxpayers to consolidate the separate 10/50 OFL and SLL recapture accounts into one set of OFL and SLL accounts of the single 10/50 dividend basket may be unfavorable to taxpayers that have an OFL or SLL account in a separate 10/50 dividend basket and that no longer are qualifying shareholders with respect to the foreign corporation. In pre-2003 taxable years, recapture of the OFL or SLL account would not occur because the taxpayer would not receive any additional dividends from the corporation that would be treated as 10/50 dividend income in the separate 10/50 loss basket (unless the former shareholder reacquired a sufficient interest in the corporation to become a qualifying shareholder). Accordingly, the regulations will provide that where a taxpayer no longer is a qualifying shareholder with respect to a foreign corporation on December 20, 2002 (or no longer is a qualifying shareholder on the first day of the taxpayer's first post-2002 taxable year, pursuant to a transaction that is the subject of a binding contract which is in effect on December 20, 2002), any OFL or SLL recapture accounts with respect to the taxpayer's separate 10/50 dividend basket for that corporation will not be consolidated into the single 10/50 dividend basket's OFL and SLL accounts.

Consistent with the exception for OFL and SLL accounts with respect to stock of a foreign corporation in which the taxpayer is no longer a qualifying shareholder, the regulations will not permit a taxpayer to carry over excess credits arising in separate 10/50 dividend baskets to the single 10/50 dividend basket where OFL and SLL accounts in the separate 10/50 dividend baskets are not consolidated into the OFL and SLL accounts of the single 10/50 dividend basket. However, the regulations will allow a taxpayer to elect to carry over all excess credits in non-PFIC separate 10/50 dividend baskets to the single 10/50 dividend basket if the taxpayer consolidates the OFL and SLL recapture accounts of all such separate 10/50 dividend baskets into the OFL and SLL accounts of the single 10/50 dividend basket.

B. *Recapture of an SLL arising in other baskets*

The regulations will provide that to the extent an SLL in another basket (*e.g.*, the general or passive basket) offset income in

a non-PFIC separate 10/50 dividend basket in a pre-2003 taxable year, income in the loss basket subsequently earned in post-2002 taxable years will be recaptured as income in the single 10/50 dividend basket. Recapturing SLL accounts that originally offset income in separate 10/50 dividend baskets as income in the single 10/50 dividend basket is consistent with the rule (discussed in Part V, above) permitting taxpayers to carry over excess credits from separate 10/50 dividend baskets into the single 10/50 dividend basket. For example, assume a general basket SLL offset income in a separate 10/50 dividend basket. In such a case, any excess credits in that separate 10/50 basket will carry over to the single 10/50 dividend basket, and general basket income in a post-2002 taxable year will be recharacterized as income in the single 10/50 dividend basket.

VII. *TREATMENT OF SEPARATE 10/50 DIVIDEND BASKETS MAINTAINED AT THE CFC LEVEL*

Where a CFC has non-PFIC separate 10/50 dividend baskets containing earnings and deficits accumulated in pre-2003 taxable years, the regulations will require, as a general rule, that the earnings and deficits be consolidated in and form the opening balance of the earnings pool of the single 10/50 dividend basket beginning in the CFC's first U.S. post-2002 taxable year. The pools of post-1986 foreign income taxes in the non-PFIC separate 10/50 dividend baskets similarly will be consolidated in the post-1986 foreign income taxes pool of the single 10/50 dividend basket. However, a separate 10/50 dividend basket containing non-look-through earnings of the CFC accumulated in periods prior to becoming a CFC will not be consolidated. These earnings will be treated as earnings in the non-look-through pool of post-1986 undistributed earnings, which are deemed distributed only after distributions exhaust the post-1986 look-through pools, which include the earnings in the pool of the post-2002 single 10/50 dividend basket. *See* § 1.904–4(g)(3)(i)(B).

The regulations also will provide an exception from the general rule combining earnings and deficits and foreign income taxes where a CFC has an accumulated deficit in a separate 10/50 dividend basket with respect to stock in a foreign corporation that is no longer a member of a qualified group that includes the CFC. Treasury and the Service were concerned that requiring consolidation in this case could result in a large deficit in the single 10/50 dividend basket for some CFCs. Treasury and the Service also believe it is appropriate in this situation to simplify the general rule requiring the ratable allocation of deficits in determining deemed-paid taxes in connection with distributions or inclusions. *See* § 1.960–1(i)(4). Accordingly, the regulations will provide that where a CFC has a deficit in a separate 10/50 dividend basket with respect to stock in a foreign corporation that is not a member of a qualified group that includes the CFC on December 20, 2002 (or is not a qualified group member on the first day of the CFC's first post-2002 taxable year pursuant to a binding contract in effect on December 20, 2002), the deficit in the separate 10/50 dividend basket will not be consolidated in the opening balance of the CFC's single 10/50 dividend basket. Instead, the deficit will be allocated to reduce post-1986 undistributed earnings in the CFC's other baskets (ratably on the basis of accumulated earnings in the other baskets as of the first day of the CFC's first post-2002 taxable year), and the deficit will be permanently reduced to zero. In pre-2003 taxable years, only dividend income from the same 10/50 corporation could eliminate the deficit in the separate 10/50 dividend basket, so that if the 10/50 corporation was no longer a member of the same qualified group as the CFC, the CFC would not have any additional earnings in that basket out of which to pay a dividend, and its U.S. shareholder therefore would be ineligible to claim an indirect credit with respect to any foreign taxes in the deficit basket. *See* § 1.902–1(b)(4). Accordingly, any foreign taxes in the separate 10/50 dividend basket will remain in that basket, and a qualifying shareholder of the CFC generally will not be eligible to claim an indirect credit for these taxes.

VIII. *EFFECTIVE DATE*

Regulations to be issued relating to the guidance set forth in this notice will be effective for taxable years beginning after December 31, 2002. Until such regulations are issued, taxpayers may rely on this notice.

IX. *REQUEST FOR COMMENTS AND CONTACT INFORMATION*

Treasury and the Service request comments on the rules described in this notice and any additional issues that should be addressed by regulations. Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: Ginny Chung (Notice 2003–5), room 4555, CC:INTL:Br3, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to *Notice.Comments@m1.irscounsel.treas.gov.* Comments will be available for public inspection and copying. Treasury and the IRS request comments by February 18, 2003. For further information regarding this notice, contact Ginny Chung of the Office of Associate Chief Counsel (International) at (202) 622–3850 (not a toll-free call).

Extension of Relief Relating to Application of Nondiscrimination Rules for Certain Governmental Plans

Notice 2003–6

I. PURPOSE

The Internal Revenue Service and the Treasury intend to issue regulations that will provide further guidance on the application of the nondiscrimination requirements of the Internal Revenue Code for governmental plans within the meaning of § 414(d), other than for plans of State and local governments or political subdivisions, agencies or instrumentalities thereof. It is anticipated that these regulations will provide that such governmental plans will be deemed to satisfy §§ 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) of the Code until the first day of the first plan year beginning on or after the date final regulations are issued. In addition, this notice requests comments on how the nondiscrimination requirements should be applied to such governmental plans under these regulations.

II. BACKGROUND

Section 414(d) of the Code provides that the term "governmental plan" means a plan established and maintained for its employ-

ees by the government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. The term "governmental plan" also includes any plan to which the Railroad Retirement Act of 1935 or 1937 (the "Act") applies and which is financed by contributions under that Act, and any plan of an international organization which is exempt from taxation by reason of the International Organizations Immunities Act (59 Stat. 669).

Section 1505 of the Taxpayer Relief Act of 1997 ("TRA '97") generally provides that the nondiscrimination rules do not apply to State and local governmental plans. In particular, § 1505 of TRA '97 amended the Code to provide that §§ 401(a)(3), 401(a)(4), and 401(a)(26) shall not apply to such plans. Section 1505 of TRA '97 amended § 401(k) of the Code to provide that State and local governmental plans shall be treated as meeting the requirements of § 401(k)(3). In addition, § 1505(a)(3) of TRA '97 amended § 410(c) of the Code to provide that governmental plans shall be treated as meeting the requirements of § 410 for purposes of § 401(a). This amendment to § 410(c), by its terms, is not limited to State and local governmental plans but applies to all governmental plans within the meaning of § 414(d).

Notice 2001–46, 2001–2 C.B. 122, provided that governmental plans, other than plans maintained by State or local governments or political subdivisions or instrumentalities thereof, would be deemed to satisfy §§ 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) of the Internal Revenue Code until the first day of the first plan year beginning on or after January 1, 2003. Notice 2001–46 also provided that the regulations relating to these provisions would not apply until plan years beginning on or after that date.

III. EXTENSION OF RELIEF RELATING TO APPLICATION OF NONDISCRIMINATION RULES FOR CERTAIN GOVERNMENTAL PLANS

It is anticipated that future regulations will provide that governmental plans within the meaning of § 414(d), other than those maintained by State or local governments or political subdivisions, agencies or instrumentalities thereof, shall be treated as satisfying the requirements of §§ 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) until the first day of the first plan year beginning on or after the date final regulations describing the application of these provisions to such plans are issued.

IV. REQUEST FOR COMMENTS

The Service and Treasury request comments on how the nondiscrimination requirements described above should be applied to governmental plans within the meaning of § 414(d) other than those maintained by State or local governments or political subdivisions, agencies or instrumentalities thereof. Comments should be submitted by February 28, 2003, to CC:ITA:RU (Notice 2003–6), Room 5226, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, D.C. 20044. Comments may be hand-delivered between the hours of 8 a.m. and 4 p.m., Monday through Friday to CC:ITA:RU (Notice 2003–6), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington D.C. Alternatively, comments may be submitted via the Internet at *Notice.Comments@irscounsel.treas.gov.* All comments will be available for public inspection.

V. EFFECT ON OTHER DOCUMENTS

Notice 2001–46 is modified.

DRAFTING INFORMATION

The principal author of this notice is Diane S. Bloom of Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, contact the Employee Plans taxpayer assistance telephone service between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday, by calling (877) 829–5500 (a toll-free number). Ms. Bloom may be reached at (202) 283–9888 (not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Rents and Royalties

REG–151043–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the inclusion in gross income of advance rentals. The proposed regulations authorize the Commissioner to provide rules allowing for the inclusion of advance rentals in gross income in a year other than the year of receipt. The proposed regulations will affect taxpayers that receive advance payments for the use of certain items (such as intellectual property) to be designated by the Commissioner.

DATES: Written or electronic comments and requests for a public hearing must be received by February 17, 2003.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–151043–02), room 5226, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:ITA:RU (REG–151043–02), Courier's Desk Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at *www.irs.gov/regs*.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Edwin B. Cleverdon, at (202) 622–7900; concerning submissions of comments, Guy Traynor, at (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 relating to the inclusion in gross income of advance rentals under section 61.

Explanation of Provisions

Currently § 1.61–8(b) provides that, except as provided in section 467 and the regulations thereunder, advance rentals must be included in gross income in the year of receipt regardless of the period covered or the method of accounting employed by the taxpayer. The proposed amendments authorize the Commissioner to provide, through administrative guidance, rules for deferring income inclusion of advance rentals to a taxable year other than the year of receipt. This amendment will ensure that the Commissioner, in modifying Rev. Proc. 71–21, 1971–2 C.B. 549, may provide deferral rules for licenses of intellectual property.

Proposed Effective Date

The regulations, as proposed, are effective on the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

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

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is Edwin B. Cleverdon, Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendment to the Regulations

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

PART—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 § 1.61–8, the first sentence of paragraph (b) is revised to read as follows:

§ 1.61–8 Rents and royalties.

* * * * *

(b) * * * Except as provided in section 467 and the regulations thereunder, and except as otherwise provided by the Commissioner in published guidance (see § 601.601(d)(2) of this chapter), gross income includes advance rentals, which must be included in income for the year of receipt regardless of the period covered or the method of accounting employed by the taxpayer. * * *

David A. Mader,
Assistant Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 17, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 18, 2002, 67 F.R. 77450)

New Form 8883, *Asset Allocation Statement Under Section 338*

Announcement 2003–2

The IRS has released new **Form 8883**, *Asset Allocation Statement Under Section 338*. Form 8883 is used to report information about transactions involving the deemed sale of corporate assets under section 338.

You can obtain Form 8883 by telephone or by using IRS electronic information services.

Request by	Number or address
Telephone	**1–800–TAX–FORM** (1–800–829–3676)
Personal Computer:	
IRS Web Site	***www.irs.gov***
File transfer protocol	**ftp.irs.gov**

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

Numerical Finding List[1]

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2002–26 through 2002–52 is in Internal Revenue Bulletin 2003–1, dated January 6, 2003.

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[2] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2002–26 through 2002–52 is in Internal Revenue Bulletin 2003–1, dated January 6, 2003.