

## HIGHLIGHTS OF THIS ISSUE

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

### INCOME TAX

#### **Rev. Rul. 2001-6, page 491.**

#### **Deductibility of payments in redemption of stock held by an employee stock ownership plan (ESOP).**

Payments in redemption of stock held by an ESOP that are used to make distributions to terminating ESOP participants are not deductible and do not constitute "applicable dividends" under section 404(k)(1) of the Code.

#### **T.D. 8919, page 505.**

#### **REG-119352-00, page 525.**

Temporary and proposed regulations provide guidance under section 1502 of the Code regarding the time for filing an application for a tentative carryback adjustment by consolidated groups and by certain new members of consolidated groups. A public hearing on the proposed regulations is scheduled for April 26, 2001.

#### **T.D. 8922, page 508.**

#### **REG-121928-98, page 520.**

Temporary and proposed regulations provide guidance relating to the recovery of attorney's fees and other costs where a qualified offer has been made under section 7430 of the Code. A public hearing on the proposed regulations is scheduled for May 23, 2001.

#### **T.D. 8923, page 485.**

Final regulations under sections 170, 2055, and 2522 of the Code relate to the definition of a guaranteed annuity interest and a unitrust interest for purposes of the gift, estate, and income tax charitable deductions.

#### **T.D. 8924, page 489.**

#### **REG-106791-00, page 521.**

Temporary, final, and proposed regulations under section 301 of the Code relate to the assumption of liabilities in certain corporate transactions. A public hearing on the proposed regulations is scheduled for May 31, 2001.

#### **T.D. 8925, page 496.**

Final regulations under section 708 of the Code clarify the tax consequences of partnership mergers and divisions.

#### **T.D. 8926, page 492.**

Final regulations under sections 643 and 664 of the Code modify the application of rules governing the character of certain distributions from charitable remainder trusts.

### EMPLOYEE PLANS

#### **REG-116468-00, page 522.**

Proposed regulations under section 420(c)(3) of the Code clarify the circumstances under which an employer is considered to have significantly reduced retiree health coverage during the cost maintenance period. A public hearing is scheduled for March 15, 2001.

#### **Announcement 2001-12, page 526.**

This announcement responds to commonly asked questions regarding the rules for determining the GUST remedial amendment period for employers who use M&P or volume submitter specimen plans.

(Continued on the next page)

Finding Lists begin on page ii.

Announcements of Disbarments and Suspensions begin on page 529.

Index for January begins on page iv.



## ESTATE AND GIFT TAX

### **T.D. 8923, page 485.**

Final regulations under sections 170, 2055, and 2522 of the Code relate to the definition of a guaranteed annuity interest and a unitrust interest for purposes of the gift, estate, and income tax charitable deductions.

## EMPLOYMENT TAX

### **Notice 2001-14, page 516.**

#### **Application of employment taxes to statutory options.**

This notice provides notice of intent to issue guidance regarding an employer's income tax withholding obligations upon a disposition of stock acquired by an individual pursuant to the exercise of a statutory option. This notice also provides notice of intent to issue administrative guidance clarifying cur-

rent law as to the application of employment taxes upon an exercise of a statutory option. Public comments about the anticipated guidance must be submitted by May 7, 2001. Rev. Rul. 71-52 obsolete. Notice 87-49 modified.

## ADMINISTRATIVE

### **Notice 2001-13, page 514.**

This notice announces the extension of the Comprehensive Case Resolution pilot program, which was announced in Notice 2000-43, 2000-35 I.R.B. 209, and under which large business taxpayers may request resolution of all years they have open under examination by the Large and Mid-Size Business Division, in Appeals, and in docketed status before the United States Tax Court, through an Internal Revenue Service team process.

# 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 proce-

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

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

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

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

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

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

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

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

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

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

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

## Section 162(k).—Stock Reacquisition Expenses

26 CFR None: None.

Does section 162(k) of the Internal Revenue Code disallow any deduction claimed by a corporation under section 404(k) for payments in redemption of its stock held by an ESOP that are used to make distributions to terminating ESOP participants? See Rev. Rul. 2001-6, page 491.

## Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-6: Charitable contributions in trust.

### T.D. 8923

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

### Lifetime Charitable Lead Trusts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the definitions of a guaranteed annuity interest and a unitrust interest for purposes of the income, gift, and estate tax charitable deductions. The regulations affect taxpayers who make transfers to charitable lead trusts. The regulations restrict the permissible terms for charitable lead trusts and are necessary to ensure that the amount the taxpayer claims as a charitable deduction reasonably correlates to the amount ultimately passing to the charitable organization.

DATES: *Effective Dates:* These regulations are effective January 5, 2001.

*Applicability Dates:* For dates of applicability of these regulations, see §§1.170A-6(e), 20.2055-2(e)(3)(iii), and 25.2522(c)-3(e).

FOR FURTHER INFORMATION CONTACT: Scott S. Landes at 202-622-3090.

SUPPLEMENTARY INFORMATION:

### Background

On April 5, 2000, the IRS published in the **Federal Register** (65 F.R. 17835) a

notice of proposed rulemaking (REG-100291-00, 2000-16 I.R.B. 917) relating to the permissible terms for charitable guaranteed annuity interests and unitrust interests. This document adopts final regulations with respect to the notice of proposed rulemaking. Written comments were received with respect to the proposed regulations, but no public hearing was requested or held. A summary of the principal comments received is provided below.

In general, in order to qualify as a guaranteed annuity interest or unitrust interest for purposes of the income, estate, and gift tax charitable deductions under sections 170(c), 2055(e)(2), and 2522(c)(2), respectively, the permissible term for the charitable lead interest must be either a specified term of years, or the life or lives of individuals living at the date of the transfer. The proposed regulations limit the individuals who may be used as measuring lives to the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. This proposed limitation is intended to eliminate abusive schemes utilizing seriously ill individuals, who are unrelated to the grantor or the remainder beneficiaries, as measuring lives for charitable lead trusts.

Commentators argued that by limiting the class of individuals who can be used as measuring lives in a charitable lead trust, the regulations preclude the use of these trusts in certain nonabusive situations. In response to these comments, several changes were made to the final regulations to provide a greater degree of flexibility for selecting a measuring life.

The final regulations expand the class of permissible measuring lives to include an individual who, with respect to all non-charitable remainder beneficiaries, is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. Thus, remainder beneficiaries can include step-children and step-grandchildren of the individual who is the measuring life, and charitable organizations (described in section 170, 2055, or 2522).

The final regulations also provide that a trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's

spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed at the date of transfer to the trust taking into consideration the interests of all individuals living at that time. This change will afford drafters the flexibility to provide for alternative remainder beneficiaries in the event the primary remainder beneficiary and his or her descendants predecease the individual who is the measuring life for the term of the charitable interest.

The application of the probability test may be illustrated by assuming a grantor establishes a charitable lead annuity trust (CLAT) that provides for the annuity to be paid to a charity for the life of A who is age 75 on the date the CLAT is created. On A's death, the corpus is to pass to A's only child, B, age 50 on the date the CLAT is created. If B predeceases A, the corpus is to pass to B's issue then living and if B has no living issue at that time, then to A's heirs at law (which class could include A's siblings, uncles, aunts, nieces and nephews). B has no living children on the date the CLAT is created. Based on the current applicable Life Table contained in §20.2031-7 of the Estate Tax Regulations (Life Table 90CM), the probability that B will predecease A, and the trust will pass to individuals who are not lineal descendants of A is 10.462%, taking into account the interests of remainder beneficiaries living at the time the trust was created. Since the probability that any trust corpus will pass to beneficiaries who are not lineal descendants of A is less than 15%, the CLAT will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of A or A's spouse.

Several commentators identified hypothetical situations where an individual who is either unrelated to the remainder beneficiaries, or a remote family member, could be used as a measuring life to achieve an estate planning objective. The commentators suggested three alternative standards that would expand the class of permissible measuring lives. None of these suggestions has been adopted.

First, one commentator suggested that the regulations allow a charitable lead trust to use as a measuring life an ancestor

of any remainder beneficiary rather than an ancestor of all remainder beneficiaries. Under the suggested standard, the charitable lead trust could provide a nominal remainder interest for descendants of the measuring life, with the balance passing to the grantor's family members. Thus, the standard would do little to prevent the abuse the regulations are intended to address.

Second, one commentator suggested that the regulations provide that an individual is a permissible measuring life if all remainder beneficiaries are natural objects of the individual's bounty. However, the determination of whether a person is the natural object of one's bounty requires an inquiry into facts that may be difficult to ascertain or verify. Such a subjective standard would create uncertainty and would be difficult to administer.

Third, one commentator suggested that if the charitable interest is payable for the life of an individual, then the trust must require that, in the event the individual fails to survive to a normal life expectancy, a guaranteed lump sum will be paid to charity (determined actuarially), that will make up for the shortfall in the charitable annuity. A provision requiring such a payment in the event of the premature death of the measuring life would be complex and inconsistent with the valuation rules of section 7520. In addition, this requirement would in substance convert a life interest to a term of years interest and in some cases allow that term interest to be commuted. Thus, such a requirement may conflict with other rules prohibiting commutation or prepayment of the charitable lead interest.

In summary, the Treasury Department and the IRS acknowledge that there may be situations in which the grantor, for a valid estate planning objective, may desire to use an individual as a measuring life who does not satisfy the criteria in the regulations (for example, where a remainder beneficiary is dependent on a nonfamily member for support and the trust corpus is intended to provide that support after the death of the nonfamily member). However, the Treasury Department and the IRS believe that in these situations the grantor's objectives can be satisfied through the use of other permissible estate planning techniques. In situations where

a charitable lead trust is utilized, the Treasury Department and the IRS believe that the final regulations allow adequate flexibility for achieving legitimate estate planning objectives while providing reasonable safeguards to preclude abusive arrangements.

### Special Analyses

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

### Drafting Information

The principal author of these regulations is Scott S. Landes, Office of the Chief Counsel, IRS. Other personnel from the IRS and the Treasury Department participated in their development.

### Adoption of Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805 \* \* \*  
Section 1.170A-6 also issued under 26 U.S.C. 170(f)(4); 26 U.S.C. 642(c)(5). \* \* \*

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

1. Paragraph (c)(2)(i)(A) is amended as follows:

a. In the first sentence, the comma is removed.

b. In the second sentence, the language "of years" is added after the word "term", the language "an individual or individu-

als" is removed, and "certain individuals" is added in its place.

c. The third sentence is removed, and six new sentences are added in its place.

d. In the penultimate sentence, the language "of years" is added after the word "term", the language "an individual" is removed, and "the donor" is added in its place.

2. Paragraph (c)(2)(ii)(A) is amended as follows:

a. In the fifth sentence, the language "of years" is added after the word "term", "an individual or individuals" is removed, and "certain individuals" is added in its place.

b. The last sentence is removed, and six new sentences are added in its place.

3. Paragraph (e) is amended by adding four sentences to the end of the paragraph.

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

The additions read as follows:

#### *§1.170A-6 Charitable contributions in trust.*

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(i) \* \* \* (A) \* \* \* Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of

21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664. \* \* \*

(ii) \* \* \* (A) \* \* \* Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664.

(e) *Effective date.* \* \* \* In addition, the rule in paragraphs (c)(2)(i)(A) and (ii)(A) of this section that guaranteed annuity interests and unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals applies to transfers made on or after April 4, 2000. If a

transfer is made to a trust on or after April 4, 2000, that uses an individual other than one permitted in paragraphs (c)(2)(i)(A) and (ii)(A) of this section, the trust may be reformed to satisfy this rule. As an alternative to reformation, rescission may be available for a transfer made on or before March 6, 2001. See §25.2522(c)-3(e) of this chapter for the requirements concerning reformation or possible rescission of these interests.

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

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

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

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

1. Paragraph (e)(2)(vi) (a) is amended as follows:

a. In the third sentence, the language "of years" is added after the word "term", the language "an individual or individuals" is removed, and "certain individuals" is added in its place.

b. The fourth sentence is removed, and six new sentences are added in its place.

c. In the penultimate sentence, the language "of years" is added after the word "term", the language "an individual" is removed, and "the decedent's spouse" is added in its place.

2. Paragraph (e)(2)(vii)(a) is amended as follows:

a. In the sixth sentence, the language "of years" is added after the word "term", the language "of an individual or individuals" is removed, and "of certain individuals" is added in its place.

b. The last sentence is removed, and six new sentences are added in its place.

3. Paragraph (e)(3) is amended as follows:

a. The period at the end of paragraph (e)(3)(ii)(c) is removed, a comma is added and the word "and" is added after the comma.

b. A new paragraph (e)(3)(iii) is added. The additions read as follows:

§20.2055-2 *Transfers not exclusively for charitable purposes.*

\* \* \* \* \*

(e) \* \* \*

(2) \* \* \*

(vi) \* \* \* (a) \* \* \* Only one or more of the following individuals may be used as measuring lives: the decedent's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, as of the date of the decedent's death taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664.

\* \* \*

(vii) \* \* \* (a) \* \* \* Only one or more of the following individuals may be used as measuring lives: the decedent's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based

on the current applicable Life Table contained in §20.2031-7, as of the date of the decedent's death taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664.

\* \* \* \* \*

(3) \* \* \*

(iii) The rule in paragraphs (e)(2)(vi)(a) and (vii)(a) of this section that guaranteed annuity interests or unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals is generally effective in the case of transfers pursuant to wills and revocable trusts where the decedent dies on or after April 4, 2000. Two exceptions from the application of this rule in paragraphs (e)(2)(vi)(a) and (vii)(a) of this section are provided in the case of transfers pursuant to a will or revocable trust executed on or before April 4, 2000. One exception is for a decedent who dies on or before July 3, 2001, without having republished the will (or amended the trust) by codicil or otherwise. The other exception is for a decedent who was on April 4, 2000, under a mental disability to change the disposition of the decedent's property, and either does not regain competence to dispose of such property before the date of death, or dies prior to the later of: 90 days after the date on which the decedent first regains competence, or July 3, 2001, without having republished the will (or amended the trust) by codicil or otherwise. If a guaranteed annuity interest or unitrust interest created pursuant to a will or revocable trust where the decedent dies on or after April 4, 2000, uses an individual other than one permitted in paragraphs (e)(2)(vi)(a) and (vii)(a) of this section,

and the interest does not qualify for this transitional relief, the interest may be reformed into a lead interest payable for a specified term of years. The term of years is determined by taking the factor for valuing the annuity or unitrust interest for the named individual measuring life and identifying the term of years (rounded up to the next whole year) that corresponds to the equivalent term of years factor for an annuity or unitrust interest. For example, in the case of an annuity interest payable for the life of an individual age 40 at the time of the transfer, assuming an interest rate of 7.4% under section 7520, the annuity factor from column 1 of Table S(7.4), contained in IRS Publication 1457, Book Aleph, for the life of an individual age 40 is 12.0587 (Publication 1457 is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402). Based on Table B(7.4), contained in Publication 1457, Book Aleph, the factor 12.0587 corresponds to a term of years between 31 and 32 years. Accordingly, the annuity interest must be reformed into an interest payable for a term of 32 years. A judicial reformation must be commenced prior to the later of July 3, 2001, or the date prescribed by section 2055(e)(3)(C)(iii). Any judicial reformation must be completed within a reasonable time after it is commenced. A non-judicial reformation is permitted if effective under state law, provided it is completed by the date on which a judicial reformation must be commenced. In the alternative, if a court, in a proceeding that is commenced on or before July 3, 2001, declares any transfer made pursuant to a will or revocable trust where the decedent dies on or after April 4, 2000, and on or before March 6, 2001, null and void *ab initio*, the Internal Revenue Service will treat such transfers in a manner similar to that described in section 2055(e)(3)(J).

\* \* \* \* \*

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

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

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

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

1. Paragraph (c)(2)(vi)(a) is amended as follows:

a. In the third sentence, the language "of years" is added after the word "term", the language "a named individual or individuals" is removed, and "certain individuals" is added in its place.

b. The fourth sentence is removed, and six new sentences are added in its place.

c. In the sentence beginning "For example, the amount", the language "of years" is added after the word "term", the language "an individual" is removed, and "the donor" is added in its place.

2. Paragraph (c)(2)(vii)(a) is amended as follows:

a. In the sixth sentence, the language "of years" is added after the word "term", the language "an individual or individuals" is removed, and "certain individuals" is added in its place.

b. The last sentence is removed, and six new sentences are added in its place.

3. Paragraph (e) is amended by adding nine new sentences to the end of the paragraph.

The additions read as follows:

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

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(vi) \* \* \* (a) \* \* \* Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even if the governing instrument contains a savings

clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664. \* \* \*

\* \* \* \* \*

(vii) \* \* \* (a) \* \* \* Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664. \* \* \* \* \*

(e) *Effective date.* \* \* \* In addition, the rule in paragraphs (c)(2)(vi)(a) and

(vii)(a) of this section that guaranteed annuity interests or unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals applies to transfers made on or after April 4, 2000. If a transfer is made on or after April 4, 2000, that uses an individual other than one permitted in paragraphs (c)(2)(vi)(a) and (vii)(a) of this section, the interest may be reformed into a lead interest payable for a specified term of years. The term of years is determined by taking the factor for valuing the annuity or unitrust interest for the named individual measuring life and identifying the term of years (rounded up to the next whole year) that corresponds to the equivalent term of years factor for an annuity or unitrust interest. For example, in the case of an annuity interest payable for the life of an individual age 40 at the time of the transfer, assuming an interest rate of 7.4% under section 7520, the annuity factor from column 1 of Table S(7.4), contained in IRS Publication 1457, Book Aleph, for the life of an individual age 40 is 12.0587 (Publication 1457 is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402). Based on Table B(7.4), contained in Publication 1457, Book Aleph, the factor 12.0587 corresponds to a term of years between 31 and 32 years. Accordingly, the annuity interest must be reformed into an interest payable for a term of 32 years. A judicial reformation must be commenced prior to October 15th of the year following the year in which the transfer is made and must be completed within a reasonable time after it is commenced. A non-judicial reformation is permitted if effective under state law, provided it is completed by the date on which a judicial reformation must be commenced. In the alternative, if a court, in a proceeding that is commenced on or before July 3, 2001, declares any transfer, made on or after April 4, 2000, and on or before March 6, 2001, null and void *ab initio*, the Internal Revenue Service will treat such transfers in a manner similar to that described in section 2055(e)(3)(J).

Robert E. Wenzel,  
Deputy Commissioner  
of Internal Revenue.

Approved December 20, 2000.

Jonathan Talisman,  
Acting Assistant Secretary  
of the Treasury.

(Filed by the Office of the Federal Register on January 4, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 5, 2001, 66 F.R. 1040)

## Section 301.—Distributions of Property

26 CFR 1.301-1: Rules applicable with respect to distributions of money and other property.

### T.D. 8924

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

### Liabilities Assumed in Certain Corporate Transactions

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Temporary and final regulations.

SUMMARY: These temporary and final regulations relate to the assumption of liabilities in certain corporate transactions under section 301 of the Internal Revenue Code. The temporary and final regulations affect corporations and their shareholders. Changes to the applicable law were made by the Miscellaneous Trade and Technical Corrections Act of 1999, Public Law 106-36 (113 Stat. 127). The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG-106791-00) on page 521 of this Bulletin.

DATES: *Effective Date:* These regulations are effective January 4, 2001.

*Applicability Date:* For dates of applicability, see the Effective Dates portion of the preamble under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Mary Dean, (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION



## Background

### A. State of the Law Before the Miscellaneous Trade and Technical Corrections Act of 1999

Section 301(b)(2) of the Internal Revenue Code (Code) provides that in a distribution of property made by a corporation to a shareholder with respect to its stock, the amount of the distribution shall be reduced (but not below zero) by (A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution and (B) the amount of any liability to which the property was subject immediately before, and after, the distribution. See also §1.301-1(g) of the regulations.

Section 357 of the Code generally provides rules for the treatment of the assumption of liabilities in connection with transfers of property to which section 351 or 361 of the Code applies. Prior to the Miscellaneous Trade and Technical Corrections Act of 1999 (the Act), section 357(a) provided that, except as otherwise provided, in such transfers the assumption of the transferor's liability or acquisition of property subject to a liability is not treated as money or other property, *i.e.*, is not treated as boot received by the transferor.

Prior to the Act, section 357(c) provided that in an exchange to which section 351 applies or section 361 applies by reason of a section 368(a)(1)(D) reorganization, if the sum of the amount of the liabilities assumed plus the amount of the liabilities to which the property transferred is subject exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess is considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

### B. Enactment of Amendments to Section 357

The Act amended the language in section 357(a) and (c) and added new section 357(d). Under the amendment to section 357(a) and (c), the reference to the acquisition of an asset subject to a liability was eliminated. Section 357(c) gain will be realized only on the excess of the amount of liabilities assumed over the adjusted

basis of the property transferred in the transaction. New section 357(d) sets forth the rules for determining the amount of both recourse and nonrecourse liabilities assumed. Section 357(d) states that except as provided in regulations, a recourse liability (or portion thereof) is treated as having been assumed if, based on all the facts and circumstances, the transferee has agreed to, and is expected to, satisfy such liability, whether or not the transferor has been relieved of such liability. A nonrecourse liability is treated as having been assumed by the transferee of any asset subject to such liability, except that the amount of nonrecourse liability treated as having been assumed is reduced by the lesser of (A) the amount of such liability which an owner of other assets not transferred to the transferee and also subject to such liability has agreed with the transferee to, and is expected to, satisfy, or (B) the fair market value of such other assets. Congress provided these clarifications because certain interpretations of the existing law failed to adequately reflect the true economics of many transactions, resulting in inappropriate positions claimed by taxpayers. See S. Rep. No. 106-2, at 75 (1999).

Section 357(d)(3) directs the Secretary to prescribe regulations necessary to carry out the purposes of subsection (d). It also authorizes the Secretary to prescribe regulations which provide that the manner in which a liability is treated as assumed under subsection (d) is applied, where appropriate, elsewhere in the Code.

### C. Application of Regulatory Authority to Section 301

The Treasury and the IRS have determined that it is appropriate to apply the rules of section 357(d), relating to the manner in which a liability is treated as assumed, to distributions of property under section 301 of the Code. Section 301(b)(2)(A) provides that the amount of the distribution will be reduced if the transferee assumes a liability of the corporation. Section 301(b)(2)(B) provides that the amount of the distribution will be reduced if the transferee receives property subject to a liability. These two sections do not provide specific rules for determining the amount of liabilities assumed, as contained in section 357(d). The lack of specific rules has led to interpretations of

existing law that fail to reflect the true economics of certain transactions. For reasons similar to those that motivated the enactment of section 357(d), these interpretations are inappropriate for purposes of section 301. Notice 99-59, 1999-2 C.B. 761, illustrates one such case. In the transaction addressed in Notice 99-59, a corporation distributes property subject to a recourse liability, with the expectation that the distributee will take the position that it receives little or no net distribution, even though it is anticipated that the distributor will later satisfy its continuing primary liability on the debt.

## Explanation of Provisions

### *Liabilities Assumed in Connection with Distributions to Shareholders*

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 301 relating to liabilities assumed in connection with distributions made by a corporation to shareholders with respect to their stock. The regulations provide that the amount of a distribution under section 301 will be reduced by the amount of any liability that is treated as assumed by the distributee within the meaning of section 357(d)(1) and (2).

The Treasury and the IRS intend to propose regulations under sections 357(d) and 301 clarifying the treatment of the subsequent payment of assumed liabilities. Prior to the issuance of such regulations, the Treasury and the IRS believe that such payments generally should be treated in a manner consistent with the treatment of the liabilities assumed. Thus, in a situation where a liability is treated as assumed by the transferee under the rules of section 357(d), a later payment by the party whose liability was treated as assumed should be treated in accordance with the relationship of the parties (*e.g.*, a distribution or capital contribution). See, *e.g.*, *Enoch v. Commissioner*, 57 T.C. 781 (1972), *acq. in part*, 1974-2 C.B. 2, 4, *nonacq.*, 1984-2 C.B. 5.

### Effective Date

The regulations apply generally to distributions occurring after January 4, 2001. The regulations also apply to distributions occurring on or prior to January 4, 2001, if the distribution is made as part of a

transaction described in, or substantially similar to, the transaction in Notice 99-59, including transactions designed to reduce gain. Under section 7805(b)(3), the Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse. These regulations are being applied retroactively to prevent the abuse described in Notice 99-59. No inference should be drawn regarding the tax treatment of distributions not covered by these regulations.

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Because no preceding notice of proposed rulemaking is required for this temporary regulation, the provisions of the Regulatory Flexibility Analysis do not apply.

This Treasury decision is issued pursuant to the grants of authority in sections 357(d)(3) and 7805 of the Internal Revenue Code. This Treasury decision provides specific rules for determining the amount by which a distribution under section 301(b) will be reduced, by applying the rules of section 357(d). Section 357(d) was intended to clarify the law because certain interpretations of existing law did not reflect the economics of certain transactions. Issuing the regulation in proposed form would continue the difficulty in ascertaining the appropriate reduction in distributions under section 301(b). Based on these considerations, it is determined that this temporary regulation will provide taxpayers with the necessary guidance and authority to ensure equitable administration of the tax laws. Therefore, it would be contrary to the public interest to issue this Treasury decision with prior notice under section 553(b) or subject to the effective date limitation of section 553(d) of title 5 of the United States Code.

Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

\* \* \* \* \*

### Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805. \* \* \*  
Section 1.301-1 also issued under 26 U.S.C. 357(d)(3).  
Section 1.301-1T also issued under 26 U.S.C. 357(d)(3). \* \* \*

Par. 2. Section 1.301-1 is amended by adding two new sentences at the end of paragraph (g) to read as follows:

*§1.301-1 Rules applicable with respect to distributions of money and other property.*

\* \* \* \* \*

(g) \* \* \* This paragraph (g) applies to distributions occurring on or before January 4, 2001. See §1.301-1T for rules for distributions occurring after January 4, 2001, and for distributions made on or before January 4, 2001, if the distribution is made as part of a transaction described in, or substantially similar to, the transaction in Notice 1999-59, 1999-2 C.B. 761, including transactions designed to reduce gain (see §601.601(d)(2) of this chapter).

\* \* \* \* \*

Par. 3. Section 1.301-1T is added to read as follows:

*§1.301-1T Rules applicable with respect to distributions of money and other property (temporary).*

(a) through (f). [Reserved] For further guidance, see §1.301-1(a) through (f).

(g) *Reduction for liabilities* - - (1) *General rule.* For the purpose of section 301, no reduction shall be made for the amount of any liability, unless the liability is assumed by the shareholder within the meaning of section 357(d)(1) and (2).

(2) *No reduction below zero.* Any reduction pursuant to paragraph (g)(1) of this section shall not cause the amount of the distribution to be reduced below zero.

(3) *Effective dates* - - (i) *In general.* This paragraph (g) applies to distributions occurring after January 4, 2001.

(ii) *Retroactive application.* This paragraph also applies to distributions made on or before January 4, 2001, if the distribution is made as part of a transaction described in, or substantially similar to, the transaction in Notice 1999-59 (1999-2 C.B. 761), including transactions designed to reduce gain (see §601.601(d)(2) of this chapter).

Robert E. Wenzel,  
*Deputy Commissioner  
of Internal Revenue.*

Approved December 20, 2000.

Jonathan Talisman,  
*Acting Assistant Secretary  
of the Treasury.*

(Filed by the Office of the Federal Register on January 3, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 4, 2001, 66 F.R. 723)

## Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

**Deductibility of payments in redemption of stock held by an employee stock ownership plan.** This ruling holds that payments in redemption of stock held by an ESOP that are used to make distributions to terminating ESOP participants are not deductible and that such payments do not constitute "applicable dividends" under section 404(k)(1) of the Code.

### Rev. Rul. 2001-6

#### ISSUE

Whether payments in redemption of stock held by an ESOP that are used to make distributions to terminating ESOP participants constitute "applicable dividends" under section 404(k)(1) of the Internal Revenue Code that are deductible.

#### FACTS

Corporation A (a C corporation) has a single class of voting common stock outstanding. Corporation A maintains an employee stock ownership plan (ESOP),

as defined in section 4975(e)(7) of the Internal Revenue Code (Code), which holds stock of Corporation A. The terms of the ESOP provide that when Corporation A pays dividends on its stock, the ESOP trustee may 1) allocate the dividends on the employer securities in a participant's account to the participant; 2) allocate the dividends on the employer securities in a participant's account to the plan and distribute it in cash to the participant not later than 90 days after the close of the plan year in which paid; or 3) use the dividends on employer securities allocated to a participant's account to repay a loan to the ESOP the proceeds of which were used to acquire the employer securities, provided that employer securities with a fair market value at least equal to the value of those dividends are allocated to the participant's account.

Under the plan, participants may elect to take a distribution in cash or stock at retirement or termination of employment. In the current year, 100 participants with account balances from \$2,000 to \$200,000, totaling \$5 million, separate from service, become eligible for distributions from the ESOP, and elect cash distributions. As allowed under the plan, Corporation A redeems the shares in the terminating participants' accounts for \$5 million immediately prior to the distributions. Corporation A claims that the redemptions are treated as dividends under the applicable rules of sections 301, 302, and 316.

The ESOP pays the \$5 million redemption proceeds to the terminating participants within 90 days after the close of the plan year in which the plan received the proceeds.

#### LAW AND ANALYSIS

Section 162(k)(1) provides, with exceptions not relevant here, that no deduction otherwise allowable under Chapter 1 is allowed for any amount paid or incurred by a corporation in connection with the reacquisition of its stock or of the stock of any related person (as defined in section 465(b)(3)(C)).

Section 404(k)(1) of the Code provides that, in the case of a C corporation, there is allowed as a deduction for a taxable year the amount of any applicable dividend paid in cash by such corporation during the taxable year with respect to

applicable employer securities. This deduction is in addition to the deductions allowed in section 404(a).

Section 404(k)(2)(A) provides, in relevant part, that the term "applicable dividend" means any dividend which, in accordance with plan provisions, is paid to the plan and is distributed in cash to participants in the plan or their beneficiaries not later than 90 days after the close of the plan year in which paid.

Under section 404(k)(4), the deduction is allowable in the taxable year of the corporation in which the dividend is paid or distributed to a participant or beneficiary.

Section 404(k)(5)(A) provides that the Secretary may disallow the deduction under paragraph (1) for any dividend if the Secretary determines that such dividend constitutes, in substance, an evasion of taxation.

Under these facts, redemption payments are paid in connection with the "reacquisition" of the issuer's stock. Thus, section 162(k)(1) bars the deduction of such payments without regard to whether they would otherwise be deductible under section 404(k).

Moreover, the treatment of redemption proceeds as "applicable dividends" under section 404(k) would produce such anomalous results that section 404(k) cannot reasonably be construed as encompassing such payments. *See, e.g., Helvering v. Hammel*, 311 U.S. 504, 510-511 (1941) (the words of a statute must be given "a restricted rather than a literal or usual meaning . . . where acceptance of that meaning would lead to absurd results . . . or would thwart the obvious purpose of the statute.") The application of section 404(k) to redemption amounts not only would allow employers to claim deductions for payments that do not represent true economic costs, but also would vitiate important rights and protections for recipients of ESOP distributions, including the right to reduce taxes by utilizing the return of basis provisions under section 72, the right to make rollovers of ESOP distributions received upon separation from service, and the protection against involuntary cash-outs. *See* sections 72(e)(5)(D) and 411(a)(11)(C); section 1.402(c)-2, A-4(e) of the Income Tax Regulations. Therefore, the term "applicable dividends" under section 404(k) does not include amounts paid for the redemp-

tion of stock held by an ESOP, whether or not such redemption proceeds constitute dividends under sections 301, 302, and 316.

Further, section 404(k)(5)(A) authorizes the Secretary to disallow a deduction under section 404(k)(1) for any dividend that constitutes, in substance, an evasion of taxation. Pursuant to section 404(k)(5)(A), a deduction under section 404(k)(1) would be disallowed for payments in redemption of employer securities used to make distributions to terminating ESOP participants because such treatment would constitute, in substance, an evasion of taxation.

#### HOLDING

Payments in redemption of stock held by an ESOP that are used to make distributions to terminating ESOP participants are not deductible. In addition, such payments do not constitute "applicable dividends" under section 404(k)(1) of the Internal Revenue Code. This revenue ruling applies without regard to whether there is appreciation in the employer securities in the ESOP.

#### DRAFTING INFORMATION

The principal authors of this revenue ruling are Steven J. Linder of the Employee Plans, Tax Exempt and Government Entities Division (T:EP) and John T. Ricotta of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service between the hours of 1:30 and 3:30 p.m. Eastern time, Monday through Thursday, by calling (202) 283-9516. Mr. Linder's number is (202) 283-9888. Mr. Ricotta's number is (202) 622-6060. (These telephone numbers are not toll-free.)

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#### Section 664.—Charitable Remainder Trusts

26 CFR 1.664-1: Charitable remainder trusts.

#### T.D. 8926

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
26 CFR Part 1

## Prevention of Abuse of Charitable Remainder Trusts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document finalizes regulations that modify the application of the rules governing the character of certain distributions from a charitable remainder trust. These regulations are necessary to prevent taxpayers from using charitable remainder trusts to achieve inappropriate tax avoidance. The regulations affect charitable remainder trusts described in section 664 and certain beneficiaries of those trusts.

EFFECTIVE DATES: These regulations are effective January 5, 2001. For dates of applicability of these regulations, see §§1.643(a)-8(d), 1.664-2(a)(1)(i)(e), and 1.664-3(a)(1)(i)(l).

FOR FURTHER INFORMATION CONTACT: Catherine Moore (202) 622-3070.

SUPPLEMENTARY INFORMATION:

### Background

On October 18, 1999, proposed regulations (REG-116125-99, 1999-2 C.B. 552) to amend §§1.643(a)-8 and 1.664-1 of the Income Tax Regulations (26 CFR Part 1) were published in the **Federal Register** (64 F.R. 56718). Several written comments were received in response to the notice of proposed rulemaking, and a public hearing was held on February 9, 2000. After considering all the comments, the proposed regulations under sections 643 and 664 are adopted as revised by this Treasury decision. The comments received and the revisions made are discussed below.

### Explanation of Provisions and Summary of Comments

#### I. General Background

The proposed regulations were issued in response to certain abusive transactions that attempt to use a section 664 charitable remainder trust to convert appreciated assets into cash while avoiding tax on the gain from the disposition of the assets. In these abusive transactions, a taxpayer typically contributes highly appreciated

assets to a charitable remainder trust having a relatively short term and a relatively high payout rate. Rather than sell the assets to obtain cash to pay the annuity or unitrust amount to the beneficiary, the trustee borrows money, enters into a forward sale of the assets, or engages in some similar transaction. The borrowing, forward sale, or other similar transaction does not result in current income to the trust; thus, the parties attempt to characterize the distribution of cash to the beneficiary as a tax-free return of corpus under section 664(b)(4). The proposed regulations provide that, in this situation, the trust shall be treated as having sold a *pro rata* portion of the trust assets.

#### II. Public Comments

One commentator argued that the transactions targeted by the regulations are not abusive because they comply with the statutory changes made to section 664 by the Taxpayer Relief Act of 1997 (1997 Act), Public Law 105-34, 111 Stat. 788 (1997). Those statutory changes require that the annual payout rate to noncharitable beneficiaries not exceed 50 percent of the value of the property contributed to the charitable remainder trust and that the actuarial value of the charity's remainder interest be not less than 10 percent of the value of such property. Although the charitable remainder trusts involved in transactions targeted by the proposed regulations are drafted to comply with these statutory changes, the transactions result in the same kind of abuse that Congress was concerned about in the 1997 Act. It does not follow that because Congress did not anticipate in 1997 this latest abuse that Congress intended to allow it.

In the legislative history to the 1997 Act, Congress labeled the accelerated charitable remainder trusts it was targeting as "abusive and . . . inconsistent with the purpose of the charitable remainder trust rules." S. Rep. No. 33, 105th Cong., 1st Sess. 201 (1997). Congress noted the efforts of the Treasury Department and the IRS to combat abuse in the area through issuing proposed regulations in 1997, stating:

The Committee intends that the provision of the Committee bill does not limit or alter the validity of regulations proposed by the Treasury Department on April 18, 1997, or

the Treasury Department's authority to address this or other abuses of the rules governing the taxation of charitable remainder trusts or their beneficiaries.

S. Rep. No. 33 at 201. Thus, Congress has neither prohibited nor discouraged further regulatory activity in the charitable remainder trust area. To the contrary, based on the legislative history to the 1997 Act, Congress intended the Treasury Department to continue to take all necessary action to prevent abuses in this area.

Several commentators questioned the authority to issue the regulations under section 643(a)(7). Two commentators maintained that the proposed regulations overstep the bounds of administrative rulemaking in that section 643(a)(7) was enacted along with the foreign trust provisions of the Small Business Job Protection Act of 1996 (SBJP Act), Public Law 104-88, 110 Stat. 1755 (1996), and therefore applies only to foreign trusts. One commentator, citing the introductory clause of section 664(a), "[n]otwithstanding any other provision of this subchapter," argued that the Treasury Department and the IRS are prohibited from applying section 643(a)(7) to charitable remainder trusts. Some commentators maintained that section 643(a)(7) does not authorize the promulgation of regulations imposing a deemed sale where no actual sale has occurred. These commentators implied that regulatory authority under section 643(a)(7) should be limited to the concept of distributable net income (DNI). The Treasury Department and the IRS disagree with these views.

Although the SBJP Act included dramatic changes in the foreign trust area, the trust anti-abuse rule was not limited to foreign trusts and in fact contains no reference to foreign trusts. Furthermore, the Treasury Department and the IRS believe that Congress put the anti-abuse rule in section 643 because that section contains the rules applicable to all of Part 1 of Subchapter J of the Internal Revenue Code. Section 643(a)(7) gives the Secretary of the Treasury the authority to "prescribe such regulations as may be necessary or appropriate to carry out the purposes of this *part*, including regulations to prevent avoidance of such purposes" (emphasis added). "Part" in this

context refers to Part 1 of Subchapter J and encompasses sections 641 through 685, including section 664 governing charitable remainder trusts. The legislative history to the SBJP Act clarifies that the anti-abuse rule is not limited to foreign trusts or the DNI rules. The House Conference Report states:

[The rule] authorizes the Secretary of the Treasury to issue regulations, on or after the date of enactment, that may be necessary or appropriate to carry out the purposes of the rules applicable to estates, trusts, and beneficiaries, including regulations to prevent the avoidance of those purposes.

H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 335 (1996).

In addition, the plain language of section 664(a) does not prohibit the promulgation of regulations that apply section 643(a)(7) to abusive charitable remainder trust transactions. Section 664(a) states in full:

Notwithstanding any other provision of this subchapter, the provisions of this section shall, in accordance with regulations prescribed by the Secretary, apply in the case of a charitable remainder annuity trust and a charitable remainder unitrust.

This language provides that the provisions of section 664 apply in the case of a charitable remainder annuity trust and charitable remainder unitrust. The Treasury Department and the IRS, however, do not view this language as providing that no other provisions of subchapter J can apply in the case of abusive charitable remainder trust transactions. Applying these regulations to abusive charitable remainder trust transactions does not conflict with or override the provisions of section 664. Accordingly, the Treasury Department and the IRS believe that the plain language of section 664(a) does not prohibit promulgation of these regulations.

After considering the comments questioning the authority to promulgate and finalize the proposed regulations, the Treasury Department and the IRS have concluded that the regulations are an appropriate exercise of their regulatory authority and are authorized by the regulatory authority granted to them under section 643(a)(7) and 664(a).

Another commentator, while supporting the proposed regulations in general, suggested that the regulations contain a more precise definition of the targeted abuse. In response to this comment, the stated purpose in §1.643(a)–8(a) has been modified to include a specific reference to the rules regarding the characterization of distributions from charitable remainder trusts in the hands of the recipients.

That same commentator requested clarification of whether a deemed sale by a charitable remainder trust under §1.643(a)–8(b) would generate unrelated business taxable income (UBTI) within the meaning of section 512. Section 664(c) provides that whether a charitable remainder trust has UBTI for any taxable year, and thus is subject to tax for that year, is determined under the normal rules of sections 512, 513, and 514. The proposed regulations do not affect this general rule. However, an example in the final regulations clarifies that, to the extent that a borrowing by a charitable remainder trust is recharacterized as a deemed sale by the trust under §1.643(a)–8(b), the borrowing is not “acquisition indebtedness” within the meaning of section 514(c).

Another commentator suggested eliminating the provisions in §§1.664–2(a)(1)(i)(a) and 1.664–3(a)(1)(i)(g) of the regulations requiring that the annuity amount or the fixed percentage unitrust amount generally be paid by the end of the year for which it is due. That commentator contended that the payment rule is no longer necessary in light of the proposed regulations.

The Treasury Department and the IRS believe that the proposed regulations serve a function different from the payment rule. The proposed regulations seek to eliminate tax-free distributions from charitable remainder trusts due to manipulation of the character of distributions from those trusts. The payment rule, on the other hand, eliminates tax-free distributions from charitable remainder trusts due to manipulation of the timing of the distributions. A particular distribution could run afoul of either of these rules, or both rules.

In response to this comment, and to further clarify the different functions of the two rules, some minor changes have been made to the proposed regulation to eliminate references to timing and to clarify the application of the deemed sale rule. In

addition, in order to make it less likely that a non-abusive trust would violate the payment rule, two new exceptions have been added to §§1.664–2(a)(1)(i)(a) and 1.664–3(a)(1)(i)(g). These new exceptions provide that a distribution of cash made within a reasonable period of time after the close of the year may be characterized as corpus under section 664(b)(4) to the extent it was attributable to (i) a contribution of cash to the trust with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522, or (ii) a return of basis in any asset contributed to the trust with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522, and sold by the trust during the year for which the annuity or unitrust amount was due.

One commentator asserted that the proposed regulations should not apply to charitable remainder trusts established prior to the date the proposed regulations were published in the **Federal Register**. This commentator compared the effective date of the proposed regulations to the effective date of the 1997 Act’s trust provisions. Each of the changes made by the 1997 Act applies to transfers made to trusts after the date specified in the 1997 Act, while the regulations apply to distributions made by trusts after October 18, 1999.

The Treasury Department and the IRS do not believe this assertion has merit. These effective dates are not comparable because the 1997 Act and these regulations apply to different aspects of charitable remainder trusts. The 1997 Act changed the requirements a trust must meet to qualify as a charitable remainder trust. Whether a trust qualifies as a charitable remainder trust is determined at the time property is transferred to the trust. As a result, it was appropriate to set the effective dates for the 1997 Act with respect to the time that transfers were made to a trust. The regulations, on the other hand, change the character of a distribution from a charitable remainder trust. The character of a distribution from a charitable remainder trust is not determined until after the distribution is made. Accordingly, the regulations can be applied, without being retroactive, to distributions made after the date the proposed regulations were filed with the **Federal Register**. Section 7805(b)(1).

Furthermore, the Treasury Department and the IRS would have had the authority under section 7805(b)(3) to write regulations that take effect retroactively to prevent abuse. The abuse targeted by these regulations is well documented in Notice 94-78 (1994-2 C.B. 555), the legislative history to the 1997 Act, the changes to the charitable remainder trust regulations that were finalized in 1998 (T.D. 8791, 1999-1 C.B. 364), and Notice 2000-15 (2000-12 I.R.B. 826).

Finally, the preamble to the proposed regulations requested comments on two specific issues: (1) whether there are situations where the application of the proposed regulation would be inappropriate, and (2) whether an approach that more directly related the distributed funds to the asset that is the subject of the borrowing or forward sale would be more appropriate. No comments were received on either of these issues.

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the understanding of the Treasury Department and the IRS that the number of charitable remainder trusts engaging in transactions affected by these regulations is not substantial, and none are small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the preceding notice of proposed rule-making was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Drafting Information

The principal authors of these regulations are Mary Beth Collins and Catherine Moore, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

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

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

Section 1.643(a)-8 also issued under 26 U.S.C. 643(a)(7). \* \* \*

Par. 2. Section 1.643(a)-8 is added to read as follows:

#### *§1.643(a)-8 Certain distributions by charitable remainder trusts.*

(a) *Purpose and scope.* This section is intended to prevent the avoidance of the purposes of the charitable remainder trust rules regarding the characterizations of distributions from those trusts in the hands of the recipients and should be interpreted in a manner consistent with this purpose. This section applies to all charitable remainder trusts described in section 664 and the beneficiaries of such trusts.

(b) *Deemed sale by trust.* (1) For purposes of section 664(b), a charitable remainder trust shall be treated as having sold, in the year in which a distribution of an annuity or unitrust amount is made from the trust, a *pro rata* portion of the trust assets to the extent that the distribution of the annuity or unitrust amount would (but for the application of this subparagraph (b)) be characterized in the hands of the recipient as being from the category described in section 664(b)(4) and exceeds the amount of the previously undistributed

(i) cash contributed to the trust (with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522), plus

(ii) basis in any contributed property (with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522) that was sold by the trust.

(2) Any transaction that has the purpose or effect of circumventing the rules in this paragraph (b) shall be disregarded.

(3) For purposes of paragraph (b)(1) of this section, "trust assets" do not include cash or assets purchased with the proceeds of a trust borrowing, forward sale, or similar transaction.

(4) Proper adjustment shall be made to any gain or loss subsequently realized for gain or loss taken into account under paragraph (b)(1) of this section.

(c) *Examples.* The following examples illustrate the rules of paragraph (b) of this section:

*Example 1. Deemed sale by trust.* Donor contributes stock having a fair market value of \$2 million to a charitable remainder unitrust with a unitrust amount of 50 percent of the net fair market value of the trust assets and a two-year term. The stock has a total adjusted basis of \$400,000. In Year 1, the trust receives dividend income of \$20,000. As of the valuation date, the trust's assets have a net fair market value of \$2,020,000 (\$2 million in stock, plus \$20,000 in cash). To obtain additional cash to pay the unitrust amount to the noncharitable beneficiary, the trustee borrows \$990,000 against the value of the stock. The trust then distributes \$1,010,000 to the beneficiary before the end of Year 1. Under section 664(b)(1), \$20,000 of the distribution is characterized in the hands of the beneficiary as dividend income. The rest of the distribution, \$990,000, is attributable to an amount received by the trust that did not represent either cash contributed to the trust or a return of basis in any contributed asset sold by the trust during Year 1. Under paragraph (b)(3) of this section, the stock is a trust asset because it was not purchased with the proceeds of the borrowing. Therefore, in Year 1, under paragraph (b)(1) of this section, the trust is treated as having sold \$990,000 of stock and as having realized \$792,000 of capital gain (the trust's basis in the shares deemed sold is \$198,000). Thus, in the hands of the beneficiary, \$792,000 of the distribution is characterized as capital gain under section 664(b)(2) and \$198,000 is characterized as a tax-free return of corpus under section 664(b)(4). No part of the \$990,000 loan is treated as acquisition indebtedness under section 514(c) because the entire loan has been recharacterized as a deemed sale.

*Example 2. Adjustment to trust's basis in assets deemed sold.* The facts are the same as in *Example 1*. During Year 2, the trust sells the stock for \$2,100,000. The trustee uses a portion of the proceeds of the sale to repay the outstanding loan, plus accrued interest. Under paragraph (b)(4) of this section, the trust's adjusted basis in the stock is \$1,192,000 (\$400,000 plus the \$792,000 of gain recognized in Year 1). Therefore, the trust recognizes capital gain (as described in section 664(b)(2)) in Year 2 of \$908,000.

*Example 3. Distribution of cash contributions.* Upon the death of D, the proceeds of a life insurance policy on D's life are payable to T, a charitable remainder annuity trust. The terms of the trust provide that, for a period of three years commencing upon D's death, the trust shall pay an annuity amount equal to \$x annually to A, the child of D. After the expiration of such three-year period, the remainder interest in the trust is to be transferred to charity Z. In Year 1, the trust receives payment of the life insurance proceeds and pays the appropriate *pro rata* portion of the \$x annuity to A from the insurance proceeds. During Year 1, the trust has no income. Because the entire distribution is attributable to a cash contribution (the insurance proceeds) to the trust for which a charitable deduction was allowable

under section 2055 with respect to the present value of the remainder interest passing to charity, the trust will not be treated as selling a *pro rata* portion of the trust assets under paragraph (b)(1) of this section. Thus, the distribution is characterized in A's hands as a tax-free return of corpus under section 664(b)(4).

(d) *Effective date.* This section is applicable to distributions made by a charitable remainder trust after October 18, 1999.

Par. 3. Section 1.664-1 is amended as follows:

1. Paragraph (d)(1)(iii) is redesignated as paragraph (d)(1)(iv).

2. New paragraph (d)(1)(iii) is added. The addition reads as follows:

*§1.664-1 Charitable remainder trusts.*

\*\*\*\*\*

(d) \*\*\*

(1) \*\*\*

(iii) *Application of section 643(a)(7).* For application of the anti-abuse rule of section 643(a)(7) to distributions from charitable remainder trusts, see §1.643(a)-8.

\*\*\*\*\*

Par. 4. §1.664-2 is amended as follows:

1. Paragraphs (a)(1)(i)(a)(1) and (a)(1)(i)(a)(2) are revised.

2. Paragraph (a)(1)(i)(a)(3) is added.

3. Paragraph (a)(1)(i)(e) is amended by adding a sentence at the end.

The revision and additions read as follows.

*§1.664-2 Charitable remainder annuity trust.*

(a) \*\*\*

(1) \*\*\* (i) \*\*\*

(a) \*\*\*

(1) The trust pays the annuity amount by distributing property (other than cash) that it owned at the close of the taxable year to pay the annuity amount, and the trustee elects to treat any income generated by the distribution as occurring on the last day of the taxable year in which the annuity amount is due;

(2) The trust pays the annuity amount by distributing cash that was contributed to the trust (with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522); or

(3) The trust pays the annuity amount by distributing cash received as a return of basis in any asset that was contributed to the trust (with respect to which a deduc-

tion was allowable under section 170, 2055, 2106, or 2522), and that is sold by the trust during the year for which the annuity amount is due.

\*\*\*\*\*

(e) \*\*\* Paragraphs (a)(1)(i)(a)(2) and (3) of this section apply only to distributions made on or after January 5, 2001.

\*\*\*\*\*

Par. 5. §1.664-3 is amended as follows:

1. Paragraphs (a)(1)(i)(g)(1) and (a)(1)(i)(g)(2) are revised.

2. Paragraph (a)(1)(i)(g)(3) is added.

3. Paragraph (a)(1)(i)(l) is amended by adding a sentence at the end.

The revision and additions read as follows.

\*\*\*\*\*

(g) \*\*\*

(1) The trust pays the unitrust amount by distributing property (other than cash) that it owned at the close of the taxable year, and the trustee elects to treat any income generated by the distribution as occurring on the last day of the taxable year in which the unitrust amount is due;

(2) The trust pays the unitrust amount by distributing cash that was contributed to the trust (with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522); or

(3) The trust pays the unitrust amount by distributing cash received as a return of basis in any asset that was contributed to the trust (with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522), and that is sold by the trust during the year for which the unitrust amount is due.

\*\*\*\*\*

(l) \*\*\* Paragraphs (a)(1)(i)(g)(2) and (3) of this section apply only to distributions made on or after January 5, 2001.

\*\*\*\*\*

Robert E. Wenzel,  
*Deputy Commissioner  
of Internal Revenue.*

Approved December 13, 2000.

Jonathan Talisman,  
*Acting Assistant Secretary  
of the Treasury.*

(Filed by the Office of the Federal Register on January 4, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 5, 2001, 66 F.R. 1034)

## Section 708.—Continuation of Partnership

*26 CFR 1.708-1: Continuation of Partnership.*

**T.D. 8925**

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

### Partnership Mergers and Divisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations on the tax consequences of partnership mergers and divisions. The final regulations affect partnerships and their partners.

DATES: *Effective Date:* These regulations are effective January 4, 2001.

*Applicability Date:* For dates of applicability of these regulations, see §§1.708-1(c)(7), 1.708-1(d)(7), and 1.752-5(a).

FOR FURTHER INFORMATION CONTACT: Mary Beth Collins or Dan Carmody, (202) 622-3080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Background

This document amends sections 708 and 752 of the Income Tax Regulations (26 CFR part 1) regarding partnership mergers and divisions.

On January 11, 2000, a notice of proposed rulemaking and a notice of public hearing (REG-111119-99, 2000-5 I.R.B. 455) were published in the **Federal Register** (65 F.R. 1572) regarding sections 708, 743, and 752 of the Internal Revenue Code. No one requested to speak at the public hearing. Accordingly, the public hearing scheduled for May 4, 2000, was canceled in the **Federal Register** (65 F.R. 24897) on April 28, 2000. Comments responding to the proposed regulations were received. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

## I. Partnership Mergers

Section 708(b)(2)(A) provides that in the case of a merger or consolidation of two or more partnerships, the resulting partnership is, for purposes of section 708, considered the continuation of any merging or consolidating partnership whose members own an interest of more than 50 percent in the capital and profits of the resulting partnership. Section 1.708-1(b)(2)(i) of the Income Tax Regulations provides that if the resulting partnership can be considered a continuation of more than one of the merging partnerships, the resulting partnership is the continuation of the partnership that is credited with the contribution of the greatest dollar value of assets to the resulting partnership. If the members of none of the merging partnerships own more than a 50 percent interest in the capital and profits of the resulting partnership, all of the merged partnerships are considered terminated, and a new partnership results. The taxable years of the merging partnerships that are considered terminated are closed under section 706(c).

## II. Partnership Divisions

Section 708(b)(2)(B) provides that, in the case of a division of a partnership into two or more partnerships, the resulting partnerships (other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits of the prior partnership) are considered a continuation of the prior partnership. Section 1.708-1(b)(2)(ii) provides that any other resulting partnership is not considered a continuation of the prior partnership but is considered a new partnership. If the members of none of the resulting partnerships owned an interest of more than 50 percent in the capital and profits of the prior partnership, the prior partnership is terminated. Where members of a partnership that has been divided do not become members of a resulting partnership that is considered a continuation of the prior partnership, such members' interests are considered liquidated as of the date of the division.

### Explanation of Revisions and Summary of Comments

#### I. Assets-Up Form for Partnership Mergers and Divisions

The proposed regulations provide that the form of a partnership merger or divi-

sion accomplished under laws of the applicable jurisdiction will be respected if the partnership undertakes the steps of one of two prescribed forms. Generally, for partnership mergers, a terminating partnership contributes its assets and liabilities to the resulting partnership in exchange for interests in the resulting partnership, and immediately thereafter, the terminated partnership distributes interests in the resulting partnership to its partners in liquidation of the terminating partnership (Assets-Over Form). Alternatively, for partnership mergers, the terminating partnership liquidates by distributing its assets and liabilities to its partners who then contribute the assets and liabilities to the resulting partnership (Assets-Up Form). The default rule for partnership mergers is the Assets-Over Form, so that if a transaction is not characterized under the Assets-Up Form, it will be characterized under the Assets-Over Form regardless of whether that form is followed.

In general, for partnership divisions, a prior partnership transfers certain assets and liabilities to a resulting partnership in exchange for interests in the resulting partnership, and immediately thereafter, the prior partnership distributes the resulting partnership interests to partners who are designated to receive interests in the resulting partnership (Assets-Over Form). Alternatively, for partnership divisions, the prior partnership distributes certain assets and liabilities to some or all of its partners who then contribute the assets and liabilities to a resulting partnership in exchange for interests in the resulting partnership (Assets-Up Form). As with partnership mergers, the default rule for partnership divisions is the Assets-Over Form, so that if a transaction is not characterized under the Assets-Up Form, it will be characterized under the Assets-Over Form regardless of whether that form is followed.

One commentator expressed concern that where the assets of an operating business are distributed to the partners as joint owners, and the partners continue to operate the business, the owners of the assets may be considered to remain partners for federal income tax purposes. Under the proposed regulations, it was intended that the Assets-Up Form would be respected where the assets are conveyed to the partners under the laws of the applicable juris-

diction and then reconveyed to the resulting partnership. An example has been added to the final regulations to confirm this result. The example also confirms that a partnership can use the Assets-Up Form for partnership mergers and divisions regardless of whether the partners could otherwise generally hold certain assets, such as undivided interests in goodwill, outside of a partnership.

The same commentator suggested that the Assets-Up Form should be respected if, rather than actually conveying ownership of the assets under applicable jurisdictional law, the partners assign their rights to receive title to the assets in liquidation of the partnership, or direct the partnership to transfer title to the assets to the resulting partnership. In providing that the Assets-Up Form would be respected in accomplishing partnership mergers and divisions, the IRS and Treasury did not intend to establish a regime whereby partners essentially could elect between the Assets-Up Form and the Assets-Over Form by creating different documents that have the same legal effect. The IRS and Treasury believe that if the Assets-Up Form is to be respected, a partnership must actually undertake the steps that are necessary, under the laws of the applicable jurisdiction, to convey ownership of the assets that are distributed to the partners. For most types of assets, this will not require the actual transfer and recording of a deed or certificate of title.

While the IRS and Treasury believe that it should be necessary for a partnership to actually convey ownership of the partnership's assets to its partners in order to follow the Assets-Up Form, it should not be necessary for the partners to actually assume the liabilities of the partnership in order to follow such form. Pursuant to section 752 and the regulations thereunder, a partner essentially is deemed to have directly incurred a share of the partnership's liabilities. Requiring the partners to actually assume debt that they already are deemed to have incurred is unnecessary. Such a requirement also could create a trap for the unwary. If a partner momentarily assumes an amount of the partnership's debt that is less than the partner's share of such debt under section 752 (and other partners momentarily assume an amount of debt in excess of their shares), the partner could inappropri-



ately recognize gain as a result of the deemed distribution.

## II. *Bifurcation of Assets-Over Form and Assets-Up Form*

The proposed regulations provide that the form of a partnership merger or division accomplished under laws of the applicable jurisdiction will be respected if the partnership undertakes the steps of either the Assets-Over Form or the Assets-Up Form. One commentator recommended that a single partnership merger or division be respected if the partnership undertakes the steps of the Assets-Over Form with respect to some assets and the Assets-Up Form with respect to others. For example, in a partnership merger, the terminating partnership could distribute some assets to certain partners who then contribute the assets to the resulting partnership in exchange for interests in the resulting partnership (Assets-Up Form), and simultaneously, the terminating partnership could transfer the remaining assets to the resulting partnership in exchange for interests in the resulting partnership and then distribute the interests to the remaining partners in liquidation of their interests in the terminating partnership (Assets-Over Form).

In the preamble to the proposed regulations, the IRS and Treasury recognized that there are numerous transactions that may be undertaken pursuant to local jurisdictional law to accomplish the result of a partnership merger or division. The rules set forth in the proposed regulations were not intended to provide unlimited flexibility among the various structural alternatives for accomplishing these transactions. Instead, the proposed regulations were intended to provide a set of administrable rules that taxpayers and the IRS could apply in characterizing these transactions.

In view of this purpose, the IRS and Treasury do not believe it is appropriate for a partnership merger to be accomplished using both the Assets-Over Form and the Assets-Up Form when all the assets and liabilities of the terminated partnership are transferred to a single resulting partnership. While a partnership merger may be accomplished by using any number of transactional structures, the result is a single transaction that combines two partnerships. In the two alternatives set forth in the proposed regulations, and adopted in these

final regulations, each partner must participate (or will be deemed to participate) in the partnership merger in the same manner (with the exception of those partners who are subject to the buy-out rule). Therefore, if the partners wish for a partnership merger to be characterized under the Assets-Up Form, the terminated partnership must undertake the steps of the Assets-Up Form for all of its assets when it distributes the assets to its partners. Otherwise, the transaction will be characterized under the Assets-Over Form. However, where more than two partnerships are combined, each combination will be viewed as a separate merger so that the characterization of a merger of one partnership into the resulting partnership under the Assets-Over Form will not prevent a simultaneous merger of another partnership into the same resulting partnership from being characterized under the Assets-Up Form.

For the same reasons, with respect to partnership divisions, the IRS and Treasury believe that it is appropriate to require consistency in applying either the Assets-Over Form or the Assets-Up Form to characterize a transfer of assets to a resulting partnership. However, where a single partnership is divided in a transaction that involves a transfer of assets (either actual or deemed) to multiple partnerships, the transfer to each resulting partnership should be viewed separately. As with mergers involving more than two partnerships, it is consistent with the purposes of these regulations, in the context of divisions, to allow the transfer to one resulting partnership to be characterized under the Assets-Over Form while characterizing the transfer to another resulting partnership under the Assets-Up Form. The proposed regulations provided an example that illustrates when such a division accomplished under both the Assets-Over Form and the Assets-Up Form will be respected. The final regulations do not change the example. See §1.708-1(d)(5) Example 7 of the final regulations. The final regulations also add an example to illustrate when a division accomplished under both the Assets-Over Form and the Assets-Up Form will not be respected.

## III. *Clarification of Partnership Merger Buy-out Rule*

The proposed regulations contain a special buy-out rule that allows a resulting

partnership in a merger to fund the purchase of one or more partners' interests in a terminating partnership without triggering the disguised sale rules, which otherwise would cause all of the partners in the terminating partnership to recognize gain or loss as a result of the purchase. Specifically, the proposed regulations provide that if the merger agreement (or similar document) specifies that the resulting partnership is purchasing the exiting partner's interest in the terminating partnership and the amount paid for the interest, the transaction will be treated as a sale of the exiting partner's interest to the resulting partnership.

Because the transaction described in the proposed regulations is treated as a sale of a partnership interest, the resulting partnership inherits the exiting partner's capital account in the terminating partnership and any section 704(c) liability of the exiting partner. Additionally, if the terminating partnership has an election in effect under section 754 (or makes an election under section 754), the resulting partnership will have a special basis adjustment regarding the terminating partnership's property under section 743. The proposed regulations provide that the resulting partnership's basis adjustments under section 743 must be allocated solely to the partners who were partners in the resulting partnership immediately before the merger.

Commentators questioned whether the exiting partner must be a party to the merger agreement in order to obtain the benefit of the special buy-out rule contained in the proposed regulations. Another commentator asked whether the exiting partner must consent to the sale treatment. The commentator explained that it may be difficult to receive consent from small investors in a large partnership whose interests are being sold to the resulting partnership.

The IRS and Treasury believe that the exiting partner does not have to be a party to the merger agreement in order to obtain the benefit of the special buy-out rule. However, to ensure that all partners to the transaction treat the transaction consistently when filing their returns, the final regulations require that, prior to or contemporaneous with the transfer, the exiting partner must consent to the sale treatment provided in the special rule.

Commentators noted that the resulting partnership's basis adjustments under section 743 should not be allocated solely to the partners who were partners in the resulting partnership immediately before the merger. As indicated in §1.708-1(c)(4) Example 4 of the proposed regulations, where the resulting partnership has acquired an interest in the terminating partnership in accordance with the special buy-out rule, the terminating partnership, as part of the merger, distributes assets to the resulting partnership in liquidation of the resulting partnership's interest in the terminating partnership. Accordingly, the resulting partnership should take an exchanged basis in the distributed assets under section 732(b), rather than a transferred basis that includes the basis adjustment under section 743(b). In response to these comments, the IRS and Treasury have removed the proposed regulations under section 743 and have clarified the example to indicate that the basis rules under section 732(b) apply.

Commentators also asked whether a partnership termination under section 708(b)(1)(B) occurs immediately before a merger if exiting partners sell 50 percent or more of the total interests in the terminating partnership under the buy-out provision. Although not discussed in the final regulations, it follows from treating the buyout as occurring immediately prior to the merger that, if exiting partners sell 50 percent or more of the total interest in the terminating partnership's capital and profits as part of a merger, then a partnership termination under section 708(b)(1)(B) will occur immediately before the merger.

#### *IV. Partnership Division Tax Consequences*

The proposed regulations provide that the resulting partnership that is regarded as continuing shall file a return for the taxable year of the partnership that has been divided. Commentators requested that the final regulations clarify the tax consequences of a partnership that is regarded as continuing. For instance, commentators asked how a partnership files a return and which partnership retains the prior partnership's employer identification number (EIN) when more than one resulting partnership is consid-

ered a continuation of the prior partnership. Additionally, commentators asked whether subsequent elections by one resulting partnership that is regarded as continuing binds all resulting partnerships that are regarded as continuing.

In response to these comments, the final regulations clarify certain tax consequences that follow from a partnership division when more than one resulting partnership is regarded as continuing. Specifically, the final regulations provide that when more than one resulting partnership is regarded as continuing, the resulting partnership that is treated as the divided partnership will file a return for the taxable year of the partnership that has been divided and retain the EIN of the prior partnership. All other resulting partnerships that are regarded as continuing and all new partnerships (i.e., resulting partnerships that are not considered continuing) will file separate returns for the taxable year beginning on the day after the date of the division with new EINs for each partnership.

The final regulations also provide that all resulting partnerships that are continuing partnerships are subject to preexisting elections that were made by the prior partnership. However, a post-division election that is made by a resulting partnership will not bind any of the other resulting partnerships.

#### *V. Definition of Partnership Mergers and Divisions*

The proposed regulations do not define what constitutes a partnership merger or division. Some commentators have requested that these terms be defined in the final regulations. Other practitioners have stated that the selectivity that would be created by attempting to draw lines in such definitions could lead to planning opportunities that would be adverse to the government's interest. The IRS and Treasury have decided not to provide comprehensive definitions of what is a partnership merger or division in these final regulations.

In addition to requesting guidance as to the general definitions of a partnership merger and division, some commentators have asked more narrowly whether a partnership division can occur when only one partner from the prior partnership is a partner in a resulting partnership.

Consider the following example: ABC partnership owns X business and Y business. A and B each own a 20-percent interest, and C owns a 60-percent interest in the ABC partnership. C does not want to continue in the partnership with A and B and would like to operate X business with D. Accordingly, ABC partnership distributes X business to C in liquidation of C's interest in partnership ABC. Subsequently, C forms a partnership with D and contributes X business to the CD partnership. After the distribution and contribution of X business, AB partnership owns Y business and CD partnership owns X business.

The IRS and Treasury believe that the above transaction does not constitute a division. To have a division, at least two members of the prior partnership must be members of each resulting partnership that exists after the transaction. In the above example, C is the only member of the ABC partnership in the CD partnership. Accordingly, this transaction would not be treated as a division for Federal income tax purposes. The final regulations modify the proposed regulations to clarify this result.

#### *VI. Application of Sections 704(c) and 737 in Partnership Divisions*

In the preamble to the proposed regulations, the IRS and Treasury requested comments as to whether expanded exceptions under sections 704(c)(1)(B) and 737 would be appropriate in the context of partnership divisions. Most commentators agreed that it would not be wise to expand the current exceptions. In a related point, some commentators stated that the contribution of assets in a division should not create new section 704(c) property or section 737 net precontribution gain.

To the extent that a partnership division merely affects a restructuring of the form in which the partners hold property (that is, each partner's overall interest in each partnership property does not change), the IRS and Treasury agree that a partnership division should not create new section 704(c) property or section 737 net precontribution gain. However, it is not clear that this result is necessarily appropriate where a division is non-*pro rata* as to the partners, where some property is extracted from or added to the partnerships in

connection with the division, or where new partners are added to the ownership group in connection with the division. The IRS and Treasury intend to study this issue and request comments in this regard.

*VII. Effective Date*

The proposed regulations apply to mergers and divisions occurring on or after the date final regulations are published in the **Federal Register**. Commentators requested that the final regulations allow partnerships to apply the regulations to mergers and divisions occurring on or after January 11, 2000, (the date the proposed regulations were published in the **Federal Register**). The commentators explained that the regulations provide needed clarity in an area that has lacked guidance.

The IRS and Treasury believe it is appropriate to allow partnerships to apply the final regulations retroactively to the publication date of the proposed regulations. Therefore, the final regulations apply to mergers and divisions occurring on or after January 4, 2001. However, a

partnership may apply the rules in the final regulations for mergers and divisions occurring on or after January 11, 2000.

**Special Analyses**

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

**Drafting Information**

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

\* \* \* \* \*

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

**PART 1—INCOME TAXES**

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

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

Par. 2. Section 1.708-1 is amended as follows:

1. Paragraph (b) is amended by removing paragraph (b)(2) and by redesignating each paragraph listed in the first column of the following table as the paragraph listed in the second column as indicated in the following table:

*Old Paragraph*

- (b)(1)(i)
- (b)(1)(i)(a)
- (b)(1)(i)(b)
- (b)(1)(ii)
- (b)(1)(iii)
- (b)(1)(iii)(a)
- (b)(1)(iii)(b)
- (b)(1)(iv)
- (b)(1)(v)

*Redesignated Paragraph*

- (b)(1)
- (b)(1)(i)
- (b)(1)(ii)
- (b)(2)
- (b)(3)
- (b)(3)(i)
- (b)(3)(ii)
- (b)(4)
- (b)(5)

2. Paragraphs (c) and (d) are added to read as follows:

*§1.708-1 Continuation of partnership.*

\* \* \* \* \*

(c) *Merger or consolidation*—(1) *General rule.* If two or more partnerships merge or consolidate into one partnership, the resulting partnership shall be considered a continuation of the merging or consolidating partnership the members of which own an interest of more than 50 percent in the capital and profits of the resulting partnership. If the resulting partnership can, under the preceding sentence, be considered a continuation of more than one of the merging or consolidating partnerships,

it shall, unless the Commissioner permits otherwise, be considered the continuation solely of that partnership which is credited with the contribution of assets having the greatest fair market value (net of liabilities) to the resulting partnership. Any other merging or consolidating partnerships shall be considered as terminated. If the members of none of the merging or consolidating partnerships have an interest of more than 50 percent in the capital and profits of the resulting partnership, all of the merged or consolidated partnerships are terminated, and a new partnership results.

(2) *Tax returns.* The taxable years of any merging or consolidating partnerships which are considered terminated shall be

closed in accordance with the provisions of section 706(c) and the regulations thereunder, and such partnerships shall file their returns for a taxable year ending upon the date of termination, i.e., the date of merger or consolidation. The resulting partnership shall file a return for the taxable year of the merging or consolidating partnership that is considered as continuing. The return shall state that the resulting partnership is a continuation of such merging or consolidating partnership, shall retain the employer identification number (EIN) of the partnership that is continuing, and shall include the names, addresses, and EINs of the other merged or consolidated partnerships. The respec-

tive distributive shares of the partners for the periods prior to and including the date of the merger or consolidation and subsequent to the date of merger or consolidation shall be shown as a part of the return.

(3) *Form of a merger or consolidation*—(i) *Assets-over form*. When two or more partnerships merge or consolidate into one partnership under the applicable jurisdictional law without undertaking a form for the merger or consolidation, or undertake a form for the merger or consolidation that is not described in paragraph (c)(3)(ii) of this section, any merged or consolidated partnership that is considered terminated under paragraph (c)(1) of this section is treated as undertaking the assets-over form for Federal income tax purposes. Under the assets-over form, the merged or consolidated partnership that is considered terminated under paragraph (c)(1) of this section contributes all of its assets and liabilities to the resulting partnership in exchange for an interest in the resulting partnership, and immediately thereafter, the terminated partnership distributes interests in the resulting partnership to its partners in liquidation of the terminated partnership.

(ii) *Assets-up form*. Despite the partners' transitory ownership of the terminated partnership's assets, the form of a partnership merger or consolidation will be respected for Federal income tax purposes if the merged or consolidated partnership that is considered terminated under paragraph (c)(1) of this section distributes all of its assets to its partners (in a manner that causes the partners to be treated, under the laws of the applicable jurisdiction, as the owners of such assets) in liquidation of the partners' interests in the terminated partnership, and immediately thereafter, the partners in the terminated partnership contribute the distributed assets to the resulting partnership in exchange for interests in the resulting partnership.

(4) *Sale of an interest in the merging or consolidating partnership*. In a transaction characterized under the assets-over form, a sale of all or part of a partner's interest in the terminated partnership to the resulting partnership that occurs as part of a merger or consolidation under section 708(b)(2)(A), as described in paragraph (c)(3)(i) of this section, will be respected as a sale of a partnership inter-

est if the merger agreement (or another document) specifies that the resulting partnership is purchasing interests from a particular partner in the merging or consolidating partnership and the consideration that is transferred for each interest sold, and if the selling partner in the terminated partnership, either prior to or contemporaneous with the transaction, consents to treat the transaction as a sale of the partnership interest. See section 741 and §1.741-1 for determining the selling partner's gain or loss on the sale or exchange of the partnership interest.

(5) *Examples*. The following examples illustrate the rules in paragraphs (c)(1) through (4) of this section:

*Example 1*. Partnership AB, in whose capital and profits A and B each own a 50-percent interest, and partnership CD, in whose capital and profits C and D each own a 50-percent interest, merge on September 30, 1999, and form partnership ABCD. Partners A, B, C, and D are on a calendar year, and partnership AB and partnership CD also are on a calendar year. After the merger, the partners have capital and profits interests as follows: A, 30 percent; B, 30 percent; C, 20 percent; and D, 20 percent. Since A and B together own an interest of more than 50 percent in the capital and profits of partnership ABCD, such partnership shall be considered a continuation of partnership AB and shall continue to file returns on a calendar year basis. Since C and D own an interest of less than 50 percent in the capital and profits of partnership ABCD, the taxable year of partnership CD closes as of September 30, 1999, the date of the merger, and partnership CD is terminated as of that date. Partnership ABCD is required to file a return for the taxable year January 1 to December 31, 1999, indicating thereon that, until September 30, 1999, it was partnership AB. Partnership CD is required to file a return for its final taxable year, January 1 through September 30, 1999.

*Example 2*. (i) Partnership X, in whose capital and profits A owns a 40-percent interest and B owns a 60-percent interest, and partnership Y, in whose capital and profits B owns a 60-percent interest and C owns a 40-percent interest, merge on September 30, 1999. The fair market value of the partnership X assets (net of liabilities) is \$100X, and the fair market value of the partnership Y assets (net of liabilities) is \$200X. The merger is accomplished under state law by partnership Y contributing its assets and liabilities to partnership X in exchange for interests in partnership X, with partnership Y then liquidating, distributing interests in partnership X to B and C.

(ii) B, a partner in both partnerships prior to the merger, owns a greater than 50-percent interest in the resulting partnership following the merger. Accordingly, because the fair market value of partnership Y's assets (net of liabilities) was greater than that of partnership X's, under paragraph (c)(1) of this section, partnership X will be considered to terminate in the merger. As a result, even though, for state law purposes, the transaction was undertaken with partnership Y contributing its assets and liabilities to partnership X and distributing interests in partner-

ship X to its partners, pursuant to paragraph (c)(3)(i) of this section, for Federal income tax purposes, the transaction will be treated as if partnership X contributed its assets to partnership Y in exchange for interests in partnership Y and then liquidated, distributing interests in partnership Y to A and B.

*Example 3*. (i) The facts are the same as in *Example 2*, except that partnership X is engaged in a trade or business and has, as one of its assets, goodwill. In addition, the merger is accomplished under state law by having partnership X convey an undivided 40-percent interest in each of its assets to A and an undivided 60-percent interest in each of its assets to B, with A and B then contributing their interests in such assets to partnership Y. Partnership Y also assumes all of the liabilities of partnership X.

(ii) Under paragraph (c)(3)(ii) of this section, the form of the partnership merger will be respected so that partnership X will be treated as following the assets-up form for Federal income tax purposes.

*Example 4*. (i) Partnership X and partnership Y merge when the partners of partnership X transfer their partnership X interests to partnership Y in exchange for partnership Y interests. Immediately thereafter, partnership X liquidates into partnership Y. The resulting partnership is considered a continuation of partnership Y, and partnership X is considered terminated.

(ii) The partnerships are treated as undertaking the assets-over form described in paragraph (c)(3)(i) of this section because the partnerships undertook a form that is not the assets-up form described in paragraph (c)(3)(ii) of this section. Accordingly, for Federal income tax purposes, partnership X is deemed to contribute its assets and liabilities to partnership Y in exchange for interests in partnership Y, and, immediately thereafter, partnership X is deemed to have distributed the interests in partnership Y to its partners in liquidation of their interests in partnership X.

*Example 5*. (i) A, B, and C are partners in partnership X. D, E, and F are partners in Partnership Y. Partnership X and partnership Y merge, and the resulting partnership is considered a continuation of partnership Y. Partnership X is considered terminated. Under state law, partnerships X and Y undertake the assets-over form of paragraph (c)(3)(i) of this section to accomplish the partnership merger. C does not want to become a partner in partnership Y, and partnership X does not have the resources to buy C's interest before the merger. C, partnership X, and partnership Y enter into an agreement specifying that partnership Y will purchase C's interest in partnership X for \$150 before the merger, and as part of the agreement, C consents to treat the transaction in a manner that is consistent with the agreement. As part of the merger, partnership X receives from partnership Y \$150 that will be distributed to C immediately before the merger, and interests in partnership Y in exchange for partnership X's assets and liabilities.

(ii) Because the merger agreement satisfies the requirements of paragraph (c)(4) of this section and C provides the necessary consent, C will be treated as selling its interest in partnership X to partnership Y for \$150 before the merger. See section 741 and §1.741-1 to determine the amount and character of C's gain or loss on the sale or exchange of its interest in partnership X.

(iii) Because the merger agreement satisfies the requirements of paragraph (c)(4) of this section, partnership Y is considered to have purchased C's interest in partnership X for \$150 immediately before the merger. See §1.704-1(b)(2)(iv)(f) for determining partnership Y's capital account in partnership X. Partnership Y's adjusted basis of its interest in partnership X is determined under section 742 and §1.742-1. To the extent any built-in gain or loss on section 704(c) property in partnership X would have been allocated to C (including any allocations with respect to property revaluations under section 704(b) (reverse section 704(c) allocations)), see section 704 and §1.704-3(a)(7) for determining the built-in gain or loss or reverse section 704(c) allocations apportionable to partnership Y. Similarly, after the merger is completed, the built-in gain or loss and reverse section 704(c) allocations attributable to C's interest are apportioned to D, E, and F under section 704(c) and §1.704-3(a)(7).

(iv) Under paragraph (c)(3)(i) of this section, partnership X contributes its assets and liabilities attributable to the interests of A and B to partnership Y in exchange for interests in partnership Y; and, immediately thereafter, partnership X distributes the interests in partnership Y to A and B in liquidation of their interests in partnership X. At the same time, partnership X distributes assets to partnership Y in liquidation of partnership Y's interest in partnership X. Partnership Y's bases in the distributed assets are determined under section 732(b).

(6) *Prescribed form not followed in certain circumstances.* (i) If any transactions described in paragraph (c)(3) or (4) of this section are part of a larger series of transactions, and the substance of the larger series of transactions is inconsistent with following the form prescribed in such paragraph, the Commissioner may disregard such form, and may recast the larger series of transactions in accordance with their substance.

(ii) *Example.* The following example illustrates the rules in paragraph (c)(6) of this section:

*Example.* A, B, and C are equal partners in partnership ABC. ABC holds no section 704(c) property. D and E are equal partners in partnership DE. B and C want to exchange their interests in ABC for all of the interests in DE. However, rather than exchanging partnership interests, DE merges with ABC by undertaking the assets-up form described in paragraph (c)(3)(ii) of this section, with D and E receiving title to the DE assets and then contributing the assets to ABC in exchange for interests in ABC. As part of a prearranged transaction, the assets acquired from DE are contributed to a new partnership, and the interests in the new partnership are distributed to B and C in complete liquidation of their interests in ABC. The merger and division in this example represent a series of transactions that in substance are an exchange of interests in ABC for interests in DE. Even though paragraph (c)(3)(ii) of this section provides that the form of a merger will be respected for Federal income tax purposes if the steps prescribed under the assets-up form are fol-

lowed, and paragraph (d)(3)(i) of this section provides a form that will be followed for Federal income tax purposes in the case of partnership divisions, these forms will not be respected for Federal income tax purposes under these facts, and the transactions will be recast in accordance with their substance as a taxable exchange of interests in ABC for interests in DE.

(7) *Effective date.* This paragraph (c) is applicable to partnership mergers occurring on or after January 4, 2001. However, a partnership may apply paragraph (c) of this section to partnership mergers occurring on or after January 11, 2000.

(d) *Division of a partnership—(1) General rule.* Upon the division of a partnership into two or more partnerships, any resulting partnership (as defined in paragraph (d)(4)(iv) of this section) or resulting partnerships shall be considered a continuation of the prior partnership (as defined in paragraph (d)(4)(ii) of this section) if the members of the resulting partnership or partnerships had an interest of more than 50 percent in the capital and profits of the prior partnership. Any other resulting partnership will not be considered a continuation of the prior partnership but will be considered a new partnership. If the members of none of the resulting partnerships owned an interest of more than 50 percent in the capital and profits of the prior partnership, none of the resulting partnerships will be considered a continuation of the prior partnership, and the prior partnership will be considered to have terminated. Where members of a partnership which has been divided into two or more partnerships do not become members of a resulting partnership which is considered a continuation of the prior partnership, such members' interests shall be considered liquidated as of the date of the division.

(2) *Tax consequences—(i) Tax returns.* The resulting partnership that is treated as the divided partnership (as defined in paragraph (d)(4)(i) of this section) shall file a return for the taxable year of the partnership that has been divided and retain the employer identification number (EIN) of the prior partnership. The return shall include the names, addresses, and EINs of all resulting partnerships that are regarded as continuing. The return shall also state that the partnership is a continuation of the prior partnership and shall set forth separately the respective distributive

shares of the partners for the periods prior to and including the date of the division and subsequent to the date of division. All other resulting partnerships that are regarded as continuing and new partnerships shall file separate returns for the taxable year beginning on the day after the date of the division with new EINs for each partnership. The return for a resulting partnership that is regarded as continuing and that is not the divided partnership shall include the name, address, and EIN of the prior partnership.

(ii) *Elections.* All resulting partnerships that are regarded as continuing are subject to preexisting elections that were made by the prior partnership. A subsequent election that is made by a resulting partnership does not affect the other resulting partnerships.

(3) *Form of a division—(i) Assets-over form.* When a partnership divides into two or more partnerships under applicable jurisdictional law without undertaking a form for the division, or undertakes a form that is not described in paragraph (d)(3)(ii) of this section, the transaction will be characterized under the assets-over form for Federal income tax purposes.

(A) *Assets-over form where at least one resulting partnership is a continuation of the prior partnership.* In a division under the assets-over form where at least one resulting partnership is a continuation of the prior partnership, the divided partnership (as defined in paragraph (d)(4)(i) of this section) contributes certain assets and liabilities to a recipient partnership (as defined in paragraph (d)(4)(iii) of this section) or recipient partnerships in exchange for interests in such recipient partnership or partnerships; and, immediately thereafter, the divided partnership distributes the interests in such recipient partnership or partnerships to some or all of its partners in partial or complete liquidation of the partners' interests in the divided partnership.

(B) *Assets-over form where none of the resulting partnerships is a continuation of the prior partnership.* In a division under the assets-over form where none of the resulting partnerships is a continuation of the prior partnership, the prior partnership will be treated as contributing all of its assets and liabilities to new resulting partnerships in exchange for interests in the

resulting partnerships; and, immediately thereafter, the prior partnership will be treated as liquidating by distributing the interests in the new resulting partnerships to the prior partnership's partners.

(ii) *Assets-up form*—(A) *Assets-up form where the partnership distributing assets is a continuation of the prior partnership*. Despite the partners' transitory ownership of some of the prior partnership's assets, the form of a partnership division will be respected for Federal income tax purposes if the divided partnership (which, pursuant to §1.708-1(d)(4)(i), must be a continuing partnership) distributes certain assets (in a manner that causes the partners to be treated, under the laws of the applicable jurisdiction, as the owners of such assets) to some or all of its partners in partial or complete liquidation of the partners' interests in the divided partnership, and immediately thereafter, such partners contribute the distributed assets to a recipient partnership or partnerships in exchange for interests in such recipient partnership or partnerships. In order for such form to be respected for transfers to a particular recipient partnership, all assets held by the prior partnership that are transferred to the recipient partnership must be distributed to, and then contributed by, the partners of the recipient partnership.

(B) *Assets-up form where none of the resulting partnerships are a continuation of the prior partnership*. If none of the resulting partnerships are a continuation of the prior partnership, then despite the partners' transitory ownership of some or all of the prior partnership's assets, the form of a partnership division will be respected for Federal income tax purposes if the prior partnership distributes certain assets (in a manner that causes the partners to be treated, under the laws of the applicable jurisdiction, as the owners of such assets) to some or all of its partners in partial or complete liquidation of the partners' interests in the prior partnership, and immediately thereafter, such partners contribute the distributed assets to a resulting partnership or partnerships in exchange for interests in such resulting partnership or partnerships. In order for such form to be respected for transfers to a particular resulting partnership, all assets held by the prior partnership that are transferred to the resulting partnership must be distributed to, and then con-

tributed by, the partners of the resulting partnership. If the prior partnership does not liquidate under the applicable jurisdictional law, then with respect to the assets and liabilities that, in form, are not transferred to a new resulting partnership, the prior partnership will be treated as transferring these assets and liabilities to a new resulting partnership under the assets-over form described in paragraph (d)(3)(i)(B) of this section.

(4) *Definitions*—(i) *Divided partnership*. For purposes of paragraph (d) of this section, the divided partnership is the continuing partnership which is treated, for Federal income tax purposes, as transferring the assets and liabilities to the recipient partnership or partnerships, either directly (under the assets-over form) or indirectly (under the assets-up form). If the resulting partnership that, in form, transferred the assets and liabilities in connection with the division is a continuation of the prior partnership, then such resulting partnership will be treated as the divided partnership. If a partnership divides into two or more partnerships and only one of the resulting partnerships is a continuation of the prior partnership, then the resulting partnership that is a continuation of the prior partnership will be treated as the divided partnership. If a partnership divides into two or more partnerships without undertaking a form for the division that is recognized under paragraph (d)(3) of this section, or if the resulting partnership that had, in form, transferred assets and liabilities is not considered a continuation of the prior partnership, and more than one resulting partnership is considered a continuation of the prior partnership, the continuing resulting partnership with the assets having the greatest fair market value (net of liabilities) will be treated as the divided partnership.

(ii) *Prior partnership*. For purposes of paragraph (d) of this section, the prior partnership is the partnership subject to division that exists under applicable jurisdictional law before the division.

(iii) *Recipient partnership*. For purposes of paragraph (d) of this section, a recipient partnership is a partnership that is treated as receiving, for Federal income tax purposes, assets and liabilities from a divided partnership, either directly (under the assets-over form) or indirectly (under the assets-up form).

(iv) *Resulting partnership*. For purposes of paragraph (d) of this section, a resulting partnership is a partnership resulting from the division that exists under applicable jurisdictional law after the division and that has at least two partners who were partners in the prior partnership. For example, where a prior partnership divides into two partnerships, both partnerships existing after the division are resulting partnerships.

(5) *Examples*. The following examples illustrate the rules in paragraphs (d)(1), (2), (3), and (4) of this section:

*Example 1*. Partnership ABCD is in the real estate and insurance businesses. A owns a 40-percent interest, and B, C, and D each owns a 20-percent interest, in the capital and profits of the partnership. The partnership and the partners report their income on a calendar year. On November 1, 1999, they separate the real estate and insurance businesses and form two partnerships. Partnership AB takes over the real estate business, and partnership CD takes over the insurance business. Because members of resulting partnership AB owned more than a 50-percent interest in the capital and profits of partnership ABCD (A, 40 percent, and B, 20 percent), partnership AB shall be considered a continuation of partnership ABCD. Partnership AB is required to file a return for the taxable year January 1 to December 31, 1999, indicating thereon that until November 1, 1999, it was partnership ABCD. Partnership CD is considered a new partnership formed at the beginning of the day on November 2, 1999, and is required to file a return for the taxable year it adopts pursuant to section 706(b) and the applicable regulations.

*Example 2*. (i) Partnership ABCD owns properties W, X, Y, and Z, and divides into partnership AB and partnership CD. Under paragraph (d)(1) of this section, partnership AB is considered a continuation of partnership ABCD and partnership CD is considered a new partnership. Partnership ABCD distributes property Y to C and titles property Y in C's name. Partnership ABCD distributes property Z to D and titles property Z in D's name. C and D then contribute properties Y and Z, respectively, to partnership CD in exchange for interests in partnership CD. Properties W and X remain in partnership AB.

(ii) Under paragraph (d)(3)(ii) of this section, partnership ABCD will be treated as following the assets-up form for Federal income tax purposes.

*Example 3*. (i) The facts are the same as in *Example 2*, except partnership ABCD distributes property Y to C and titles property Y in C's name. C then contributes property Y to partnership CD. Simultaneously, partnership ABCD contributes property Z to partnership CD in exchange for an interest in partnership CD. Immediately thereafter, partnership ABCD distributes the interest in partnership CD to D in liquidation of D's interest in partnership ABCD.

(ii) Under paragraph (d)(3)(i) of this section, because partnership ABCD did not undertake the assets-up form with respect to all of the assets transferred to partnership CD, partnership ABCD will be treated as undertaking the assets-over form in transferring the assets to partnership CD. Accordingly, for Federal income tax purposes, partnership ABCD

is deemed to contribute property Y and property Z to partnership CD in exchange for interests in partnership CD, and immediately thereafter, partnership ABCD is deemed to distribute the interests in partnership CD to partner C and partner D in liquidation of their interests in partnership ABCD.

*Example 4.* (i) Partnership ABCD owns three parcels of property: property X, with a value of \$500; property Y, with a value of \$300; and property Z, with a value of \$200. A and B each own a 40-percent interest in the capital and profits of partnership ABCD, and C and D each own a 10 percent interest in the capital and profits of partnership ABCD. On November 1, 1999, partnership ABCD divides into three partnerships (AB1, AB2, and CD) by contributing property X to a newly formed partnership (AB1) and distributing all interests in such partnership to A and B as equal partners, and by contributing property Z to a newly formed partnership (CD) and distributing all interests in such partnership to C and D as equal partners in exchange for all of their interests in partnership ABCD. While partnership ABCD does not transfer property Y, C and D cease to be partners in the partnership. Accordingly, after the division, the partnership holding property Y is referred to as partnership AB2.

(ii) Partnerships AB1 and AB2 both are considered a continuation of partnership ABCD, while partnership CD is considered a new partnership formed at the beginning of the day on November 2, 1999. Under paragraph (d)(3)(i)(A) of this section, partnership ABCD will be treated as following the assets-over form, with partnership ABCD contributing property X to partnership AB1 and property Z to partnership CD, and distributing the interests in such partnerships to the designated partners.

*Example 5.* (i) The facts are the same as in *Example 4*, except that partnership ABCD divides into three partnerships by operation of state law, without undertaking a form.

(ii) Under the last sentence of paragraph (d)(4)(i) of this section, partnership AB1 will be treated as the resulting partnership that is the divided partnership. Under paragraph (d)(3)(i)(A) of this section, partnership ABCD will be treated as following the assets-over form, with partnership ABCD contributing property Y to partnership AB2 and property Z to partnership CD, and distributing the interests in such partnerships to the designated partners.

*Example 6.* (i) The facts are the same as in *Example 4*, except that partnership ABCD divides into three partnerships by contributing property X to newly-formed partnership AB1 and property Y to newly-formed partnership AB2 and distributing all interests in each partnership to A and B in exchange for all of their interests in partnership ABCD.

(ii) Because resulting partnership CD is not a continuation of the prior partnership (partnership ABCD), partnership CD cannot be treated, for Federal income tax purposes, as the partnership that transferred assets (i.e., the divided partnership), but instead must be treated as a recipient partnership. Under the last sentence of paragraph (d)(4)(i) of this section, partnership AB1 will be treated as the resulting partnership that is the divided partnership. Under paragraph (d)(3)(i)(A) of this section, partnership ABCD will be treated as following the assets-over form, with partnership ABCD contributing property Y to partnership AB2 and property Z to partnership CD, and distributing the interests in such

partnerships to the designated partners.

*Example 7.* (i) Partnership ABCDE owns Blackacre, Whiteacre, and Redacre, and divides into partnership AB, partnership CD, and partnership DE. Under paragraph (d)(1) of this section, partnership ABCDE is considered terminated (and, hence, none of the resulting partnerships are a continuation of the prior partnership) because none of the members of the new partnerships (partnership AB, partnership CD, and partnership DE) owned an interest of more than 50 percent in the capital and profits of partnership ABCDE.

(ii) Partnership ABCDE distributes Blackacre to A and B and titles Blackacre in the names of A and B. A and B then contribute Blackacre to partnership AB in exchange for interests in partnership AB. Partnership ABCDE will be treated as following the assets-up form described in paragraph (d)(3)(ii)(B) of this section for Federal income tax purposes.

(iii) Partnership ABCDE distributes Whiteacre to C and D and titles Whiteacre in the names of C and D. C and D then contribute Whiteacre to partnership CD in exchange for interests in partnership CD. Partnership ABCDE will be treated as following the assets-up form described in paragraph (d)(3)(ii)(B) of this section for Federal income tax purposes.

(iv) Partnership ABCDE does not liquidate under state law so that, in form, the assets in new partnership DE are not considered to have been transferred under state law. Partnership ABCDE will be treated as undertaking the assets-over form described in paragraph (d)(3)(i)(B) of this section for Federal income tax purposes with respect to the assets of partnership DE. Thus, partnership ABCDE will be treated as contributing Redacre to partnership DE in exchange for interests in partnership DE; and, immediately thereafter, partnership ABCDE will be treated as distributing interests in partnership DE to D and E in liquidation of their interests in partnership ABCDE. Partnership ABCDE then terminates.

(6) *Prescribed form not followed in certain circumstances.* If any transactions described in paragraph (d)(3) of this section are part of a larger series of transactions, and the substance of the larger series of transactions is inconsistent with following the form prescribed in such paragraph, the Commissioner may disregard such form, and may recast the larger series of transactions in accordance with their substance.

(7) *Effective date.* This paragraph (d) is applicable to partnership divisions occurring on or after January 4, 2001. However, a partnership may apply paragraph (d) of this section to partnership divisions occurring on or after January 11, 2000.

Par. 3. Section 1.752-1 is amended as follows:

1. A sentence is added to the end of paragraph (f).

2. The current *Example* in paragraph (g) is redesignated as *Example 1*.

3. *Example 2* is added in paragraph (g). The additions read as follows:

### *§1.752-1 Treatment of partnership liabilities.*

\* \* \* \* \*

(f) \* \* \* When two or more partnerships merge or consolidate under section 708(b)(2)(A), as described in §1.708-1(c)(3)(i), increases and decreases in partnership liabilities associated with the merger or consolidation are netted by the partners in the terminating partnership and the resulting partnership to determine the effect of the merger under section 752.

(g) \* \* \*

#### *Example 1.* \* \* \*

*Example 2. Merger or consolidation of partnerships holding property encumbered by liabilities.* (i) B owns a 70 percent interest in partnership T. Partnership T's sole asset is property X, which is encumbered by a \$900 liability. Partnership T's adjusted basis in property X is \$600, and the value of property X is \$1,000. B's adjusted basis in its partnership T interest is \$420. B also owns a 20 percent interest in partnership S. Partnership S's sole asset is property Y, which is encumbered by a \$100 liability. Partnership S's adjusted basis in property Y is \$200, the value of property Y is \$1,000, and B's adjusted basis in its partnership S interest is \$40.

(ii) Partnership T and partnership S merge under section 708(b)(2)(A). Under section 708(b)(2)(A) and §1.708-1(c)(1), partnership T is considered terminated and the resulting partnership is considered a continuation of partnership S. Partnerships T and S undertake the form described in §1.708-1(c)(3)(i) for the partnership merger. Under §1.708-1(c)(3)(i), partnership T contributes property X and its \$900 liability to partnership S in exchange for an interest in partnership S. Immediately thereafter, partnership T distributes the interests in partnership S to its partners in liquidation of their interests in partnership T. B owns a 25 percent interest in partnership S after partnership T distributes the interests in partnership S to B.

(iii) Under paragraph (f) of this section, B nets the increases and decreases in its share of partnership liabilities associated with the merger of partnership T and partnership S. Before the merger, B's share of partnership liabilities was \$650 (B had a \$630 share of partnership liabilities in partnership T and a \$20 share of partnership liabilities in partnership S immediately before the merger). B's share of S's partnership liabilities after the merger is \$250 (25 percent of S's total partnership liabilities of \$1,000). Accordingly, B has a \$400 net decrease in its share of S's partnership liabilities. Thus, B is treated as receiving a \$400 distribution from partnership S under section 752(b). Because B's adjusted basis in its partnership S interest before the deemed distribution under section 752(b) is \$460 (\$420 + \$40), B will not recognize gain under section 731. After the merger, B's adjusted basis in its partnership S interest is \$60.

\* \* \* \* \*



Par. 4. In §1.752-5, paragraph (a) is amended by adding two sentences after the third sentence.

*§1.752-5 Effective dates and transition rules.*

(a) *In general.* \* \* \* In addition, §1.752-1(f) last sentence and (g) *Example 2*, do not apply to any liability incurred or assumed by a partnership prior to January 4, 2001. Nevertheless, §1.752-1(f) last sentence and (g) *Example 2*, may be relied on for any liability incurred or assumed by a partnership prior to January 4, 2001, and, unless the partnership makes an election under paragraph (b)(1) of this section, on or after December 28, 1991, other than a liability incurred or assumed by the partnership pursuant to a written binding contract in effect prior to December 28, 1991, and at all times thereafter. \* \* \*

\* \* \* \* \*

David A. Mader,  
*Acting Deputy Commissioner  
of Internal Revenue.*

Approved December 20, 2000.

Jonathan Talisman,  
*Acting Assistant Secretary  
of the Treasury.*

(Filed by the Office of the Federal Register on January 3, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 4, 2001, 66 F.R. 715)

## Section 1502.—Regulations

*26 CFR 1.1502-78T: Rules for filing applications for tentative carryback adjustments.*

**T.D. 8919**

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

### **Guidance on Filing an Application for a Tentative Carryback Adjustment in a Consolidated Return Context**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the fil-

**2001-6 I.R.B.**

ing of an application for a tentative carryback adjustment. These temporary regulations provide guidance to determine the time for filing such application by a consolidated group. This document also contains temporary regulations relating to the filing of an application for a tentative carryback adjustment by certain corporations for the separate return year created by their becoming a member of a consolidated group. These temporary regulations may affect all consolidated groups. The text of these temporary regulations also serves as the text of proposed regulations set forth in the notice of proposed rulemaking (REG-119352-00) on page 525 of this Bulletin.

**DATES:** *Effective Date:* January 4, 2001.

*Applicability Date:* For dates of applicability for these regulations, see paragraph (g)(2)(v) of this section.

**FOR FURTHER INFORMATION CONTACT:** Christopher M. Bass or Frances L. Kelly, (202) 622-7770.

**SUPPLEMENTARY INFORMATION:**

#### **Background**

This document contains temporary amendments to the Income Tax Regulations (26 CFR Part 1) under section 1502 of the Internal Revenue Code of 1986 (Code). The amendments provide guidance as to the time for filing an application for a tentative carryback adjustment by a consolidated group. The amendments also extend the time for filing an application for a tentative carryback adjustment by certain corporations for the separate return year created by their becoming new members of a consolidated group.

Section 6411(a) requires that an application for a tentative carryback adjustment be filed on or after the date of filing for the return for the taxable year of the loss (or unused business credit) from which the carryback results and within a period of twelve (12) months after the end of such taxable year. Section 6411(c) provides that if the corporation seeking a tentative carryback adjustment made or was required to make a consolidated return for the year in which the loss or credit arose or for the preceding taxable year affected by such loss or credit, the provisions of Section 6411(a) apply only to such extent and subject to such conditions, limitations

and exceptions as the Secretary may by regulations prescribe. Section 1.6411-4 refers taxpayers to the consolidated return regulations, specifically §1.1502-78, for further rules applicable to consolidated groups filing for a tentative carryback adjustment.

Section 1.1502-78(a) addresses the proper party to file an application for a tentative carryback adjustment. However, there is no provision addressing the time for filing such application. Section 1.1502-78 does not currently alter the statutory rule as to “when” the end of a taxable year occurs for purposes of determining whether the twelve-month rule of section 6411 has been satisfied. Under §1.1502-76, the due date for the separate return of a new member is generally extended until the due date of the return of the consolidated group. In certain instances, however, such separate return cannot be filed before the expiration of the twelve-month period under section 6411(a). Thus, a new member may be prevented from filing an application for a tentative carryback adjustment.

Section 1.1502-76(b)(1)(i) provides that the consolidated return must include the common parent’s items of income, gain, deduction, loss, and credit for the entire consolidated year, and each subsidiary’s items for the portion of the year for which it is a member. Items of a corporation for the portion of the year not included in the consolidated return must be included in a separate return (including the consolidated return of another group). Thus, the items of a new member of a consolidated group are included in two returns: first, the consolidated return for the period of time it is a member of the group; and second, a separate return (including the consolidated return of another group) for the pre-affiliation period prior to becoming a member of the consolidated group. This pre-affiliation period is a separate return year as defined in §1.1502-1(e).

The tax returns for the periods that end and begin upon a corporation becoming (or ceasing to be) a member of a consolidated group are separate taxable years for all Federal income tax purposes. Section 1.1502-76(b)(2)(i). Although these periods are separate taxable years, items of income, gain, deduction, loss, and credit (other than extraordinary items) may be ratably allocated between such years if:



(1) the corporation is not required to change its annual accounting period or its method of accounting as a result of its change in status as a member; and (2) a timely ratably allocation election is made. Section 1.1502-76(b)(2)(ii)(A). If a ratably allocation cannot be made (or is not made), the corporation must close its books at the close of the day on which its status as a member changes and its items of income, gain, deduction, loss, and credit for the pre-affiliation period are included in its separate return. Section 1.1502-76(b)(2)(ii).

Section 1.1502-76(c) determines the time for filing the new member's separate return. The provisions of this section apply only to a corporation which, immediately prior to becoming a new member of a group, was the common parent of another consolidated group, or was not required to join in the filing of a consolidated return. Under §1.1502-76(c), the due date of the new member's separate return is dependent upon the filing of the consolidated group's tax return. If the consolidated return for the group has been filed by the due date for the new member's separate return, then the separate return must be filed no later than the due date of the consolidated group's return, including extensions. If the consolidated return for the group has not been filed by the due date for the new member's separate return, then the separate return must be filed on or before such due date. In each case, the due date for the new member's separate return is determined with regard to extensions of time for filing but without regard to the member's new affiliated status. The close of the new member's separate return year is treated as the close of its normal taxable year. Therefore, §1.1502-76(c) effectively extends the period of time in which a new member is required to file its separate return because otherwise, the taxable year would end on the date it becomes a member. Section 1.1502-76(b)(2).

While §1.1502-76(c) extends the due date for filing the new member's separate return, there is no similar provision that extends the due date for filing an application for a tentative carryback adjustment for the separate return year. Neither section 6411(a) nor §1.1502-78 interprets the close of the new member's separate return

year as the close of its normal taxable year. Therefore, an application for a tentative carryback adjustment must be filed: (1) on or after the extended date for filing the return for the taxable year; and (2) within a period of twelve months after the close of such taxable year. Since the separate return year is treated as a separate taxable year for all Federal income tax purposes under §1.1502-76(b)(2)(i), a new member that chooses to file an application for a tentative carryback adjustment under section 6411 must do so within twelve (12) months after the close of its separate return year (not its normal taxable year).

The practical effect of extending the due date for filing the new member's separate return under §1.1502-76(c) without extending the time period for filing an application for a tentative carryback adjustment is that a corporation that becomes a member of a consolidated group early in its taxable year may effectively be precluded from filing the application. This results because the twelve-month period for filing the refund application may expire prior to the due date (extended or unextended) for the filing of the new member's separate return.

The problem is illustrated by the following example:

On April 30, 2000, 100% of the stock of Corporation X, a stand-alone corporation, is acquired by Group Y. Both Corporation X and Group Y file their returns on a calendar year basis. Under §1.1502-76(c), Corporation X's separate return for the period, January 1-April 30, 2000 (the April 2000 Year), is due on or before September 15, 2001 (with extensions). However, its application for a tentative carryback adjustment for the April 2000 Year is due no later than April 30, 2001, twelve months after the end of the April 2000 Year.

As a practical matter, the separate return of some new members cannot be filed before the group's consolidated return is filed. As previously noted, §1.1502-76(b)(2) provides, under certain circumstances, that the new member's items of income, gain, deduction, loss, and credit may be ratably allocated between the pre-affiliation and the post-affiliation periods. The new member may not know whether the common parent will

elect to ratably allocate its items. Such allocation would alter the income or loss of the new member for its separate return year. The new member also may not know the proper amount of income and loss to report and thus cannot file its separate return or its application for a tentative carryback adjustment until the group's consolidated return has been filed. Furthermore, Rev. Rul. 75-327 (1975-2 C.B. 481) holds that, because the IRS must rely on the information provided by the taxpayer in its application for a tentative carryback adjustment and much of that information (such as NOLs) is based on the return for the loss year, section 6411(a) requires that the return for the loss year be filed before the application for a tentative refund can be filed.

This problem is not generally faced by corporations that become members of a consolidated group in the latter part of their taxable year. For example, if Corporation X had been acquired on October 15, 2000, rather than April 15, 2000, its application for a tentative carryback adjustment would be due on or before October 15, 2001, a month after its separate return is due (with extensions).

### Explanation of Provisions

The consolidated return regulations do not address the time for filing an application for a tentative carryback adjustment. Rather, the consolidated return regulations rely upon the general provisions of section 6411 for guidance. The amendments to §1.1502-78 provide a general rule for all consolidated taxpayers stating that the provisions of section 6411(a) shall apply to determine the time for filing an application for a tentative carryback adjustment by a consolidated group.

In addition, the amendments provide a special rule designed to remedy the problem faced by some corporations that become new members of a consolidated group. For such members, the amendments extend the period of time for filing an application for a tentative carryback adjustment resulting from losses or credits arising in the new member's last separate return year. For these purposes, the amendments treat the separate return year as ending on the same date as the end of the current taxable year of the consolidated group.

The special rule of these temporary regulations will apply only to a corporation that, immediately prior to becoming a new member of a group, was the common parent of another consolidated group, or was not required to join in the filing of a consolidated return. The situation not covered involves the acquisition of a member of another consolidated group. In this case, the corporation's items of income, gain, deduction, loss and credit for the period prior to becoming a member of the new consolidated group will be included in the consolidated return of its former group. The due date for the former group's consolidated return is not affected by the acquisition and the due date for its application for a tentative carryback adjustment relates back to the end of the former group's taxable year.

The approach taken attempts to provide consistency between §1.1502-76(c) and §1.1502-78. In addition, this approach provides certainty to taxpayers and allows for simplicity of administration by the IRS.

### Special Analyses

It has been determined that this notice of temporary rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Because no preceding notice of proposed rulemaking is required for this temporary regulation, the provisions of the Regulatory Flexibility Act do not apply.

This Treasury decision ensures that all new members of consolidated groups have the opportunity to file an application for a tentative carryback adjustment, a benefit currently unavailable to some new members. Issuing this regulation in proposed form would continue the difficulty of filing an application for a tentative carryback adjustment for affected new members. Based on these considerations, it is determined that this temporary regulation will provide taxpayers with the necessary guidance and authority to ensure equitable administration of the tax laws. Therefore, it would be contrary to the public interest to issue this Treasury decision with prior notice under section 553(b) or subject to the effective date limitation of section 553(d) of title 5 of the United States Code.

Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small

Business Administration for comment on their impact on small business.

### Drafting Information

The principal authors of these temporary regulations are Christopher M. Bass and Frances L. Kelly, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1 — INCOME TAXES

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

Authority: 26 U.S.C. 7805 \* \* \*  
Section 1.1502-78T also issued under 26 U.S.C. 1502 and 6411(c). \* \* \*

Par. 2. Section 1.1502-78T is added to read as follows:

#### *§1.1502-78T Rules for filing applications for tentative carryback adjustments.*

(a) through (f) [Reserved]. For further guidance, see §1.1502-78(a) through (f).

(g) *Time for filing application—(1) General rule.* The provisions of section 6411(a) apply to the filing of an application for a tentative carryback adjustment by a consolidated group.

(2) *Special rule for new members—(i) New member.* A new member is a corporation that, in the preceding taxable year, did not qualify as a member, as defined in §1.1502-1(b), of the consolidated group that it now joins.

(ii) *End of taxable year.* Solely for the purpose of complying with the twelve-month requirement for making an application for a tentative carryback adjustment under section 6411(a), the separate return year of a qualified new member shall be treated as ending on the same date as the end of the current taxable year of the consolidated group that the qualified new member joins.

(iii) *Qualified new member.* A new member of a consolidated group qualifies for purposes of the provisions of this paragraph (g)(2), if immediately prior to becoming a new member, either—

(A) It was the common parent of a consolidated group; or

(B) It was not required to join in the filing of a consolidated return.

(iv) *Examples.* The provisions of this paragraph (g)(2) may be illustrated by the following examples:

*Example 1.* Individual A owns 100 percent of the stock of X, a corporation filing returns on a calendar year basis. On January 31 of year 1, X becomes a member of the Y consolidated group, which also files returns on a calendar year basis. X is a qualified new member as defined in paragraph (g)(2)(iii)(B) of this section because, immediately prior to becoming a new member of the Y consolidated group, X was not required to join in the filing of a consolidated return. As a result of its becoming a new member of Group Y, X's separate return for the short taxable year (January 1 of year 1 through January 31 of year 1) is due September 15 of year 2 (with extensions). Section 1.1502-76(c). Group Y's consolidated return is also due September 15 of year 2 (with extensions). Section 1.1502-76(c). Solely for the purpose of complying with the twelve-month requirement for making an application for a tentative carryback adjustment under Section 6411(a), X's taxable year for the separate return year is treated as ending on December 31 of year 1. X's application for a tentative carryback adjustment is therefore due on or before December 31 of year 2.

*Example 2.* Assume the same facts as in *Example 1* except that immediately prior to becoming a new member of Group Y, X was a member of the Z consolidated group. Because X was required to join in the filing of the consolidated return for Group Z, X is not a qualified new member as defined in paragraph (g)(2)(iii) of this section. X's items for the one-month period will be included in the consolidated return for Group Z. Group Z's application for a tentative carryback adjustment, if any, continues to be due within 12 months of the end of its taxable year, which is not affected by X's change in status as a new member of Group Y.

(v) *Effective date.* The provisions of this paragraph (g)(2) apply for applications by new members of consolidated groups for tentative carryback adjustments resulting from net operating losses, net capital losses, or unused business credits arising in separate return years of new members that begin on or after January 1, 2001.

Robert E. Wenzel,  
Deputy Commissioner  
of Internal Revenue.

Approved December 13, 2000.

Jonathan Talisman,  
Acting Assistant Secretary  
of the Treasury.

(Filed by the Office of the Federal Register on January 3, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 4, 2001, 66 F.R. 713)

## Section 7430.—Awarding of Costs and Certain Fees

26 CFR 301.7430-7T: *Qualified offers (temporary).*

T.D. 8922

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

#### Awards of Attorney's Fees and Other Costs Based Upon Qualified Offers

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the circumstances under which a party, by reason of having made a qualified offer, will be entitled to an award of reasonable administrative and litigation costs in a civil tax proceeding brought in a court of the United States (including the Tax Court). The regulations implement certain changes made by section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998. They affect taxpayers who make qualified offers. The text of these regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG-121928-98) on page 520 of this Bulletin.

DATES: *Effective Dates.* These regulations are effective January 3, 2001.

*Applicability Date:* These regulations apply to qualified offers made in administrative or court proceedings described in section 7430 after January 3, 2001.

FOR FURTHER INFORMATION CONTACT: Thomas D. Moffitt (202) 622-7900 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Background

This document contains amendments to the Procedure and Administration Regulations (26 CFR part 301) that reflect changes to section 7430 made by section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998 relating to the circumstances under which taxpayers may recover reasonable administrative and litigation costs in a court pro-

ceeding with respect to the determination or refund of any tax, interest or penalty when taxpayers have made a qualified offer.

#### Explanation of Provisions

In general, a prevailing party may recover the reasonable administrative and litigation costs incurred in administrative and court proceedings if the proceedings relate to the determination or refund of any tax, interest or penalty under the Internal Revenue Code. The regulations provide information concerning the circumstances under which the making of a qualified offer will result in the taxpayer being a prevailing party for purposes of a recovery of costs. In general, a taxpayer is a prevailing party by reason of making a qualified offer if the taxpayer's liability under the last qualified offer would equal or exceed the amount of the taxpayer's liability (determined without regard to interest) attributable to the adjustments included in the last qualified offer that were actually determined by the court through litigation, plus the amount of any additional adjustments included in the last qualified offer that were determined by settlements entered into after the making of the last qualified offer. Adjustments raised by any party subsequent to the making of the last qualified offer are disregarded in determining the liability of the taxpayer to be compared with the liability under the last qualified offer. These regulations apply in multiple taxpayer situations, such as joint returns, but do not set forth any special rules regarding the aggregation or segregation of the qualified offer or liability in situations that may present special circumstances, such as claims for innocent spouse relief. After study, further guidance may be issued elaborating on the treatment of such situations under these regulations.

To qualify as a prevailing party under this rule, in addition to the above, taxpayers must also satisfy the net worth requirements of section 7430(c)(4)(A)(ii). Furthermore, to qualify for an award, taxpayers must satisfy the remaining requirements of section 7430, such as not unreasonably protracting the proceedings and, for purposes of an award of litigation costs, exhausting their administrative remedies. On the other hand, a taxpayer qualifying as a prevailing party by reason of having made a qualified offer need not substantially prevail on either the amount in controversy or the most significant issue or set of

issues presented. Similarly, whether the positions of the United States in the administrative and litigation proceedings were substantially justified is not relevant for an award under the qualified offer rule. An award based upon the taxpayer having made a qualified offer is limited to those reasonable administrative and litigation costs incurred on or after the date of the last qualified offer, with respect to the adjustments that were included in the last qualified offer, and litigated to a judicial determination. If the taxpayer qualifies as a prevailing party without regard to the qualified offer rule, the reasonable administrative and litigation costs to which the taxpayer is thus entitled may not be awarded again by reason of the taxpayer having made a qualified offer.

A qualified offer is a written offer that: 1) is made by the taxpayer to the United States during the qualified offer period; 2) establishes the taxpayer's liability (determined without regard to interest) by setting forth the amount of the taxpayer's offer on all adjustments at issue in the proceeding at the time the qualified offer is made; 3) is designated as a qualified offer at the time it is made; and 4) remains open at least until the earliest of the date the offer is rejected, the date the trial begins, or the 90<sup>th</sup> day after the date the offer is made.

The qualified offer period ends on the date which is thirty days before the date the case is first set for trial. In cases that are pending in the United States Tax Court, cases are placed upon a calendar for trial. Each case appearing on a trial calendar is to be called at the time and place scheduled. In determining when the qualified offer period ends for cases in the Tax Court and other courts of the United States using calendars for trial, a case is considered to be set for trial on the date scheduled for the calendar call. Cases may be removed from a trial calendar at any time. Thus, a case may be removed from a calendar before the date that precedes by thirty days the date scheduled for that calendar. To promote the settlement of such cases, the qualified offer period does not end until the case remains on a calendar for trial on the date that precedes by 30 days the scheduled date of the calendar call for that trial session. The qualified offer period may not be extended, although the period during which a qualified offer remains open may extend beyond the end of the qualified offer period.

A taxpayer cannot qualify as a prevailing party by reason of having made a qualified offer if the determination of the court in the proceeding with respect to the adjustments included in the last qualified offer is entered exclusively pursuant to a settlement. Neither can a taxpayer qualify as a prevailing party by reason of having made a qualified offer in any proceeding in which the amount of tax liability is not in issue, including any declaratory judgment proceeding, any proceeding to enforce or quash any summons issued pursuant to the Internal Revenue Code of 1986, and any action to restrain disclosure under section 6110(f).

### Special Analyses

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

### Drafting Information

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

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### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

#### PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.7430-7T is added to read as follows:

#### §301.7430-7T *Qualified offers (temporary)*.

(a) *In general.* Section 7430(c)(4)(E) (the qualified offer rule) provides that a party to a court proceeding satisfying the timely filing and net worth requirements of section 7430(c)(4)(A)(ii) shall be treated as the prevailing party if the liability of the taxpayer pursuant to the judgment in the proceeding (determined without regard to interest) is equal to or less than the liability of the taxpayer which would have been so determined if the United States had accepted the last qualified offer of the party as defined in section 7430(g). For purposes of this section, the term judgment means the cumulative determinations of the court concerning the adjustments at issue and litigated to a determination in the court proceeding. In making the comparison between the liability under the qualified offer and the liability under the judgment, the taxpayer's liability under the judgment is further modified by the provisions of paragraph (b)(3) of this section. The provisions of the qualified offer rule do not apply if the taxpayer's liability under the judgment, as modified by the provisions of paragraph (b)(3) of this section, is determined exclusively pursuant to a settlement, or to any proceeding in which the amount of tax liability is not in issue, including any declaratory judgment proceeding, any proceeding to enforce or quash any summons issued pursuant to the Internal Revenue Code, and any action to restrain disclosure under section 6110(f). If the qualified offer rule applies to the court proceeding, the determination of whether the liability under the qualified offer would have equaled or exceeded the liability pursuant to the judgment is made by reference to the last qualified offer made with respect to the tax liability at issue in the administrative or court proceeding. An award of reasonable administrative and litigation costs under the qualified offer rule only includes those costs incurred on or after the date of the last qualified offer and is limited to those costs attributable to the adjustments at issue at the time the last qualified offer was made that were included in the court's judgment

other than by reason of settlement. The qualified offer rule is inapplicable to reasonable administrative or litigation costs otherwise awarded to a taxpayer who is a prevailing party under any other provision of section 7430(c)(4). This section sets forth the requirements to be satisfied for a taxpayer to be treated as a prevailing party by reason of the taxpayer making a qualified offer as well as the circumstances leading to the application of the exceptions, special rules, and coordination provisions of the qualified offer rule. Furthermore, this section sets forth the elements necessary for an offer to be treated as a qualified offer under section 7430(g).

(b) *Requirements for treatment as a prevailing party based upon having made a qualified offer.*—(1) *In general.* In order to be treated as a prevailing party by reason of having made a qualified offer, the liability of the taxpayer for the type or types of tax and the taxable year or years at issue in the proceeding, as calculated pursuant to paragraph (b)(2) of this section, based on the last qualified offer, as defined in paragraph (c) of this section, made by the taxpayer in the court or administrative proceeding, must equal or exceed the liability of the taxpayer pursuant to the judgment by the court for the same type or types of tax and the same taxable year or years, as calculated pursuant to paragraph (b)(3) of this section. Furthermore, the taxpayer must meet the timely filing and net worth requirements of section 7430(c)(4)(A)(ii). If all of the adjustments subject to the last qualified offer are settled prior to the entry of the judgment by the court, the taxpayer is not a prevailing party by reason of having made a qualified offer. The taxpayer may, however, still qualify as a prevailing party if the requirements of section 7430(c)(4)(A) are met.

(2) *Liability under the last qualified offer.* For purposes of making the comparison of liability described in paragraph (b)(1) of this section, the taxpayer's liability under the last qualified offer is the change in the taxpayer's liability for the type or types of tax and the taxable year or years at issue in the proceeding from the tax shown on the return or returns (or as previously adjusted) which would have resulted from the acceptance by the United States of the taxpayer's last quali-

fied offer on all of the adjustments at issue in the administrative or court proceeding at the time that offer was made. The portion of a taxpayer's liability that is attributable to adjustments raised by either party after the making of the last qualified offer is not included in the calculation of the liability under that offer. The taxpayer's liability under the last qualified offer is calculated without regard to adjustments to be fully resolved, by stipulation of the parties, through any other pending court or administrative proceeding. Furthermore, the taxpayer's liability under the last qualified offer is calculated without regard to interest unless the taxpayer's liability for, or entitlement to, interest is a contested issue in the administrative or court proceeding and is one of the adjustments included in the last qualified offer.

(3) *Liability pursuant to the judgment.* For purposes of making the comparison of liability described in paragraph (b)(1) of this section, the taxpayer's liability pursuant to the judgment is the change in the taxpayer's liability for the type or types of tax and the taxable year or years at issue in the proceeding from the tax shown on the return or returns (or as previously adjusted), resulting from amounts contained, or to be contained, in the judgment as a result of the court's determinations, and amounts contained in settlements not included in the judgment, that are attributable to all adjustments that were included in the last qualified offer. This liability includes amounts attributable to adjustments included in the last qualified offer and settled by the parties prior to the entry of judgment regardless of whether those amounts are actually included in the judgment entered by the court. The taxpayer's liability pursuant to the judgment does not include amounts attributable to adjustments that are not included in the last qualified offer, even if those amounts are actually included in the judgment entered by the court. The taxpayer's liability pursuant to the judgment is calculated without regard to adjustments to be fully resolved, by stipulation of the parties, through any other pending court or administrative proceeding. Furthermore, the taxpayer's liability pursuant to the judgment is calculated without regard to interest unless the taxpayer's liability for, or entitlement to, interest is a contested

issue in the administrative or court proceeding and is one of the adjustments included in the last qualified offer. Where adjustments raised by either party subsequent to the making of the last qualified offer are included in the judgment entered by the court, or are settled prior to the court proceeding, the taxpayer's liability pursuant to the judgment is calculated by treating the subsequently raised adjustments as if they had never been raised.

(c) *Qualified offer*—(1) *In general.* A qualified offer is defined in section 7430(g) to mean a written offer which—

(i) Is made by the taxpayer to the United States during the qualified offer period;

(ii) Specifies the offered amount of the taxpayer's liability (determined without regard to interest, unless interest is a contested issue in the proceeding);

(iii) Is designated at the time it is made as a qualified offer for purposes of section 7430(g); and

(iv) By its terms, remains open during the period beginning on the date it is made and ending on the earliest of the date the offer is rejected, the date the trial begins, or the 90<sup>th</sup> day after the date the offer is made.

(2) *To the United States.* (i) A qualified offer is made to the United States if it is delivered to the Internal Revenue Service; Office of Appeals; Office of Chief Counsel (including field personnel), Internal Revenue Service; or Department of Justice office or personnel having jurisdiction over the tax matter at issue in the administrative or court proceeding. If those offices or persons are unknown to the taxpayer making the qualified offer, the taxpayer may deliver the offer to the appropriate office, as follows:

(A) If the taxpayer's initial pleading in a court proceeding has been answered, the taxpayer may deliver the offer to the office that filed the answer.

(B) If the taxpayer's petition in the Tax Court has not yet been answered, the taxpayer may deliver the offer to the Office of Chief Counsel, 1111 Constitution Avenue, NW., Washington, DC 20224.

(C) If the taxpayer's initial pleading in a court of the United States other than the Tax Court has not yet been answered, the taxpayer may deliver the offer to the Attorney General of the United States, 950 Pennsylvania Ave., NW., Washington,

DC 20530-0001 and for a suit brought in a United States district court, a copy of the offer should also be delivered to the United States Attorney for the district in which the suit was brought.

(D) In any other situation, the taxpayer may deliver the offer to the office that sent the taxpayer the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

(ii) Until an offer is received by the appropriate personnel or office under this paragraph (c)(2) of this section, it is not considered to have been made, with the following exception. If the offer is deposited in the United States mail, in an envelope or other appropriate wrapper, postage prepaid, properly addressed to the appropriate personnel or office under this paragraph (c)(2), the date of the United States postmark stamped on the cover in which the offer is mailed shall be deemed to be the date of receipt of that offer by the addressee. If any offer is deposited with a designated delivery service, as defined in section 7502(f)(2), in lieu of the United States mail, the provisions of section 7502(f)(1) shall apply in determining whether that offer qualifies for this exception.

(3) *Specifies the offered amount.* A qualified offer specifies the offered amount if it specifies the dollar amount for the liability of the taxpayer, calculated as set forth in paragraph (b)(2) of this section. This amount must be with respect to all of the adjustments at issue in the administrative or court proceeding at the time the offer is made and only those adjustments. The specified amount must be that amount, the acceptance of which by the United States will fully resolve the taxpayer's liability, and only that liability, (determined without regard to adjustments stipulated by the parties to be fully resolved through another pending court or administrative proceeding, or interest, unless interest is a contested issue in the proceeding) for the type or types of tax and the taxable year or years at issue in the proceeding.

(4) *Designated at the time it is made as a qualified offer.* An offer is not a qualified offer unless it is designated in writing at the time it is made that it is a qualified offer for purposes of section 7430(g). An

offer made at a time when one or more adjustments not included in the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals have been raised by the taxpayer and remain unresolved, is not considered to be designated as a qualified offer at the time it is made unless contemporaneously or prior to the making of the qualified offer, the taxpayer has provided the United States with the substantiation and legal and factual arguments necessary to allow for informed consideration of the merits of those adjustments. For example, a taxpayer will be considered to have provided the United States with the necessary substantiation and legal and factual arguments if the taxpayer (or a qualified representative of the taxpayer described in §601.502 of this chapter) participates in an Appeals office conference, participates in a District Counsel conference, or confers with the Department of Justice and at that time discloses all relevant information regarding the taxpayer's tax matter to the extent such information and its relevance were known or should have been known to the taxpayer at the time of such conference. All relevant information includes, but is not limited to, the legal and factual arguments supporting the taxpayer's position on any adjustments raised by the taxpayer after the issuance of the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

(5) *Remains open.* A qualified offer remains open for acceptance by the Government from the date it is made, as defined in paragraph (c)(2) of this section, at least until the earliest of the date it is rejected in writing by a person with authority to reject the settlement, the date the trial begins, or the 90<sup>th</sup> day after being received by the United States. The offer, by its written terms, may remain open after the occurrence of one or more of the above-referenced events. Once made, the period during which a qualified offer remains open may be extended by the taxpayer prior to its expiration, but such an extension cannot be used to make an offer meet the minimum period for remaining open required by this paragraph.

(6) *Last qualified offer.* A taxpayer may make multiple qualified offers during the qualified offer period. For purposes of the

comparison under paragraph (b) of this section, the making of a qualified offer supercedes any previously made qualified offers. In making the comparison described in paragraph (b) of this section, only the qualified offer made most closely in time to the end of the qualified offer period is compared to the taxpayer's liability under the judgment.

(7) *Qualified offer period.* To constitute a qualified offer, an offer must be made during the qualified offer period. The qualified offer period begins on the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent to the taxpayer. For this purpose, the date of the notice of claim disallowance will begin the qualified offer period in a refund case. If there has been no notice of claim disallowance in a refund case, the qualified offer period begins on the date on which the answer or other responsive pleading is filed with the court. The qualified offer period ends on the date which is thirty days before the date the case is first set for trial. In determining when the qualified offer period ends for cases in the Tax Court and other courts of the United States using calendars for trial, a case will be considered to be set for trial on the date scheduled for the calendar call. A case may be removed from a trial calendar at any time. Thus, a case may be removed from a calendar before the date that precedes by thirty days the date scheduled for that calendar. The qualified offer period does not end until the case remains on a calendar for trial on the date that precedes by 30 days the scheduled date of the calendar call for that trial session. The qualified offer period may not be extended beyond the periods set forth in this paragraph, although the period during which a qualified offer remains open may extend beyond the end of the qualified offer period.

(d) [Reserved]

(e) *Examples.* The following examples illustrate the provisions of this section:

*Example 1. Definition of a judgment.* The Internal Revenue Service audits Taxpayer A for year X and issues a notice of proposed deficiency (30-day letter) proposing to disallow deductions 1, 2, 3, and 4. A files a protest and participates in a conference with the Internal Revenue Service Office of Appeals (Appeals). Appeals allows deduction 1, and issues a statutory notice of deficiency for deductions 2, 3, and 4. A's petition to the United States Tax Court for year X never mentions deduction 2. Prior to trial, A

concedes deduction 3. After the trial, the Tax Court issues an opinion allowing A to deduct a portion of deduction 4. As used in paragraph (a) of this section, the term *judgment* means the cumulative determinations of the court concerning the adjustments at issue in the court proceeding. Thus, the term judgment does not include deduction 1 because it was never at issue in the court proceeding. Similarly, the term judgment does not include deduction 2 because it was not placed at issue by A in the court proceeding. Although deduction 3 was at issue in the court proceeding, it is not included in the term judgment because it was not determined by the court, but rather by concession or settlement. For purposes of section 7430(c)(4)(e), the term judgment only includes the portion of deduction 4 disallowed by the Tax Court.

*Example 2. Liability under the offer and liability under the judgment.* Assume the same facts as in *Example 1* except that A makes a qualified offer after the Appeals conference which is not accepted by the Internal Revenue Service. A's offer is with respect to all adjustments at issue at that time. Those adjustments are deductions 2, 3, and 4. At the conclusion of the litigation, A's entitlement to an award based upon the qualified offer will depend, among other things, on a comparison of the change in A's liability for income tax for year X resulting from the judgment of the Tax Court with the change that would have resulted had the Internal Revenue Service accepted A's qualified offer. In making this comparison, the term judgment (as discussed in *Example 1*) is modified by including the amounts of settled or conceded adjustments that were at issue at the time the qualified offer was made. Any settled or conceded adjustments that were not at issue at the time the qualified offer was made, either because the settlement or concession occurred before the offer or because the adjustment was not raised until after the offer, are not included in the comparison. Thus, A's offer on deductions 2, 3, and 4 is compared with the change in A's liability resulting from the Tax Court's determination of deduction 4, and the concessions of issues 2 and 3 by A.

*Example 3. Offer Must resolve full liability.* Assume the same facts as in *Example 2* except that A's offer after the Appeals conference explicitly states that it is only with respect to adjustments 2 and 3 and not with respect to adjustment 4. Even if A's liability pursuant to the judgment, calculated under paragraph (b)(3) of this section as illustrated in *Example 2*, is equal to or less than it would have been had the Internal Revenue Service accepted A's offer after the Appeals conference, A is not a prevailing party under section 7430(c)(4)(E). This is because a qualified offer must include all adjustments at issue at the time the offer is made. Since A's offer excluded adjustment 4, which was an adjustment at issue at the time the offer was made, it does not constitute a qualified offer pursuant to paragraph (b)(2) of this section.

*Example 4. Qualified offer rule inapplicable when all issues settled.* Taxpayer B receives a notice of proposed deficiency (30-day letter) proposing to disallow both a personal interest deduction in the amount of \$10,000 (Adjustment 1), and a charitable contribution deduction in the amount of \$2,000 (Adjustment 2), and to include in income \$4,000 of unreported interest income (Adjustment 3). B timely files a protest with Appeals. At the Appeals confer-

ence B presents substantiation for the charitable contribution and presents arguments that the interest paid was deductible mortgage interest and that the interest received was held in trust for Taxpayer C. At the conference, B also provides the Appeals officer assigned to B's case a written offer to settle the case for a deficiency of \$2,000, exclusive of interest. The offer states that it is a qualified offer for purposes of section 7430(g) and that it will remain open for acceptance by the Internal Revenue Service for a period in excess of 90 days. After considering B's substantiation and arguments, the Appeals Officer accepts the \$2,000 offer to settle the case in full. Although B's offer is a qualified offer, because all three adjustments contained in the qualified offer were settled, the qualified offer rule is inapplicable.

*Example 5. Qualified offer rule inapplicable when all issues contained in the qualified offer are settled; subsequently raised adjustments ignored.* Assume the same facts as in *Example 4* except that B's qualified offer was for a deficiency of \$1,800 and the Internal Revenue Service rejected that offer. Subsequently, the Internal Revenue Service issued a statutory notice of deficiency disallowing the three adjustments contained in *Example 4*, and, in addition, disallowing a home office expense in the amount of \$5,000 (Adjustment 4). After petitioning the Tax Court, B presents the field attorney assigned to the case with a written offer, which is not designated as a qualified offer for purposes of section 7430(g), to settle the three adjustments that had been the subject of the qualified offer, plus adjustment 4, for a total deficiency of \$2,500. After negotiating with B, a settlement is reached on the three adjustments that were the subject of the rejected qualified offer, for a deficiency of \$1,800. Adjustment 4 is litigated in the Tax Court and the court determines that B is entitled to the full \$5,000 deduction for that adjustment. Consequently, a decision is entered by the Tax Court reflecting the \$1,800 settlement amount, which matches exactly the amount of B's only qualified offer in the case. Although the determined liability for adjustments 1, 2, and 3, equals that of the rejected qualified offer, because all three adjustments contained in the qualified offer were settled, the qualified offer rule is inapplicable.

*Example 6. Exclusion of adjustments made after the qualified offer is made.* Assume the same facts as in *Example 5* except the settlement is reached only on adjustments 1 and 2, for a liability of \$1,500. Adjustments 3 and 4 are tried in the Tax Court and in accordance with the court's opinion, the taxpayer has a \$300 deficiency attributable to Adjustment 3, and a \$1,550 deficiency attributable to adjustment 4. Consequently, a decision is entered reflecting the \$1,500 settled amount, the \$300 liability on adjustment 3, and the \$1,550 liability on adjustment 4. The \$3,350 deficiency reflected in the Tax Court's decision exceeds the last (and only) qualified offer made by B. For purposes of determining whether B is a prevailing party as a result of having made a qualified offer in the proceeding, the liability attributable to adjustment 4, which was raised after the last qualified offer was made, is not included in the comparison of B's liability under the judgment with B's offered liability under the last qualified offer. Thus, B's \$1,800 liability under the judgment, as modified for purposes of the qualified offer rule comparison, is equal to B's offered liability under the last qualified offer. Because B's liability under

the last qualified offer equals or exceeds B's liability under the judgment, as calculated under paragraph (b)(3) of this section, B is a prevailing party for purposes of section 7430. Assuming B satisfies the remaining requirements of section 7430, B may recover those reasonable administrative and litigation costs attributable to adjustment 3. To qualify for any further award of reasonable administrative and litigation costs, B must satisfy the full requirements of section 7430(c)(4)(A).

*Example 7. Qualified offer in a refund case.* Taxpayer C timely files an amended return claiming a refund of \$1,000. This refund claim results from several omitted deductions which, if allowed, would reduce D's tax liability from \$10,000 to \$9,000. C receives a notice of claim disallowance and files a complaint with the appropriate United States District Court. Subsequently, C makes a qualified offer for a refund of \$500. The offer is rejected and after trial the court finds C is entitled to a refund of \$700. The change in C's liability from the tax shown on the return that would have resulted from the acceptance of C's qualified offer is a reduction in that liability of \$500. The change in C's liability from the tax shown on the return resulting from the judgment of the court is a reduction in that liability of \$700. Because C's liability under the qualified offer exceeds C's liability under the judgment, C is a prevailing party for purposes of section 7430. Assuming C satisfies the remaining requirements of section 7430, C may recover those reasonable litigation costs incurred on or after the date of the qualified offer. To qualify for any further award of reasonable administrative and litigation costs C must satisfy the full requirements of section 7430(c)(4)(A).

*Example 8. End of qualified offer period when case is removed from tax court trial calendar more than 30 days before scheduled trial calendar.* Taxpayer E has petitioned the Tax Court in response to the issuance of a notice of deficiency. E receives notice that the case will be heard on the July trial session in E's city of residence. The scheduled date for the calendar call for that trial session is July 1<sup>st</sup>. On May 15<sup>th</sup>, E's motion to remove the case from the July trial session and place it on the October trial session for that city is granted. The scheduled date for the calendar call for the October trial session is October 1<sup>st</sup>. On May 31<sup>st</sup>, E delivers a qualified offer to the field attorney assigned to the case. On August 31<sup>st</sup>, E delivers a revised qualified offer to the field attorney assigned to the case. Neither offer is accepted. The case is tried during the October trial session, and at some time thereafter, a decision is entered by the court. Assume the judgment in the case, as calculated under paragraph (b)(3) of this section, is greater than the amount offered, as calculated under paragraph (b)(2) of this section, in the qualified offer delivered on May 31<sup>st</sup>, but less than the amount offered, as similarly calculated, in the qualified offer delivered on August 31<sup>st</sup>. Because the qualified offer period did not end until September 1<sup>st</sup>, and the offer of August 31<sup>st</sup> otherwise satisfied the requirements of paragraph (c) of this section, the last qualified offer which is compared to the judgment was the offer delivered on August 31<sup>st</sup>. Consequently, E is a prevailing party under section 7430(c)(4)(e).

*Example 9. End of qualified offer period when case is removed from tax court trial calendar less than 30 days before scheduled trial calendar.* Assume the same facts as in *Example 8* except that

E's motion was granted on June 15<sup>th</sup>. Because the qualified offer period had ended on June 1<sup>st</sup> when the case remained on the July trial session on the date that preceded by 30 days the scheduled date of the calendar call for that trial session, the offer delivered on May 31<sup>st</sup> was E's last qualified offer. The August 31<sup>st</sup> offer is not a qualified offer for purposes of this rule. Consequently, E is not a prevailing party under the qualified offer rule. Therefore, E must satisfy the full requirements of section 7430(c)(4)(A) to qualify for any award of reasonable administrative and litigation costs.

*Example 10. When a qualified offer can be made and to whom it must be made.* During the examination of Taxpayer F's return, the Internal Revenue Service issues a notice of deficiency without having first issued a 30-day letter. After receiving the notice of deficiency F timely petitions the Tax Court. The next day F mails an offer to the office that issued the notice of deficiency, which offer satisfies the requirements of paragraphs (c)(3),(4),(5) and (6) of this section. This is the only written offer made by F during the administrative or court proceeding, and by its terms it is to remain open for a period in excess of 90 days after the date of mailing to the office issuing the notice of deficiency. The office that issued the notice of deficiency transmitted the offer to the field attorney with jurisdiction over the Tax Court case. After answering the case, the field attorney refers the case to Appeals pursuant to Rev. Proc. 87-24 (1987-1 C.B. 720). After careful consideration, Appeals rejects the offer and holds a conference with F where some adjustments are settled. The remainder of the adjustments are tried in the Tax Court and F's liability resulting from the Tax Court's determinations, when added to F's liability resulting from the settled adjustments, is less than F's liability would have been under the offer rejected by Appeals. Because the Tax Court case had not yet been answered when the offer was sent, F properly mailed the offer to the office that issued the notice of deficiency. Thus, F's offer satisfied the requirements of paragraph (c)(2) of this section. Furthermore, even though F did not receive a 30-day letter, F's offer was made after the beginning of the qualified offer period, satisfying the requirements of paragraph (c)(7) of this section, because the issuance of the statutory notice provided F with notice of the Internal Revenue Service's determination of a deficiency, and the docketing of the case provided F with an opportunity for administrative review in the Internal Revenue Service Office of Appeals under Rev. Proc. 87-24 (1987-1 C.B. 720). Because F's offer satisfied all of the requirements of paragraph (c) of this section, the offer was a qualified offer and F is a prevailing party.

*Example 11. Last qualified offer.* Assume the same facts as in *Example 10* except that at the Appeals conference F makes a new qualified offer concerning the remaining issues. Because this subsequent qualified offer is closer in time to the end of the qualified offer period than the offer made one day after the petition was filed, the subsequent offer would be the last qualified offer made by F and it is F's liability under this offer which would be compared to F's liability under the judgment to determine whether F was a prevailing party under the qualified offer rule.

*Example 12. Substitution of parties permitted under last qualified offer.* Taxpayer G receives a 30-

day letter and participates in a conference with the Office of Appeals but no agreement is reached. Subsequently, G receives a notice of deficiency and petitions the Tax Court. Upon receiving the Internal Revenue Service's answer to the petition, G sends a qualified offer to the field attorney who signed the answer, by United States mail. The qualified offer stated that it would remain open for more than 90 days. Thirty days after making the offer, G dies and, on motion under Rule 63(a) of the Tax Court's Rules of Practice and Procedure by G's personal representative, H is substituted for G as a party in the Tax Court proceeding. H makes no qualified offers to settle the case and the case proceeds to trial, with the Tax Court issuing an opinion partially in favor of H. Even though H was not a party when the qualified offer was made, that offer constitutes a qualified

offer because by its terms, when made, it was to remain open until at least the earlier of the date it is rejected, the date of trial, or 90 days. If the liability of H under that last qualified offer, as determined under paragraph (b)(2) of this section, equals or exceeds the liability under the judgment of the Tax Court, as determined under paragraph (b)(3) of this section, H will be a prevailing party for purposes of an award of reasonable litigation costs under section 7430.

(f) *Effective date.* This section is applicable with respect to qualified offers made in administrative or court proceedings described in section 7430 after January 3, 2001 and before January 3, 2004.

Robert E. Wenzel,  
*Deputy Commissioner  
of Internal Revenue.*

Approved December 6, 2000.

Jonathan Talisman,  
*Acting Assistant Secretary  
of the Treasury.*

(Filed by the Office of the Federal Register on January 3, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 4, 2001, 66 F.R. 725)



## Part III. Administrative, Procedural, and Miscellaneous

### Extension of Comprehensive Case Resolution Pilot Program

#### Notice 2001-13

##### 1. EXTENSION OF COMPREHENSIVE CASE RESOLUTION PILOT PROGRAM

This Notice announces the extension of the Comprehensive Case Resolution pilot program, which was announced in Notice 2000-43, 2000-35 I.R.B. 209, and under which large business taxpayers may request resolution of all years they have open under examination by the Large and Mid-Size Business Division (LMSB), in Appeals, and in docketed status before the United States Tax Court (Tax Court), through an Internal Revenue Service (IRS) team process. The purpose of the Comprehensive Case Resolution program is to enable taxpayers and the IRS to work together to resolve all open issues on all open years currently or previously under examination. The program is intended to reduce costs, burden and delays by expediting completion of these cases through a cooperative effort. The purpose of this extension of the pilot program is to allow time for additional applications to be filed.

The program is jointly administered by LMSB, Appeals, and, if a taxpayer has a docketed case for any year, the Office of Chief Counsel (Chief Counsel). In the pilot phase, the program is available to large businesses that currently have at least one open year under examination in a Coordinated Examination and at least one prior year in Appeals (including docketed cases currently under Appeals' jurisdiction). Taxpayers interested in participating in the pilot program or with questions about the program should contact their Team Manager or the Comprehensive Case Resolution Pilot Coordinator (CCR Pilot Coordinator) to discuss their suitability for the program.

During the pilot phase of the program, LMSB, Appeals and, if there is a docketed case, Chief Counsel, plan to select eight to ten taxpayers from among those requesting participation in the program. Applications may be made beginning with the publication date of this Notice until

April 30, 2001, or until a sufficient number of applicants have been accepted to conduct the pilot program, whichever occurs first. The CCR Pilot Coordinator may be contacted to ascertain whether the application period has been closed. Taxpayers participating in the pilot program will be asked to assist in monitoring and evaluating the process. After evaluating the pilot program cases, the IRS may then offer the program, with or without modification, on a permanent basis.

The IRS believes that the Comprehensive Case Resolution program offers significant potential benefits for taxpayers as well as the IRS, and invites large business taxpayers to participate.

##### 2. DESCRIPTION OF THE COMPREHENSIVE CASE RESOLUTION PROGRAM

The goal of the Comprehensive Case Resolution program is to help taxpayers that have tax years under examination by LMSB and in Appeals (including docketed cases under Appeals jurisdiction) resolve all open issues in all such years through an IRS Comprehensive Case Resolution process (CCR process). In some situations it may also be appropriate to include tax years which are docketed before the Tax Court and not under Appeals' jurisdiction. The effect of this program will be to expedite the taxpayer's LMSB years, where the audit is substantially complete, into a resolution process. This CCR process will constitute the taxpayer's formal administrative appeal for the LMSB years. The program's goal is to resolve all tax controversies, without litigation, on a basis that is fair and impartial to both the government and the taxpayer. The CCR process will plan aggressive timelines for completion, with a target of closing all years within six to twelve months. If agreement cannot be reached using this process, Appeals will not again consider the unagreed issues from the years under examination by LMSB.

Taxpayers with an LMSB Coordinated Examination that is substantially complete may request to participate in this program. "Substantially complete" means: (1) audit work on all significant issues is complete and the taxpayer has indicated agreement or disagreement with

each proposed adjustment; and (2) all claims and affirmative issues have been raised by the taxpayer and audited. Interested taxpayers with questions as to whether audit work is sufficiently complete should consult with their Team Manager.

Each affected IRS function (LMSB, Appeals, and Chief Counsel) will independently recommend whether the taxpayer should be accepted into the pilot program. When a taxpayer is accepted for the pilot program, the IRS will form a team representing LMSB, Appeals, and, if appropriate, Chief Counsel to work with the taxpayer to resolve outstanding unagreed issues.

For taxpayers accepted into the pilot program, the IRS will not issue a notice of proposed deficiency, commonly called a "30-day letter," for the years currently under examination by LMSB upon commencement of the program. Accordingly, for those years, the accrual of increased interest on large corporate underpayments under § 6621(c) of the Internal Revenue Code will not begin at that time. However, if those years are not resolved within 12 months after the initial issue discussion conference is held under the pilot program, the IRS will issue a letter of proposed deficiency to begin the accrual of interest at the increased rate.

Taxpayers not accepted for the pilot program will continue to follow existing LMSB, Appeals, and, where relevant, Tax Court, procedures for resolution of their cases.

##### 3. SUBJECT MATTER FOR THE COMPREHENSIVE CASE RESOLUTION PROGRAM

The Comprehensive Case Resolution program is intended to expedite resolution of all disputed issues on all open tax years that have been or are being examined. Generally, all issues that could appropriately be considered by Appeals will be suitable for the program. To ensure fair treatment of the taxpayer, issues already agreed between the taxpayer and IRS in LMSB or Appeals generally will not be re-opened. Certain issues may not be appropriate for this process. The IRS and the taxpayer may agree to exclude these issues but proceed with the program on

the remaining issues. If the Office of Chief Counsel determines that it would be inappropriate to include some or all docketed years in the process, the IRS may proceed under the program with the remaining years with the taxpayer's concurrence. Further, the IRS may determine that certain issues will not be part of the process, including issues that have been designated for litigation by Chief Counsel.

#### 4. PROCEDURES FOR REQUESTING COMPREHENSIVE CASE RESOLUTION PROCESS

**Before initiating a formal request.** Taxpayers interested in participating in the pilot program, or with questions about the program and its suitability for their cases, may contact the LMSB Team Manager for the year currently under examination. Taxpayers also may contact Cary Russ, the CCR Pilot Coordinator, at (202) 283-8330 (not a toll-free number), for further information about this pilot program.

**Initiating the request for the pilot program.** The taxpayer must submit its request to participate in the pilot program in writing to the Team Manager. The CCR Pilot Coordinator and the Team Manager are available to assist the taxpayer in preparing its pilot program request.

Contents of the request. A concise written statement requesting the CCR process should include:

- (1) The taxpayer's name, EIN, and address and the name, title, address and telephone number of a person to contact.
- (2) The tax years for which Comprehensive Case Resolution is sought, the IRS office considering each year, and the name of the IRS Appeals Officer and counsel of record handling any matter not under the jurisdiction of LMSB.
- (3) For the years currently under LMSB examination, a list of all unagreed issue(s). The taxpayer should include copies of unagreed Forms 5701, Notice of Proposed Adjustment, or a short description of the unagreed issues if no Form 5701 has been issued. Although a formal protest is not required, the request must contain a brief expla-

nation of the taxpayer's position regarding each issue. (If accepted into the program, a taxpayer will have an opportunity to present a more complete statement of its position at a later stage.)

- (4) For the years in Appeals, the current status of each issue, including whether agreement (oral or written) has been reached.
- (5) If docketed year(s) under Chief Counsel's jurisdiction are included, the current status of all unresolved issues, including whether agreement (oral or written) has been reached, the date calendared for trial, if any, and any other deadlines established by the Court.
- (6) An acknowledgment that the taxpayer consents to *ex parte* communications between IRS Appeals Officers and any other IRS personnel in the context of the CCR process.
- (7) An acknowledgment that participation in the CCR process constitutes the administrative appeal for all years under LMSB examination included in this application.
- (8) A statement that the taxpayer will not file new claims or raise new affirmative issues for any year, regardless of jurisdiction, during the CCR process. Claims and affirmative issues must be raised and audit work completed before the CCR process begins.
- (9) An acknowledgment that this is an expedited program in which the taxpayer will work with the IRS CCR team to establish accelerated timelines for completion of the CCR process.
- (10) A statement of the taxpayer's willingness to participate in a pilot program and to assist in monitoring and evaluating the process.

**Perjury statement.** A request for the pilot program must include a declaration, signed by a person currently authorized to sign the taxpayer's federal income tax return, in the following form:

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and

belief, the facts presented in support of the request for Comprehensive Case Resolution are true, correct and complete.

If the request is signed by an authorized representative, a copy of Form 2848, Power of Attorney and Declaration of Representative, must accompany the request.

#### 5. SELECTION OF TAXPAYERS FOR THE PILOT PROGRAM

**Team Manager's Role:** The Team Manager will immediately forward a copy of the taxpayer's application to the CCR Pilot Coordinator, Appeals and, if appropriate, Chief Counsel. The Team Manager will assess the readiness of the LMSB years for the CCR process. This assessment will include whether the years are, or will be, substantially complete prior to April 30, 2001.

**Appeals Management's Role:** Appeals management will assess the status of each issue and the anticipated completion date(s) of the years before Appeals (including docketed years in Appeals settlement jurisdiction).

**Chief Counsel's Role:** If years are docketed before the Tax Court, Chief Counsel will provide an assessment similar to Appeals of the status of those years. Chief Counsel may direct the CCR Pilot Coordinator not to include a docketed year or years in the CCR process.

**CCR Pilot Coordinator's Role:** The CCR Pilot Coordinator will provide guidance to taxpayers and to IRS personnel on the program, will ensure that LMSB, Appeals and Chief Counsel timely provide information listed above, and will keep the CCR Pilot Executive informed of all program activity.

**CCR Pilot Executive's Role:** The CCR Pilot Executive will provide general oversight for the program, interface with Appeals and Chief Counsel, lead in the training effort, and meet with taxpayers as appropriate. The CCR Pilot Executive will convene an evaluation team to include LMSB, Appeals and, if appropriate, Chief Counsel. The team will be responsible for determining whether the applicant meets the selection criteria.

**Selection Criteria:** In general, the team will evaluate the request using criteria that include the following:

General criteria:

- (1) Application by April 30, 2001 (unless a sufficient number of applicants have been accepted to conduct the pilot sooner);
- (2) Taxpayer under Coordinated Examination by LMSB and also in Appeals;
- (3) LMSB examination years are substantially complete; and
- (4) The Appeals years will not be settled before the first issue resolution conference is held.

Additional pilot program criteria:

- (1) Having a cross-section of taxpayers of varying sizes, representing different industry lines, a geographical dispersion of cases, and a variety of issues;
- (2) IRS resource availability in LMSB, Appeals and Chief Counsel;
- (3) The likelihood of the case being resolved through this process; and
- (4) In the case of a docketed year, the ability to comply with the Tax Court's procedures and deadlines.

**Communication with taxpayer.** The CCR Pilot Executive will advise taxpayers in writing whether they will be included in the pilot program. A taxpayer may not appeal the decision that it not be included in the pilot program.

## 6. CONDUCTING THE COMPREHENSIVE CASE RESOLUTION PROCESS

**Initial 60 days.** Once a case is accepted into the pilot program, the IRS will form a resolution team composed of members from LMSB and Appeals (and Chief Counsel, if there is a docketed case). Within the first 30 days, the CCR team will contact the taxpayer to schedule an initial planning meeting. At the planning meeting, the parties will confirm the issues to be resolved, identify who will be involved in the process and their respective authorities, answer any questions about the process, and establish a timeline for resolution of all issues. Additionally, the team and the taxpayer will schedule the first issue resolution conference no later than 60 days after the case is accepted into the pilot program.

**Resolution process.** Comprehensive Case Resolution constitutes the taxpayer's for-

mal exercise of its appeal rights for the years under examination by LMSB. Therefore, conferences between the taxpayer and the IRS CCR team will follow existing Appeals procedures. If the IRS and taxpayer reach agreement, years will be closed using Appeals processes and closing documents. If the parties are unable to reach agreement on any issue(s), Appeals will issue a statutory notice of deficiency on the unagreed issue(s). Should any case be subject to review by U.S. Competent Authority or the Joint Committee on Taxation, the case will be closed after those approvals are obtained.

## 7. WITHDRAWAL FROM THE COMPREHENSIVE CASE RESOLUTION PROCESS

Taxpayers may withdraw from the pilot program by submitting a written request, but only within 30 days after acceptance into the program or 20 days after the initial planning meeting, whichever is later. Thereafter, with respect to the years under LMSB jurisdiction at the time of application for the pilot program, the process will be completed with a total or partial agreement or issuance of a statutory notice of deficiency.

A taxpayer's withdrawal from the pilot program returns each open year to the jurisdiction of the IRS function it was under prior to acceptance into the pilot program.

Taxpayers will be afforded administrative appeal on the years under LMSB jurisdiction as if the taxpayer had not applied for the pilot program.

## 8. MISCELLANEOUS

**Record keeping requirements.** No aspect of the CCR process will affect the record keeping requirements imposed by any section of the Internal Revenue Code. **No user fee.** There is no user fee for participating in the pilot program.

## 9. COMMENTS

The IRS invites interested persons to comment on this program. Send submissions to:

Internal Revenue Service  
Attn: Cary Russ  
Large and Mid-Size Business  
Division LM:PFTG  
Mint Building, 3rd Floor, M-3-312

1111 Constitution Avenue, NW  
Washington, DC 20224

Submissions also may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Such submissions should be marked: Attn: Cary Russ, Large and Mid-Size Business Division LM:PFTG, Mint Building, 3rd Floor, M-3-312.

Alternatively, interested persons may submit comments via e-mail to:

PFTG1@irs.gov

These addresses are for comments on the pilot program. Requests by eligible taxpayers to participate in the pilot program should be submitted as described in section 4 above.

## 10. FURTHER INFORMATION

For further information regarding this Notice, contact Cary Russ, the CCR Pilot Coordinator, at (202) 283-8330 (not a toll-free number), or the Team Manager for your current examination.

## Application of Employment Taxes to Statutory Options

### Notice 2001-14

#### I. Purpose and Overview

This notice is intended to clarify the application of FICA, FUTA and income tax withholding to statutory stock options. With respect to incentive stock options (ISOs) described in section 422(b) and options granted under an employee stock purchase plan (ESPP) described in section 423(b) (collectively, "statutory options"), the notice

- provides that, in the case of any statutory option exercised before January 1, 2003, the Service will not assess FICA tax or FUTA tax upon the exercise of the option and will not treat the disposition of stock acquired by an employee pursuant to the exercise of the option as subject to income tax withholding;
- concludes that Rev. Rul. 71-52 is obsolete and that the holding of Rev. Rul. 71-52 does not apply to the exercise of statutory options or to the dis-

position of stock acquired pursuant to the exercise of statutory options; and

- announces the intent to issue further administrative guidance to clarify current law with respect to FICA tax and FUTA tax on statutory options and to address the issue of whether the disposition of stock acquired by an employee pursuant to the exercise of a statutory option will be subject to income tax withholding. This notice invites public comment on this anticipated guidance.

## II. Background

### A. Income Tax Withholding and Reporting on Options

Income tax withholding is imposed under section 3402(a) of the Internal Revenue Code of 1986 (Code), which requires employers paying wages to deduct and withhold income tax on those wages. For income tax withholding purposes, section 3401(a) provides that the term “wages,” with certain exceptions, means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash.

The legislative history of sections 3401 through 3404 indicates that a purpose of income tax withholding is to enable individuals to pay income tax in the year in which the income is earned. H.R. Conf. Rep. No. 510, 78<sup>th</sup> Cong., 1<sup>st</sup> Sess., at 1 (1943); H.R. Rep. No. 401, 78<sup>th</sup> Cong., 1<sup>st</sup> Sess., at 1 (1943); S. Rep. No. 221, 78<sup>th</sup> Cong., 1<sup>st</sup> Sess., at 1 (1943). Income tax withholding generally is imposed upon remuneration paid by an employer only to the extent that an employee has income.

Under section 421, no compensation income results when a statutory option is exercised. Section 421(a) provides that, if a share of stock is transferred to an individual in a transfer that meets the requirements of section 422(a) or 423(a), no income results at the time of the transfer. Instead, compensation income is deferred until the sale or other disposition of the stock acquired pursuant to the exercise of a statutory option.

Employers making wage payments to an employee (or former employee) that are subject to income tax withholding generally must report such wage pay-

ments on Form W-2, as provided in section 31.6051-1(a)(1) of the Employment Tax Regulations. Under certain circumstances, a payment made by an employer to an employee (or former employee) must be reported on Form W-2 even if the payment is not subject to income tax withholding. Specifically, section 1.6041-2(a)(1) of the Income Tax Regulations generally requires reporting if the total amount of the payment and any other payments of remuneration (including wages, if any) made to the employee (or former employee) that are required to be reported on Form W-2 aggregate at least \$600 in a calendar year.

### B. FICA and FUTA Tax

Under sections 3111 and 3301, Federal Insurance Contributions Act (FICA) tax and Federal Unemployment Tax Act (FUTA) tax, respectively, are imposed on the employer in an amount equal to a percentage of the wages paid by that employer. Under section 3101, FICA tax also is imposed on the employee. Under sections 3121(a) and 3306(b), the term “wages” for FICA tax purposes and FUTA tax purposes, respectively, means, with certain exceptions, all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. Neither the Code nor the relevant regulations contain any provision excluding the value of stock transferred pursuant to the exercise of a statutory option from wages for FICA tax and FUTA tax purposes.

In 1981, the Supreme Court in *Rowan Companies, Inc. v. U.S.*, 452 U.S. 247, held essentially that the definition of “wages” for FICA tax and income tax withholding purposes was the same. As part of the Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65, Congress reversed this holding. Sections 3121(a) and 3306(b)<sup>1</sup> were amended to provide that “[n]othing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from ‘wages’ as used in such chapter shall be construed to require a similar exclusion from ‘wages’ in the regulations prescribed for purposes of this chapter.” This sentence makes clear that the definition of wages for income tax withholding purposes is not always the same as the definition

of wages for FICA tax and FUTA tax purposes, and that an item of income can be wages for FICA tax purposes even if it is not wages for income tax withholding purposes.

The legislative history of the 1983 provision explains that Congress intended to reverse the holding in *Rowan*, and the Senate Report states: “Since the [social] security system has objectives which are significantly different from the objective underlying the income tax withholding rules, the committee believes that amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion.” S. Rep. No. 23, 98<sup>th</sup> Cong., 1<sup>st</sup> Sess., at 42 (1983).

### C. Administrative Guidance

Revenue Ruling 71-52 (1971-1 C.B. 278) addressed the FICA tax, FUTA tax and income tax withholding consequences applicable to the exercise of qualified stock options under former section 422<sup>2</sup>. The ruling holds that a taxpayer does not make a payment of wages for FICA tax, FUTA tax and income tax withholding purposes at the time of the exercise of a qualified stock option under former section 422, and that income realized by employees and former employees from a disqualifying disposition of stock acquired by the exercise of a qualified stock option is also not wages for FICA tax, FUTA tax and income tax withholding purposes.

Rev. Rul. 71-52 was published before the 1983 statutory changes to sections 3121(a) and 3306(b) described above. In addition, in 1971, the Old-Age, Survivors, and Disability Insurance (OASDI) contri-

<sup>1</sup>Sections 3121(a) and 3306(b) were amended by section 327(b)(1) and (c)(4), respectively, of the Social Security Amendments of 1983.

<sup>2</sup>Section 603 of the Tax Reform Act of 1976, Pub. L. No. 94-355, 90 Stat. 1520, amended former section 422 to provide, generally, that qualified stock options could not be granted after May 20, 1976. Current section 422 (Incentive Stock Options) was added to the Internal Revenue Code of 1954, as section 422A, by section 251(a) of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172. Subsequently, section 11801(c)(9)(A)(i) of the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388, repealed former section 422 (Qualified Stock Options) and redesignated former Code section 422A as section 422 of the Internal Revenue Code of 1986.

bution and benefit base was only \$4,800, as compared to the current OASDI wage base of \$80,400. Further, in 1971, the \$4,800 limit applied to the Hospital Insurance (HI) portion of the FICA tax as well as to the OASDI portion; by contrast, under current law, there is no limit on the amount of wages for purposes of the HI portion. Accordingly, in 1971, since most optionees had other wages that equaled or exceeded the FICA wage base, inclusion of option-related income in FICA wages would have had no effect on the FICA tax liability or Social Security benefits of most optionees (and no appreciable effect on FICA receipts). Given the increased wage base for purposes of the OASDI portion of the FICA tax and removal of the limit on the wage base for purposes of the HI portion, that is no longer the case.

Notice 87-49 (1987-2 C.B. 355) addresses potential inconsistencies among, and coordination of, the proposed regulations under section 83, former section 422A (current section 422), and Rev. Rul. 71-52. Notice 87-49 provides that Rev. Rul. 71-52 is being reconsidered, but until the results of such reconsideration are announced, the principles of Rev. Rul. 71-52 will apply to the disposition of stock acquired by an individual pursuant to the exercise of an ISO, which does not meet the requirements of former section 422A(a) (current section 422(a)).

### III. Reconsideration of Rev. Rul. 71-52 and Interim Guidance

#### A. Reconsideration of Rev. Rul. 71-52

Treasury and the Service have concluded that the holding and principles of Rev. Rul. 71-52 do not apply to the exercise of ISOs or options granted under an ESPP, or to the disposition of stock acquired pursuant to such statutory options, and have therefore determined that Rev. Rul. 71-52 is obsolete. Accordingly, the provisions of Notice 87-49 described above no longer apply.

#### B. Interim Guidance

In view of the lack of clear administrative guidance regarding the application of FICA, FUTA, and income tax withholding to statutory options, the Service, with respect to statutory options exercised before January 1, 2003, will not treat the

disposition of stock acquired by an employee pursuant to the exercise of a statutory option as subject to income tax withholding and will not assess FICA tax or FUTA tax upon the exercise of a statutory option.

This Part III.B applies to an exercise of a statutory option and the disposition of stock acquired by an individual pursuant to the exercise of a statutory option, if the exercise occurs on or after publication of this notice and before January 1, 2003. However, employers may, at their option, choose to apply this Part III.B with respect to any exercise of statutory options, or dispositions of stock acquired by individuals pursuant to any exercise of statutory options, that occurred before the publication of this notice. Thus, with respect to exercises of statutory options covered by this Part III.B, the Service will not require payment of FICA tax or FUTA tax, will not assert penalties or interest, and will honor otherwise allowable adjustments and claims for refund of any FICA tax or FUTA tax paid. Furthermore, with respect to dispositions of stock acquired pursuant to the exercise of statutory options covered by this Part III.B, the Service will not require income tax withholding and will not assert penalties or interest. This Part III.B does not relieve individual taxpayers of the obligation to include any compensation in income upon a disposition of stock acquired pursuant to the exercise of a statutory option, and does not relieve employers of any of their reporting obligations.

### IV. Request for Comments on Anticipated Administrative Guidance

#### A. Anticipated Guidance

Treasury and the Service anticipate issuing administrative guidance that will clarify current law with respect to FICA tax, FUTA tax, and income tax withholding on statutory options. It is anticipated that the administrative guidance would reflect the view that the statute defines "wages" for FICA tax and FUTA tax purposes broadly, without any statutory exclusion for exercises of statutory options. With respect to the disposition of stock acquired pursuant to such an exercise, however, it is the view of Treasury and the Service that there may be authority for future administrative guidance to

treat amounts realized upon such disposition of stock as not being subject to income tax withholding.

Comments are requested regarding the anticipated administrative guidance. In particular, comments are requested on whether it is appropriate, in light of the issues of administrative feasibility associated with a requirement of income tax withholding upon disposition of stock acquired pursuant to the exercise of a statutory option (when the optionee may no longer be employed by the grantor), to treat amounts realized upon the disposition as not being subject to income tax withholding. All comments will be available for public inspection and copying.

#### B. Prospective Effective Date

It is anticipated that the administrative guidance described in this Part IV will be effective only prospectively. However, it is anticipated that employers will be permitted to apply the guidance to exercises of statutory options that occurred on an earlier date and to a disposition of stock acquired pursuant to such exercises.

### V. Effect on Other Documents

This notice constitutes the result of the reconsideration of Rev. Rul. 71-52, referred to in Notice 87-49. This notice concludes that the holding and principles of Rev. Rul. 71-52 do not apply to the exercise of ISOs described in section 422(b) or options granted under an ESPP described in section 423(b), or to the disposition of stock acquired pursuant to the exercise of such statutory options and, thus, Rev. Rul. 71-52 is determined to be obsolete. Notice 87-49 is modified to the extent it is inconsistent with this notice.

### VI. Submission of Comments

Comments must be submitted by May 7, 2001. Comments should reference Notice 2001-14, and be addressed to:

Associate Chief Counsel  
(Tax Exempt and Government Entities)  
CC:TEGE  
ATTN: Employment Taxes and  
Statutory Options  
Room 5214  
Internal Revenue Service  
1111 Constitution Ave., N.W.  
Washington, D.C. 20224

## VII. Drafting Information

The principal author of this notice is Stephen Tackney of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice contact Stephen Tackney at (202) 622-6040 (not a toll-free call).

## Part IV. Items of General Interest

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

### Awards of Attorney's Fees and Other Costs Based Upon Qualified Offers

REG-121928-98

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In T.D. 8922 on page 508 of this Bulletin, the IRS is issuing temporary regulations relating to the circumstances in which a party, by reason of having made a qualified offer, will be entitled to an award of court costs and certain fees in a civil tax proceeding brought in a court of the United States (including the Tax Court). The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by April 4, 2001. Outlines of topics to be discussed at the public hearing scheduled for May 23, 2001, at 10 a.m., must be received by May 2, 2001. The IRS and Treasury specifically request comments on the clarity of the proposed rule and how it may be made easier to understand.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG-121928-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG-121928-98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.gov/prod/tax\\_regs/regslst.ht](http://www.irs.gov/prod/tax_regs/regslst.ht)

ml. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the hearing, submission of written comments, and to be placed on the building access list to attend the hearing, Treena V. Garrett, (202) 622-7180; concerning the regulations, Thomas D. Moffitt (202) 622-7900 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

#### Background

Temporary regulations in T.D. 8922 provide rules relating to the circumstances in which a party, by reason of having made a qualified offer, will be entitled to an award of court costs and certain fees in a civil tax proceeding brought in a court of the United States (including the Tax Court). The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

Comments are specifically requested on the rule requiring the provision of information and arguments regarding adjustments raised by taxpayers after the issuance of the first letter of proposed deficiency which provides the taxpayer with an opportunity for administrative review in the Internal Revenue Service Office of Appeals and still unresolved at the time the last qualified offer is made. The changes to section 7430 made by Congress anticipate qualified offers based upon the adjustments at issue when the first letter of proposed deficiency is sent. Adjustments subsequently raised by taxpayers would not be subject to the audit development preceding the issuance of such first letter of proposed deficiency. The proposed rule is intended to eliminate any such differences between the adjustments subject to the last qualified offer.

Comments are also specifically requested on the rule establishing the end of the qualified offer period, for courts using trial calendars, at the point where the case remains listed on a trial calendar thirty days before the scheduled date for the calendar call for that trial session. The proposed rule is intended to keep the qualified

offer period open until shortly before trial while ensuring that the last day of the qualified offer period can be ascertained on that day.

#### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the 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 Public Hearing

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

A public hearing has been scheduled for May 23, 2001, at 10 a.m., in room 4718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having a visitor's name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CON-

TACT caption.

An outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) must be submitted by any person that wishes to present oral comments at the hearing. Outlines must be received by May 2, 2001.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving requests to speak has passed. Copies of the agenda will be available free of charge at the hearing.

### Drafting Information

The principal author of these regulations is Thomas D. Moffitt, Office of Assistant Chief Counsel (Field Service). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

#### PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

#### §301.7430-0 [Removed]

Par. 2. Section 301.7430-0 is removed.

Par. 3. Section 301.7430-7 is added to read as follows:

*§301.7430-7 Qualified offers.*

[The text of this proposed section is the same as the text of §301.7430-7T published in T.D. 8922.]

Robert E. Wenzel,  
Deputy Commissioner  
of Internal Revenue.

(Filed by the Office of the Federal Register on January 3, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 4, 2001, 66 F.R. 749)

## Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations, and Notice of Public Hearing

### Liabilities Assumed in Certain Corporate Transactions

#### REG-106791-00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations, and notice of public hearing.

SUMMARY: In T.D. 8924 on page 489 of this Bulletin, the IRS is issuing temporary regulations relating to the assumption of liabilities in certain corporate transactions under section 301 of the Internal Revenue Code. The temporary regulations affect corporations and their shareholders. The text of those temporary regulations also serves as the text of these proposed regulations. This document also gives notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by May 10, 2001. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for May 31, 2001 at 10 a.m. must be received by May 10, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG-106791-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG-106791-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page or by submitting comments directly to the IRS Internet site at <http://www.irs.gov/tax-regs/regslst.html>. A public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Mary E. Dean, (202) 622-7550; concerning submissions and the hearings, Guy Traynor, (202) 622-7180.

## SUPPLEMENTARY INFORMATION

### Background

T.D. 8924 amends the income tax regulations (26 CFR part 1) under section 301 relating to liabilities assumed in connection with distributions made by a corporation to shareholders with respect to their stock. These regulations provide that the amount of a distribution under section 301 will be reduced by the amount of any liability that is treated as assumed by the distributee within the meaning of section 357(d)(1) and (2). Thus, in a distribution under section 301, if a liability is treated as not having been assumed by the distributee under section 357(d)(1) and (2), the amount of the distribution will not be reduced by the amount of any liability the property is subject to under section 301(b)(2)(B). The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the proposed regulations.

### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. These proposed regulations under section 301 of the Internal Revenue Code (Code) address distributions by corporations in which liabilities are assumed by the shareholders or in which the distributed property is subject to liabilities. These proposed regulations provide that the amount of a distribution under section 301 will be reduced by the amount of any liability that is treated as assumed by the distributee within the meaning of section 357(d)(1) and (2).

If adopted these regulations will affect only corporations making distributions of property, in which the property is subject to a liability, or in which liabilities are assumed by the distributee. Moreover, if adopted, the proposed regulations will affect only those corporations that would have, but for the regulations, considered



liabilities to have been assumed in circumstances other than those described in section 357(d)(1) and (2). Therefore, most corporations, whether large or small, will not be affected by the proposed regulations in any given year. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, 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 businesses.

### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) or electronically generated comments that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for May 31, 2000, at 10 a.m., in room 4718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must enter at the 1111 Constitution Avenue entrance, located between 10th and 12th streets. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by May 10, 2001. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed.

Copies of the agenda will be available free of charge at the hearing.

### Drafting Information

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

\* \* \* \* \*

### Proposed Amendments to the Regulations

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

#### PART 1 — INCOME TAXES

Paragraph 1. The authority citation for 26 CFR part 1 continues to read in part as follows:

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

Par. 2. Section 1.301-1 is amended by revising paragraph (g) to read as follows:

*§1.301-1 Rules applicable with respect to distributions of money and other property.*

\* \* \* \* \*

(g) [The text of the proposed amendment to paragraph (g) of §1.301-1 is the same as the text of paragraph (g) of §1.301-1T published in T.D. 8924].

*David A. Mader,  
Acting Deputy Commissioner  
of Internal Revenue.*

(Filed by the Office of the Federal Register on January 3, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 4, 2001, 66 F.R. 748)

### Notice of Proposed Rulemaking and Notice of Public Hearing

#### Minimum Cost Requirement Permitting the Transfer of Excess Assets of a Defined Benefit Pension Plan to a Retiree Health Account

REG-116468-00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed Income Tax Regulations relating to the minimum cost requirement under section 420, which permits the transfer of excess assets of a defined benefit pension plan to a retiree health account. Pursuant to section 420(c)(3)(E), these proposed regulations provide that an employer who significantly reduces retiree health coverage during the cost maintenance period does not satisfy the minimum cost requirement of section 420(c)(3). In addition, these proposed regulations clarify the circumstances under which an employer is considered to have significantly reduced retiree health coverage during the cost maintenance period. This document also provides a notice of public hearing on these regulations.

DATES: Written or electronic comments must be received by March 6, 2001. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for March 15, 2001, must be received by February 21, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG-116468-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG-116468-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.gov/tax\\_reg/regslist.html](http://www.irs.gov/tax_reg/regslist.html).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Vernon S. Carter or Janet A. Laufer, (202) 622-6060; concerning submissions, Treena Garrett, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

#### Background

The Revenue Reconciliation Act of 1990 (Public Law 101-508)(104 Stat. 1388), section 12011, added section 420

of the Internal Revenue Code (Code), a temporary provision permitting certain qualified transfers of excess pension assets from a non-multiemployer defined benefit pension plan to a health benefits account (defined as an account established and maintained under section 401(h) of the Code (401(h) account)) that is part of the plan.<sup>1</sup> One of the conditions of a qualified section 420 transfer was that the employer satisfy a maintenance of effort requirement in the form of a “minimum cost requirement” under which the employer was required to maintain employer-provided retiree health expenditures for covered retirees, their spouses, and dependents at a minimum dollar level for a 5-year cost maintenance period, beginning with the taxable year in which the qualified transfer occurs.

The Uruguay Round Agreements Act (Public Law 103-465)(108 Stat. 4809) (December 8, 1994), extended the availability of section 420 through December 31, 2000. In conjunction with the extension, Congress modified the maintenance of effort rules for plans transferring assets for retiree health benefits so that employers could take into account cost savings realized in their health benefit plans. As a result, the focus of the maintenance of effort requirement was shifted from health costs to health benefits. Under this “benefit maintenance requirement,” which applied to qualified transfers made after December 8, 1994, an employer had to maintain substantially the same level of employer-provided retiree health coverage for the taxable year of the transfer and the following 4 years. The level of coverage required to be maintained was based

<sup>1</sup> Section 420(a)(1) and (2) provide that the trust that is part of the plan is not treated as failing to satisfy the qualification requirements of section 401(a) or (h) of the Code, and no amount is includible in the gross income of the employer maintaining the plan, solely by reason of such transfer. Also, section 420(a)(3) provides that a qualified transfer is not treated as either an employer reversion for purposes of section 4980 or a prohibited transaction for purposes of section 4975.

In addition, Title I of the Employee Retirement Income Security Act of 1974 (88 Stat. 829), as amended (ERISA), provides that a qualified transfer pursuant to section 420 is not a prohibited transaction under ERISA (ERISA section 408(b)(13)) or a prohibited reversion of assets to the employer (ERISA section 403(c)(1)). ERISA also provides certain notification requirements with respect to such qualified transfers.

on the coverage provided in the taxable year immediately preceding the taxable year of the transfer.

The Tax Relief Extension Act of 1999 (title V of H.R. 1180, the Ticket to Work and Work Incentives Improvement Act of 1999)(Public Law 106-170,113 Stat 1860) (TREA-99) extended section 420 through December 31, 2005. In conjunction with this extension, the minimum cost requirement was reinstated as the applicable “maintenance of effort” provision (in lieu of requiring the maintenance of the level of coverage) for qualified transfers made after December 17, 1999. Because the minimum cost requirement relates to per capita cost, an employer could satisfy minimum cost requirement by maintaining the average cost even though the employer defeats the purpose of the maintenance of effort requirement by reducing the number of people covered by the health plan. In response to concerns regarding this possibility, TREA-99 also added section 420(c)(3)(E), which requires the Secretary of the Treasury to prescribe such regulations as may be necessary to prevent an employer who significantly reduces retiree health coverage during the cost maintenance period from being treated as satisfying the minimum cost requirement of section 420(c)(3). If the minimum cost requirement of section 420(c)(3) is not satisfied, the transfer of assets from the pension plan to the 401(h) account is not a “qualified transfer” to which the provisions of section 420(a) apply.

### Explanation of Provisions

These proposed regulations would provide that the minimum cost requirement of section 420(c)(3) is not met if the employer significantly reduces retiree health coverage during the cost maintenance period. The proposed regulations would measure whether this occurs by looking at the number of individuals (retirees, their spouses, and dependents) who lose coverage during the cost maintenance period as a result of employer actions, measured on both an annual basis and a cumulative basis.

In determining whether an employer has significantly reduced retiree health coverage, the regulations would provide that the employer does not satisfy the minimum cost requirement if the percentage decrease in the number of individuals

provided with applicable health benefits that is attributable to employer action exceeds 10% in any year, or if the sum of the annual percentage decreases during the cost maintenance period exceeds 20%. The 10% annual limit would not apply to a taxable year that begins before February 5, 2001.

The regulations would provide a broad definition of employer action, including not only plan amendments but also situations in which other employer actions, such as the sale of all or part of the employer’s business, operate in conjunction with the existing plan terms to have the indirect effect of ending an individual’s coverage. The definition of employer action would include plan amendments that are executed before the cost maintenance period but take effect during the cost maintenance period, unless the amendment occurred before the later of December 18, 1999, and 5 years before the start of the cost maintenance period.

The regulations contain a special rule that addresses situations in which an employer adopts plan terms that establish eligibility for health coverage for some individuals, but provide that those same individuals lose health coverage upon the occurrence of a particular event or after a stated period of time. In those cases, an individual is not counted as having lost health coverage by reason of employer action merely because that individual’s coverage ends upon the occurrence of the event or after the stated period of time.

Under the proposed regulation, when an individual’s coverage ends by reason of a sale of all or part of the employer’s business, the individual is counted as an individual losing coverage by reason of employer action. The proposed regulation contains no exceptions from this rule even if the buyer provides coverage for such individuals (on the implicit assumption that the buyer rarely undertakes to provide such coverage to retirees in these transactions). Comments are specifically requested as to (1) the circumstances, if any, in which buyers commonly provide the seller’s retirees, and their spouses and dependents, with health coverage following a corporate transaction, and (2) in such cases, criteria that should apply to the replacement coverage in determining whether to treat those individuals as not having lost coverage.

## Proposed Effective Date

The regulations are proposed to be applicable to transfers of excess pension assets on or after December 18, 1999.

## 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 Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

## Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 15, 2001, beginning at 10 a.m. in the IRS Auditorium, Seventh Floor, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "For Further Information Contact" portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit written comments and an outline of the topics to be discussed and time to be devoted to each topic (a signed original and eight (8) copies) by February 21, 2001. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

## Drafting Information

The principal authors of these regulations are Vernon S. Carter and Janet A. Laufer, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

## Proposed Amendments to the Regulations

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

### PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805, 26 U.S.C. 420(c)(3)(E) \* \* \*

Par. 2. Section 1.420-1 is added to read as follows:

*§1.420-1 Significant reduction in retiree health coverage during the cost maintenance period.*

(a) *In general.* Notwithstanding section 420(c)(3)(A), the minimum cost requirements of section 420(c)(3) are not met if the employer significantly reduces retiree health coverage during the cost maintenance period.

(b) *Significant reduction—(1) In general.* An employer significantly reduces retiree health coverage during the cost maintenance period if, for any taxable year during the cost maintenance period, either —

(i) The employer-initiated reduction percentage for that taxable year exceeds 10%; or

(ii) The sum of the employer-initiated reduction percentages for that taxable year and all prior taxable years during the cost maintenance period exceeds 20%.

(2) *Special rule for certain taxable years.* Notwithstanding paragraph (b)(1)(i) of this section, an employer will not be treated as significantly reducing retiree health coverage for a taxable year that begins before February 5, 2001, merely because the employer-initiated reduction percentage for that taxable year exceeds 10%.

(3) *Employer-initiated reduction percentage.* The employer-initiated reduction percentage for any taxable year is the fraction B/A, expressed as a percentage, where

A = The total number of individuals (retired employees plus their spouses plus their dependents) receiving coverage for applicable health benefits as of the day before the first day of the taxable year.

B = The total number of individuals included in A whose coverage for applicable health benefits ended during the taxable year by reason of employer action.

(4) *Employer action—(i) General rule.* For purposes of paragraph (b)(3) of this section, an individual's coverage for applicable health benefits ends during a taxable year by reason of employer action, if on any day within the taxable year, the individual's eligibility for applicable health benefits ends as a result of a plan amendment or any other action of the employer (e.g., the sale of all or part of the employer's business) that, in conjunction with the plan terms, has the effect of ending the individual's eligibility. An employer action is taken into account for this purpose regardless of when the employer action actually occurs (e.g., the date the plan amendment is executed), except that employer actions occurring before the later of December 18, 1999, and the date that is 5 years before the start of the cost maintenance period are disregarded.

(ii) *Special rule.* Notwithstanding paragraph (b)(4)(i) of this section, coverage for an individual will not be treated as having ended by reason of employer action merely because such coverage ends

under the terms of the plan if those terms were adopted contemporaneously with the provision under which the individual became eligible for retiree health coverage.

(c) *Definitions.* The following definitions apply for purposes of this section:

(1) *Applicable health benefits.* Applicable health benefits means applicable health benefits as defined in section 420(e)(1)(C)

(2) *Cost maintenance period.* Cost maintenance period means the cost maintenance period as defined in section 420(c)(3)(D).

(d) *Examples.* The following examples illustrate the application of this section:

*Example 1.* (i) Employer W maintains a defined benefit pension plan that includes a 401(h) account and permits qualified transfers that satisfy section 420. The number of individuals receiving coverage for applicable health benefits as of the day before the first day of Year 1 is 100. In Year 1, Employer W makes a qualified transfer under section 420. There is no change in the number of individuals receiving health benefits during Year 1. As of the last day of Year 2, applicable health benefits are provided to 99 individuals, because 2 individuals became eligible for coverage due to retirement and 3 individuals died in Year 2. During Year 3, Employer W amends its health plan to eliminate coverage for 5 individuals, 1 new retiree becomes eligible for coverage and an additional 3 individuals are no longer covered due to their own decision to drop coverage. Thus, as of the last day of Year 3, applicable health benefits are provided to 92 individuals. During Year 4, Employer W amends its health plan to eliminate coverage under its health plan for 8 more individuals, so that as of the last day of Year 4, applicable health benefits are provided to 84 individuals. During Year 5, Employer W amends its health plan to eliminate coverage for 8 more individuals.

(ii) There is no significant reduction in retiree health coverage in either Year 1 or Year 2, because there is no reduction in health coverage as a result of employer action in those years.

(iii) There is no significant reduction in Year 3. The number of individuals whose health coverage ended during Year 3 by reason of employer action (amendment of the plan) is 5. Since the number of individuals receiving coverage for applicable health benefits as of the last day of Year 2 is 99, the employer-initiated reduction percentage for Year 3 is 5.05% (5/99), which is less than the 10% annual limit.

(iv) There is no significant reduction in Year 4. The number of individuals whose health coverage ended during Year 4 by reason of employer action is 8. Since the number of individuals receiving coverage for applicable health benefits as of the last day of Year 3 is 92, the employer-initiated reduction percentage for Year 4 is 8.70% (8/92), which is less than the 10% annual limit. The sum of the employer-initiated reduction percentages for Year 3 and Year 4 is 13.75%, which is less than the 20% cumulative limit.

(v) In Year 5, there is a significant reduction under paragraph (b)(1)(ii) of this section. The number of individuals whose health coverage ended dur-

ing Year 5 by reason of employer action (amendment of the plan) is 8. Since the number of individuals receiving coverage for applicable health benefits as of the last day of Year 4 is 84, the employer-initiated reduction percentage for Year 5 is 9.52% (8/84), which is less than the 10% annual limit. However, the sum of the employer-initiated reduction percentages for Year 3, Year 4, and Year 5 is 5.05% + 8.70% + 9.52% = 23.27%, which exceeds the 20% cumulative limit.

*Example 2.* (i) Employer X maintains a defined benefit pension plan that includes a 401(h) account and permits qualified transfers that satisfy section 420. X also provides lifetime health benefits to employees who retire from Division A as a result of a plant shutdown, no health benefits to employees who retire from Division B, and lifetime health benefits to all employees who retire from Division C. In 2000, X amends its health plan to provide coverage for employees who retire from Division B as a result of a plant shutdown, but only for the 2-year period coinciding with their severance pay. Also in 2000, X amends the health plan to provide that employees who retire from Division A as a result of a plant shutdown receive health coverage only for the 2-year period coinciding with their severance pay. A plant shutdown that affects Division A and Division B employees occurs in 2000. The number of individuals receiving coverage for applicable health benefits as of the last day of 2001 is 200. In 2002, Employer X makes a qualified transfer under section 420. As of the last day of 2002, applicable health benefits are provided to 170 individuals, because the 2-year period of benefits ends for 10 employees who retired from Division A and 20 employees who retired from Division B as a result of the plant shutdown that occurred in 2000.

(ii) There is no significant reduction in retiree health coverage in 2002. Coverage for the 10 retirees from Division A who lose coverage as a result of the end of the 2-year period is treated as having ended by reason of employer action, because coverage for those Division A retirees ended by reason of a plan amendment made after December 17, 1999. However, the terms of the health plan that limit coverage for employees who retired from Division B as a result of the 2000 plant shutdown (to the 2-year period) were adopted contemporaneously with the provision under which those employees became eligible for retiree coverage under the health plan. Accordingly, under the rule provided in paragraph (b)(4)(ii) of this section, coverage for those 20 retirees from Division B is not treated as having ended by reason of employer action. Thus, the number of individuals whose health benefits ended by reason of employer action in 2002 is 10. Since the number of individuals receiving coverage for applicable health benefits as of the last day of 2001 is 200, the employer-initiated reduction percentage for 2002 is 5% (10/200), which is less than the 10% annual limit.

(e) *Effective date.* This section is applicable December 18, 1999, for qualified transfers occurring on or after that date.

Robert E. Wenzel,  
Deputy Commissioner  
of Internal Revenue.

(Filed by the Office of the Federal Register on January 4, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 5, 2001, 66 F.R. 1066)

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

### Guidance on Filing an Application for a Tentative Carryback Adjustment in a Consolidated Return Context

REG-119352-00

AGENCY: Internal Revenue Service  
(IRS), Treasury.

ACTION: Notice of proposed rulemaking  
by cross-reference to temporary regula-  
tions and notice of public hearing.

SUMMARY: In T.D. 8919 on page 505 of  
this Bulletin, the IRS is issuing temporary  
regulations relating to the filing of an  
application for a tentative carryback  
adjustment by a consolidated group and  
by certain new members of a consolidated  
group. The text of those temporary regu-  
lations also serves as the text of these pro-  
posed regulations. In addition, this docu-  
ment provides notice of a public hearing  
on these proposed regulations.

DATES: Written or electronic comments  
must be received by April 5, 2001. The  
public hearing has been scheduled for  
April 26, 2001. Outlines of topics to be  
discussed at the public hearing scheduled  
for April 26, 2001, at 10 a.m. must be  
received by April 5, 2001.

ADDRESSES: Send submissions to:  
Regulations Unit CC, room 5226  
(REG-119352-00), Internal Revenue  
Service, POB 7604, Ben Franklin Station,  
Washington, DC 2044. Submissions may  
also be hand delivered Monday through  
Friday between the hours of 8 a.m. and 5  
p.m. to Regulations Unit CC, room 5226  
(REG-119352-00), Courier's Desk,  
Internal Revenue Service, 1111  
Constitution Avenue, NW., Washington,  
DC. Alternatively, taxpayers may submit  
comments electronically via the Internet  
directly to the IRS Internet site at  
[http://www.irs.gov/tax\\_regs/regslst.html](http://www.irs.gov/tax_regs/regslst.html).  
The public hearing is scheduled for April

26, 2001, and will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulation, Christopher M. Bass or Frances L. Kelly, (202) 622-7770; concerning submissions, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor, (202) 622-7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

#### Background

Temporary regulations in T.D. 8919 amend the Income Tax Regulations (26 CFR Part 1) under section 1502 of the Internal Revenue Code of 1986 (Code). The temporary regulations provide guidance as to the time for filing an application for a tentative carryback adjustment by a consolidated group. The amendments also extend the time for filing an application for a tentative carryback adjustment by certain corporations for the separate return year created by their becoming new members of a consolidated group. The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

#### Special Analyses

It has been determined that this notice of proposed rule making is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses, and, moreover, that any burden on taxpayers is minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. The IRS and 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 made available for public inspection and copying.

A public hearing has been scheduled for April 26, 2001, beginning at 10 a.m., in room 4718, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington DC. Due to building security procedures, visitors must enter at the 10<sup>th</sup> Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must request to speak, and submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by April 5, 2001. A period of ten minutes will be allocated to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### Drafting Information

The principal authors of these proposed regulations are Christopher M. Bass and Frances L. Kelly, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

#### Proposed Amendments to the Regulations

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

#### PART 1 — INCOME TAXES

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

Authority: 26 U.S.C. 7805 \* \* \*  
Section 1.1502-78 also issued under 26 U.S.C. 1502 and 6411(c). \* \* \*

Par. 2. Section 1.1502-78, as proposed to be amended, reads as follows:

*§1.1502-78 Tentative carryback adjustments.*

[The text of the amendments to this proposed section is the same as the text of the amendments to §1.1502-78T published in T.D. 8919.]

Robert E. Wenzel,  
*Deputy Commissioner  
of Internal Revenue.*

(Filed by the Office of the Federal Register on January 3, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 4, 2001, 66 F.R. 747)

#### The GUST Remedial Amendment Period for Employers Who Use M&P or Volume Submitter Specimen Plans

#### Announcement 2001-12

This announcement –

- Provides a general summary of the rules for determining the GUST remedial amendment period for employers who use master and prototype (M&P) plans or volume submitter specimen plans. This summary is followed by answers to questions the Service has received regarding the application of these rules.
- Describes circumstances under which the Service will waive the requirement that employers certify their intent to adopt a sponsor or practitioner's M&P or volume submitter specimen plan. In some situations, such a certification is required as a condition for extend-

ing the GUST remedial amendment period.

In addition, this announcement describes the Service's policies regarding requests for additional information on opinion and advisory letter applications for M&P and volume submitter specimen plans, including applications that relate to previously approved plans.

### **Summary of Rules for Determining the GUST Remedial Amendment Period for Employers Who Use M&P or Volume Submitter Specimen Plans**

Employers who maintain tax-qualified retirement plans under section 401(a) or section 403(a) of the Internal Revenue Code generally are required to amend their plans for new law changes, which are described using the acronym "GUST," within the GUST remedial amendment period under section 401(b). (See section 1.02 of Rev. Proc. 2000-27, 2000-26 I.R.B. 1272, for a complete listing of the public laws described collectively as GUST.) The following is a general summary of the rules for determining the GUST remedial amendment period for employers who use M&P or volume submitter specimen plans.

1. The GUST remedial amendment period generally ends on the last day of the first plan year beginning in 2001 ("the regular GUST remedial amendment period"). However, employers may have a later deadline if the requirements of section 19 of Rev. Proc. 2000-20, 2000-6 I.R.B. 553, as modified by Rev. Proc. 2000-27, are met.
2. To be eligible for a later deadline under section 19 of Rev. Proc. 2000-20, an employer must either:
  - (i) adopt an M&P or volume submitter specimen plan (regardless of whether the plan has a TRA '86 opinion or advisory letter); or
  - (ii) jointly certify with an M&P sponsor or volume submitter practitioner that the employer intends to amend its plan for GUST by adopting the sponsor or practitioner's M&P or volume submitter specimen plan after the plan has received GUST approval.

This required action (either adoption of an M&P or volume submitter specimen plan or execution of a certification of intent to adopt) must take place by the end of the reg-

ular GUST remedial amendment period. In addition, the sponsor or practitioner of the M&P or volume submitter specimen plan which the employer has adopted or intends to adopt must have requested a complete GUST opinion or advisory letter for the plan by December 31, 2000. Thus, if a sponsor or practitioner requested a GUST opinion or advisory letter for an M&P or volume submitter specimen plan by December 31, 2000, employers who have adopted the plan by the end of the regular GUST remedial amendment period (December 31, 2001, in the case of calendar year plans) do not have to take further action until the time described in 3, following.

3. If the requirements described above are satisfied, the employer's deadline for amending its plan for GUST is the later of:

- (i) the end of the regular GUST remedial amendment period, or
- (ii) the end of the 12th month beginning after the date a GUST opinion or advisory letter is issued for the M&P or volume submitter specimen plan, or the opinion or advisory letter application is withdrawn.

By this deadline, the employer must adopt one of the following: the GUST-approved M&P or volume submitter specimen plan referred to above, another GUST-approved M&P or volume submitter specimen plan or individually-designed GUST amendments. In addition, in order to be entitled to extend the remedial amendment period under this rule, the employer must request a determination letter by the end of the extended period, if a determination letter is required for reliance.

(In cases where the M&P plan is an identical adoption or minor modification of a "mass submitter plan," or where the volume submitter specimen plan is an identical adoption of a "lead specimen plan," the date of the letter approving the mass submitter or lead specimen plan is irrelevant. It is the date the letter is issued for the sponsor or practitioner's plan that governs. A mass submitter plan is an M&P plan that is submitted to the Service on behalf of at least 30 M&P sponsors who will sponsor the identical plan. A lead specimen plan is a volume submitter specimen plan that is submitted to the Service on behalf of at least 30 practitioners who will sponsor the identical volume submitter specimen plan.)

4. In applying these rules, an employer who has adopted (or certified its intent to adopt) a sponsor or practitioner's M&P or volume submitter specimen plan by the end of the regular GUST remedial amendment period will be deemed to have adopted (or certified its intent to adopt) each other M&P or volume submitter specimen plan of that sponsor or practitioner.

*Example 1.* Employer X adopted Bank A's M&P plan in 1997. Bank A does not sponsor any other plans. Bank A restates its M&P plan for GUST and files an application for a complete GUST opinion letter by December 31, 2000. X does not have to take further action until the M&P plan is approved for GUST. If a GUST opinion letter for the M&P plan is issued on May 1, 2001, X must adopt the GUST-approved plan by May 31, 2002. Alternatively, X may adopt another GUST-approved M&P or volume submitter specimen plan or individually-designed GUST amendments by this date. In addition, if a determination letter is required for reliance, for example because X's plan is a nonstandardized plan, X must also apply for a GUST determination letter by May 31, 2002.

*Example 2.* Bank B sponsors two M&P plans, Plan 001 and Plan 002. Employer Y adopted Plan 001 in 1996. Employer Z adopted Plan 002 in 1996. Bank B decides to discontinue Plan 002 and does not request a GUST opinion letter for this plan. Z does not certify its intent to adopt another sponsor or practitioner's plan. Bank B files an application for a complete GUST opinion letter for Plan 001 by December 31, 2000, and a favorable letter is issued on April 30, 2001. Because Z is deemed to have adopted Plan 001 before the end of the regular GUST remedial amendment period, Z is entitled to the same GUST remedial amendment period extension as Y. Therefore, by April 30, 2002, both Y and Z must adopt the GUST-approved Plan 001, another GUST-approved M&P or volume submitter specimen plan or individually-designed GUST amendments. Each must also request a determination letter by April 30, 2002, if a determination letter is required for reliance.

*Example 3.* Practitioner C sponsors three volume submitter specimen plans, Plans 1, 2 and 3. Practitioner C files applications for complete GUST advisory letters for each of the plans on June 1, 2000. Favorable advisory letters for Plans 1 and 2 are issued on November 30, 2000. A favorable advisory letter for Plan 3 is issued on March 15, 2001. Each employer who adopted (or certified its intent to adopt) Plan 1 or Plan 2 before the end of the regular GUST remedial amendment period is also deemed to have adopted (or certified its intent to adopt) Plan 3. Therefore, the GUST remedial amendment period for each employer who adopted (or certified its intent to adopt) any of Practitioner C's volume submitter specimen plans by the end of the regular GUST remedial amendment period is extended to March 31, 2002, provided the employer adopts one of Practitioner C's GUST-approved plans, another GUST-approved volume submitter specimen or M&P plan or individually-designed GUST amendments, and requests a determination letter (if required for reliance) by this date.

## Questions and Answers

The following are answers to specific questions the Service has received regarding the rules for determining the GUST remedial amendment period for employers who use M&P or volume submitter specimen plans. These Q&As address situations involving M&P plans but are equally applicable to situations involving volume submitter specimen plans.

**Q1.** An M&P sponsor has submitted its M&P plan for GUST approval, but has not received approval by the end of 2000. Must the sponsor or the adopting employers (i.e., employers who have either adopted the plan or certified their intent to adopt the plan by the end of the regular GUST remedial amendment period) have done anything before January 1, 2001?

**A1.** No.

**Q2.** An M&P sponsor has decided to discontinue marketing its M&P plan and will not seek approval for GUST amendments to the plan. Did the employers who have adopted the M&P plan have to do anything before January 1, 2001? Did the sponsor? Do the answers change if the plan had been approved as a regional prototype plan under Rev. Proc. 89-13, 1989-1 C.B. 801?

**A2.** The employers who have adopted the M&P plan did not have to do anything at this time. Assuming the M&P sponsor is not continuing to sponsor any plan (see Q&A4 below for analysis of a case where the M&P sponsor is continuing to sponsor another plan or plans), the employers must do one of the following by the end of the regular GUST remedial amendment period:

- (i) adopt a GUST-approved M&P or volume submitter specimen plan of another sponsor or practitioner, or individually-designed GUST amendments;
- (ii) extend the GUST remedial amendment period by adopting a timely submitted M&P or volume submitter specimen plan of another sponsor or practitioner; or
- (iii) extend the GUST remedial amendment period by jointly certifying with another sponsor or practitioner that the employer intends to amend its plan for GUST by adopting the sponsor or practitioner's timely submitted M&P or volume submitter specimen plan after the

plan has been approved for GUST. The sponsor of the discontinued plan must notify the adopting employers and the Service of the discontinuance of the plan. The sponsor should also advise the adopting employers of their options for complying with GUST, as described above. It makes no difference if the plan is a regional prototype plan.

**Q3.** Is the answer to 2 different if the M&P plan is being discontinued by a mass submitter?

**A3.** The discontinuance of an M&P plan by a mass submitter does not constitute discontinuance of the M&P plans that are identical adoptions or minor modifications of the mass submitter's plan. If a mass submitter discontinues a plan, an M&P sponsor that is using the plan has the following options:

- (i) continue the plan as a nonmass submitter M&P plan;
- (ii) amend the form of the plan to be a word-for-word identical or minor modifier adoption either of another plan of the mass submitter or of a plan of another mass submitter; or
- (iii) discontinue the M&P plan as described in A2 above.

**Q4.** An M&P sponsor has several plans and decides to discontinue only one of them. What effect will this have on the deadline for amending for those employers who have adopted one of the other plans? What effect will this have on the deadline for amending for those employers who have adopted the plan that will be discontinued?

**A4.** Each employer who has adopted any of the M&P sponsor's plans (including the discontinued plan) before the end of the regular GUST remedial amendment period is deemed to have adopted all of the sponsor's plans. It is assumed that the M&P sponsor requested GUST opinion letters by December 31, 2000, for each M&P plan that will continue. Therefore, the GUST remedial amendment period for each employer who adopted any of the M&P sponsor's plans (including the discontinued plan) before the end of the regular GUST remedial amendment period will be extended until the end of the 12th month beginning after the date of approval of the last plan of the sponsor to receive a GUST opinion letter. By this time, the employers (including

those who had adopted the discontinued plan) must:

- (i) adopt any of the GUST-approved plans of the sponsor, or any other GUST-approved M&P or volume submitter specimen plan; or
- (ii) adopt individually-designed GUST amendments; and
- (iii) request a determination letter, if a determination letter is required for reliance.

### **Extending the GUST Remedial Amendment Period When Sponsor or Practitioner Does Not Timely Request Opinion or Advisory Letter**

If an M&P sponsor or volume submitter practitioner did not request GUST opinion or advisory letters for its plans by December 31, 2000, employers who have adopted the plans must take one of the following steps by the end of the regular GUST remedial amendment period:

- (i) adopt a GUST-approved M&P or volume submitter specimen plan of another sponsor or practitioner, or individually-designed GUST amendments;
- (ii) extend the GUST remedial amendment period by adopting a timely submitted M&P or volume submitter specimen plan of another sponsor or practitioner; or
- (iii) extend the GUST remedial amendment period by jointly certifying with another sponsor or practitioner that the employer intends to amend its plan for GUST by adopting the sponsor or practitioner's timely submitted M&P or volume submitter specimen plan after the plan has been approved for GUST.

The Service is aware that some sponsors and practitioners will not be requesting GUST opinion or advisory letters for their M&P or volume submitter specimen plans because the plans are being replaced by plans of other sponsors or practitioners as a result of business circumstances. In order to ameliorate the burden of requiring employers to take one of the intermediate steps described in (ii) or (iii) above in these situations, the Service is adopting the policy described in the next paragraph. This policy aims to reduce burden by providing relief from the certification requirement in appropriate, clearly defined situations.

If a sponsor or practitioner of an M&P or volume submitter specimen plan did not request a GUST opinion or advisory letter for the plan by December 31, 2000, because the plan is being replaced by an M&P or volume submitter specimen plan of another sponsor or practitioner, the Service will not require an employer who has adopted the "replaced plan" to sign a certification of intent to adopt the "replacement" plan in order to be eligible for the extension under section 19 of Rev. Proc. 2000-20, provided the following conditions are met:

- (i) the employer has adopted the replaced plan by the end of the regular GUST remedial amendment period;
- (ii) the sponsor or practitioner of the replacement plan has submitted the plan to the Service for a GUST opinion or advisory letter by December 31, 2000; and
- (iii) the sponsor or practitioner of the replacement plan and the sponsor or practitioner of the replaced plan are related in one of the following ways: (a) one was merged into the other before January 1, 2001; or (b) as of December 31, 2000, both are

members of the same controlled group of corporations within the meaning of section 414(b) or are trades or businesses which are under common control within the meaning of section 414(c).

If these conditions are met, the employer will have until the end of the 12th month beginning after the date of issuance of a GUST opinion or advisory letter for the replacement plan to adopt the GUST-approved replacement plan. (Alternatively, the employer may, on or before the end of the 12th month beginning after the date of issuance of a GUST opinion or advisory letter for the replacement plan, adopt another GUST-approved M&P or volume submitter specimen plan or individually-designed GUST amendments). If a determination letter is required for reliance, the employer must also request the determination letter on or before the end of the 12th month beginning after the date of issuance of a GUST opinion or advisory letter for the replacement plan.

The determination letter request should include a statement from the sponsor or practitioner of the replacement plan, which indicates that the sponsor has satis-

fied the requirements described above and which lists the sponsor, file folder number and name of the M&P or volume submitter specimen plan(s) being replaced. (This statement should also be included with the GUST opinion or advisory letter application for the replacement plan.) The determination letter request should also include evidence of the employer's prior adoption of the replaced plan.

#### **Service Procedures for Reviewing M&P and Volume Submitter Specimen Plans**

The Service may, at its discretion, require any additional information it considers necessary to the issuance of a favorable opinion or advisory letter. Although the Service's review of a previously approved M&P or volume submitter specimen plan is focused primarily on the requirements of GUST and plan provisions affected by the GUST requirements, the Service may request changes to any provisions of the plan when necessary, notwithstanding that the plan included the provisions when it was previously approved.

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

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

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Ser-

vice matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, en-

rolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

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



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

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

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

under title 18 of the United States Code involving dishonesty or breach of trust. Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employ-

under title 18 of the United States Code involving dishonesty or breach of trust.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employ-

ing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

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

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

weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

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

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

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

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

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service

matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, en-

rolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

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

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

## Definition of Terms

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

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

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

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

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it ap-

plies 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.  
FR.—Federal Register.  
FUTA—Federal Unemployment Tax Act.  
FX—Foreign Corporation.  
G.C.M.—Chief Counsel’s Memorandum.  
GE—Grantee.  
GP—General Partner.  
GR—Grantor.  
IC—Insurance Company.  
I.R.B.—Internal Revenue Bulletin.  
LE—Lessee.  
LP—Limited Partner.  
LR—Lessor.  
M—Minor.  
Nonacq.—Nonacquiescence.  
O—Organization.

P—Parent Corporation.  
PHC—Personal Holding Company.  
PO—Possession of the U.S.  
PR—Partner.  
PRS—Partnership.  
PTE—Prohibited Transaction Exemption.  
Pub. L.—Public Law.  
REIT—Real Estate Investment Trust.  
Rev. Proc.—Revenue Procedure.  
Rev. Rul.—Revenue Ruling.  
S—Subsidiary.  
S.P.R.—Statements of Procedural Rules.  
Stat.—Statutes at Large.  
T—Target Corporation.  
T.C.—Tax Court.  
T.D.—Treasury Decision.  
TFE—Transferee.  
TFR—Transferor.  
T.I.R.—Technical Information Release.  
TP—Taxpayer.  
TR—Trust.  
TT—Trustee.  
U.S.C.—United States Code.  
X—Corporation.  
Y—Corporation.

## Numerical Finding List<sup>1</sup>

Bulletins 2001-1 through 2001-5

### Announcements:

2001-1, 2001-2 I.R.B. 277  
2001-2, 2001-2 I.R.B. 277  
2001-3, 2001-2 I.R.B. 278  
2001-4, 2001-2 I.R.B. 286  
2001-5, 2001-2 I.R.B. 286  
2001-6, 2001-3 I.R.B. 357  
2001-7, 2001-3 I.R.B. 357  
2001-8, 2001-3 I.R.B. 357  
2001-9, 2001-3 I.R.B. 357  
2001-10, 2001-4 I.R.B. 431  
2001-11, 2001-4 I.R.B. 432

### Notices:

2001-1, 2001-2 I.R.B. 261  
2001-2, 2001-2 I.R.B. 265  
2001-3, 2001-2 I.R.B. 267  
2001-4, 2001-2 I.R.B. 267  
2001-5, 2001-3 I.R.B. 327  
2001-6, 2001-3 I.R.B. 327  
2001-7, 2001-4 I.R.B. 374  
2001-8, 2001-4 I.R.B. 374  
2001-9, 2001-4 I.R.B. 375  
2001-10, 2001-5 I.R.B. 459  
2001-11, 2001-5 I.R.B. 464  
2001-12, 2001-3 I.R.B. 328

### Proposed Regulations:

REG-251701-96, 2001-4, I.R.B. 396  
REG-106542-98, 2001-5, I.R.B. 473  
REG-104683-00, 2001-4, I.R.B. 407  
REG-106702-00, 2001-4, I.R.B. 424  
REG-107176-00, 2001-4, I.R.B. 428  
REG-107566-00, 2001-3, I.R.B. 346

### Railroad Retirement Quarterly Rates:

2001-2, I.R.B. 258

### Revenue Procedures:

2001-1, 2001-1 I.R.B. 1  
2001-2, 2001-1 I.R.B. 79  
2001-3, 2001-1 I.R.B. 111  
2001-4, 2001-1 I.R.B. 121  
2001-5, 2001-1 I.R.B. 164  
2001-6, 2001-1 I.R.B. 194  
2001-7, 2001-1 I.R.B. 236  
2001-8, 2001-1 I.R.B. 239  
2001-9, 2001-3 I.R.B. 328  
2001-10, 2001-2 I.R.B. 272  
2001-11, 2001-2 I.R.B. 275  
2001-12, 2001-3 I.R.B. 335  
2001-13, 2001-3 I.R.B. 337  
2001-14, 2001-3 I.R.B. 343  
2001-15, 2001-5 I.R.B. 465  
2001-16, 2001-4 I.R.B. 376

### Revenue Rulings:

2001-2, 2001-2 I.R.B. 255  
2001-3, 2001-3 I.R.B. 319  
2001-4, 2001-3 I.R.B. 295  
2001-5, 2001-5 I.R.B. 451

### Treasury Decisions:

8910, 2001-2 I.R.B. 258  
8911, 2001-3 I.R.B. 321  
8912, 2001-5 I.R.B. 452  
8913, 2001-3 I.R.B. 300  
8915, 2001-4 I.R.B. 359  
8916, 2001-4 I.R.B. 360  
8918, 2001-4 I.R.B. 372  
8930, 2001-5 I.R.B. 433

<sup>1</sup> A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2000-27 through 2000-52 is in Internal Revenue Bulletin 2001-1, dated January 2, 2001.

## Finding List of Current Actions on Previously Published Items<sup>1</sup>

Bulletins 2001–1 through 2001–5

### Announcement:

#### 98–99

Modified by  
Ann. 2001–9, 2001–3 I.R.B. 357

#### 99–79

Superseded by  
Ann. 2001–3, 2001–2 I.R.B. 278

#### 2000–97

Corrected by  
Ann. 2001–7, 2001–3 I.R.B. 357

### Cumulative Bulletin:

#### 1998–2

Corrected by  
Ann. 2001–5, 2001–2 I.R.B. 286

### Notices:

#### 98–39

Modified by  
Notice 2001–9, 2001–4 I.R.B. 375

#### 98–40

Modified by  
Notice 2001–9, 2001–4 I.R.B. 375

#### 99–53

Modified and superseded by  
Notice 2001–7, 2001–4 I.R.B. 374

#### 2000–21

Superseded by  
Notice 2001–1, 2001–2 I.R.B. 261

#### 2000–22

Modified and superseded by  
Notice 2001–8, 2001–4 I.R.B. 374

### Proposed Regulations:

#### REG–116733–98

Withdrawn by  
Ann. 2001–11, 2001–4 I.R.B. 432

### Revenue Procedures:

#### 83–87

Superseded by  
Rev. Proc. 2001–15, 2001–5 I.R.B. 465

#### 92–19

Superseded by  
Rev. Proc. 2001–15, 2001–5 I.R.B. 465

#### 96–17

Modified by  
Rev. Proc. 2001–9, 2001–3 I.R.B. 328

#### 99–47

Superseded by  
Rev. Proc. 2001–16, 2001–4 I.R.B. 376

#### 99–49

Modified and amplified by  
Rev. Proc. 2001–10, 2001–2 I.R.B. 272

#### 2000–1

Superseded by  
Rev. Proc. 2001–1, 2001–1 I.R.B. 1

### Revenue Procedures—continued:

#### 2000–2

Superseded by  
Rev. Proc. 2001–2, 2001–1 I.R.B. 79

#### 2000–3

Superseded by  
Rev. Proc. 2001–3, 2001–1 I.R.B. 111

#### 2000–4

Superseded by  
Rev. Proc. 2001–4, 2001–1 I.R.B. 121

#### 2000–5

Superseded by  
Rev. Proc. 2001–5, 2001–1 I.R.B. 164

#### 2000–6

Superseded by  
Rev. Proc. 2001–6, 2001–1 I.R.B. 194

#### 2000–7

Superseded by  
Rev. Proc. 2001–7, 2001–1 I.R.B. 236

#### 2000–8

Superseded by  
Rev. Proc. 2001–8, 2001–1 I.R.B. 239

#### 2000–22

Modified and superseded by  
Rev. Proc. 2001–10, 2001–2 I.R.B. 272

#### 2001–13

Clarified by  
Notice 2001–12, 2001–3 I.R.B. 328

### Revenue Rulings:

#### 64–328

Modified by  
Notice 2001–10, 2001–5 I.R.B. 459

#### 66–110

Modified by  
Notice 2001–10, 2001–5 I.R.B. 459

### Treasury Decisions:

#### 8889

Corrected by  
Ann. 2001–14, 2001–2 I.R.B. 286

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

# INDEX

## Internal Revenue Bulletins 2001-1 through 2001-5

The abbreviation and number in parenthesis following the index entry refer to the specific item; numbers in roman and italic type following the parenthesis refer to the Internal Revenue Bulletin in which the item may be found and the page number on which it appears.

### Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

## EMPLOYEE PLANS

Advance letter rulings and determination letters, areas which will not be issued from:

Associates Chief Counsel & Division Counsel/Associate Chief Counsel (TE/GE) (RP 3) 1, *111*

Associate Chief Counsel International (RP 7) 1, 236

Determination letters, issuing procedures (RP 6) 1, *194*

Full funding limitations, weighted average interest rate for December 2000 (Notice 3) 2, 267

Letter rulings, determination letters, and information letters issued by Associates Chief Counsel (RP 1) 1, *1*

Letter rulings, information letters, etc. (RP 4) 1, *121*

Life insurance contracts, "split-dollar" arrangements (Notice 10) 5, *459*

Nondiscrimination rules, governmental and church plans, relief from (Notice 9) 4, 375

Technical advice to directors and chiefs, appeals offices, from Associates Chief Counsel & Division Coun-

## EMPLOYEE PLANS—Continued

sel/Associate Chief Counsel (TE/GE) (RP 2) 1, 79

Technical advice to IRS employees (RP 5) 1, *164*

User fees, request for letter rulings (RP 8) 1, 239

## EMPLOYMENT TAX

Electronic filing, Form 940 (RP 9) 3, 328  
Forms:

940, electronic filing (RP 9) 3, 328

W-2, new code (Ann 7) 3, 357

Railroad retirement, rate determination, quarterly, January 1, 2001, 2, 258

Regulations:

26 CFR 31.6053-1,-4, amended; tips, tip reporting, employer established electronic systems (TD 8910) 2, 258

Tips:

Tips reporting:

Employer-designed tip reporting food and beverage industry (EmTRAC) programs (Notice 1) 2, 261

Employer established electronic systems (TD 8910) 2, 258

Voluntary tip reporting agreements *proformas* (TRDA and TRAC) (Ann 1) 2, 277

## ESTATE TAX

Generation-skipping transfer tax and retention of exempt status (TD 8912) 5, 452

Proposed Regulations:

26 CFR 1.641(b)-3, amended; 1.642(c)-1, revised; 1.645-1, added; 1.671-4, amended; 1.6072-1, amended; 301.6109-1, amended; election to treat trust as part of an estate (REG-106542-98) 5, 473

Regulations:

26 CFR 26.2601-1, amended; generation-skipping transfer issues (TD 8912) 5, 452

Trusts, election to treat trust as part of an estate (REG-106542-98) 5, 472

## EXCISE TAX

Air transportation, mileage awards (Notice 6) 3, 327

## EXEMPT ORGANIZATIONS

Advance letter rulings and determination letters, areas which will not be issued from Associates Chief Counsel & Division Counsel/Associate Chief Counsel (TE/GE) (RP 3) 1, *111*

Indian tribal governments treated as states, list (RP 15) 5, 465

Letter rulings, information letters, etc. (RP 4) 1, *121*

Technical advice to directors and chiefs, appeals offices, from Associate Chief Counsel (RP 2) 1, 79

Technical advice to IRS employees (RP 5) 1, *164*

User fees, request for letter rulings (RP 8) 1, 239

## INCOME TAX

Advance letter rulings and determination letters, areas which will not be issued from:

Associates Chief Counsel & Division Counsel/Associate Chief Counsel (TE/GE) (RP 3) 1, *111*

Associate Chief Counsel International (RP 7) 1, 236

Aircraft maintenance costs (RR 4) 3, 295

Appeals, extension of test of mediation procedure (Ann 9) 3, 357

Corporations:

Distributions of stock or securities in connection with an acquisition:

Purchase of 50% or greater interest in the corporation making the distribution or being distributed (REG-107566-00) 3, 346

Withdrawal of REG-116733-98 (Ann 11) 4, 432

Recognition of gain, disqualified stock (TD 8913) 3, 300

Cost-of-living adjustments for inflation, 2001 (RP 13) 3, 337; clarified (Notice 12) 3, 328

Credits:

Deemed-paid credit computations (REG-104683-00) 4, 407

Foreign tax credit limitations:

Affiliated groups and interest expense allocations (TD 8916) 4, 360

Income subject to separate limitations (REG-104683-00) 4, 407

## INCOME TAX— Continued

Low-income housing credit:  
Satisfactory bond; “bond factor” amounts for the period October through December 2000 (RR 2) 2, 255  
Research credit (Notice 2) 2, 265  
Increasing research activities, definition of qualified research (TD 8930) 5, 433  
Cumulative Bulletin 1998-2, numerical finding list, finding list of current actions on previously published items and index, corrections (Ann 5) 2, 286  
Electing small business trusts; ESBT:  
Qualifications and treatments (REG-251701-96) 4, 396  
Tiered structures (TD 8915) 4, 359  
Electronic filing; magnetic media, Form W-4, Employee’s Withholding Allowance Certificate, specifications (RP 16) 4, 376  
Federal tax deposits, removal of Federal Reserve banks as depositaries (TD 8918) 4, 372; (REG-107176-00) 4, 428  
Financial asset securitization investment trusts (FASITs) (RP 12) 3, 335  
Forms:  
1042S, specifications for filing magnetically or electronically (Ann 3) 2, 278  
W-2, new code (Ann 7) 3, 357  
W-4, Employee’s Withholding Allowance Certificate, specifications (RP 6) 4, 376  
Information reporting:  
Discharges of indebtedness (Notice 8) 4, 374  
Payments to attorneys (Notice 7) 4, 374  
Payments of qualified tuition and payments of interest on qualified education loans, magnetic media filing requirements (Ann 10) 4, 431  
Interest:  
Investment:  
Federal short-term, mid-term, and long-term rates for January 2001 (RR 3) 3, 319  
Inventory, LIFO, price indexes, department stores, November 2000 (RR 5) 5, 451  
Letter rulings, determination letters, and information letters issued by Associates Chief Counsel (RP 1) 1, 1  
Life insurance contracts, “split-dollar” arrangements (Notice 10) 5, 459  
Methods of accounting, inventories, small taxpayers (RP 10) 2, 272

## INCOME TAX— Continued

Partnerships:  
Corporate partner’s stock, partnership termination (REG-106702-00) 4, 424  
Final short-year tax return, determination of basis (Notice 5) 3, 327  
Presidentially declared disaster and combat zone, tax related deadlines (TD 8911) 3, 321  
Proposed Regulations:  
26 CFR 1.355-0, amended; 1.355-7, added; recognition of gain on certain distributions of stock or securities in connection with an acquisition (REG-107566-00) 3, 346  
26 CFR 1.444-4, added; 1.641(c)-0, -1, added; 1.1361-0, -1, amended; 1.1362-6, -7, amended; 1.1377-1, -3, amended; electing small business trusts (REG-251701-96) 4, 396  
26 CFR 1.705-1, amended; 1.705-2, added; basis adjustments upon the sale of a corporate partner’s stock (REG-106702-00) 4, 424  
26 CFR 1.902-0, -1, amended; 1.904-0, -4, -5, -6, amended; 1.904-5, revised; 1.904(b)-1, -2, revised; 1.904(b)-3, -4, removed; 1.904(j)-1, added; application of section 904 to income subject to separate limitations and computations of deemed paid credit under section 902 (REG-104683-00) 4, 407  
26 CFR 1.6302-1, -2, amended; 31.6302-1, amended; 31.6302(c)-3, amended; removal of Federal Reserve banks as federal depositaries (REG-107176-00) 4, 428  
Publications:  
547, Casualties, Disasters, and Thefts, revised (Ann 6) 3, 357  
551, Basis of Assets, revised 2000 (Ann 2) 2, 277  
583, Starting a Business and Keeping Records, revised (Ann 8) 3, 357  
1245, Specifications for Filing Forms W-4, Employee’s Withholding Allowance Certificate, magnetically or electronically (RP 6) 4, 376  
Qualified zone academy bonds, limitation for 2001 (RP 14) 3, 343  
Real estate mortgage investment conduits (REMICs), safe harbor (RP 12) 3, 335  
Regulations:  
26 CFR 1.41-0, -1, -4, revised;

## INCOME TAX— Continued

1.41-2, amended; 1.41-3, redesignated as 1.41-3A; 1.41-3, added; 1.41-5, redesignated as 1.41-4A, amended; 1.41-6, redesignated as 1.41-5, amended; 1.41-7, redesignated as 1.41-5A, amended; 1.41-8, redesignated as 1.41-6, amended; 1.41-9, redesignated as 1.41-7; 1.41-8, added; 1.41-0A through -8A, removed; 1.41-0A, added; 1.218-0, removed; 1.482-7, amended; credit for increasing research activities (TD 8930) 5, 433  
26 CFR 1.355-0, amended; 1.355-6, revised; recognition of gain on certain distributions of stock or securities (TD 8913) 3, 300  
26 CFR 1.444-4T, added; ESBT, electing small business trusts, tiered structures (TD 8915) 4, 359  
26 CFR 1.861-9, -11, -14, added; 1.861-9T, -11T, -14T, revised; 1.902-1, amended; 1.904-0, -4, -5, amended; application of section 904 to income subject to separate limitations and section 864(e) affiliated group expense allocation and apportionment rules (TD 8916) 4, 360  
26 CFR 1.894-1, amended; 1.894-1T, removed; guidance regarding claims for certain income tax convention benefits (Ann 4) 2, 286  
26 CFR 301.6302-1T, added; removal of Federal Reserve banks as depositaries (TD 8918) 4, 372  
26 CFR 301.7508-1, added; 301.7508 A-1, added; for combat zone service or Presidentialy declared disasters, tax related deadlines (TD 8911) 3, 321  
Substantial understatement penalty, adequate disclosure (RP 11) 2, 275  
Tax convention, claims for benefits (Ann 4) 2, 286  
Technical advice to directors and chiefs, appeals offices, from Associates Chief Counsel and Division Counsel/Associate Chief Counsel (TE/GE) (RP 2) 1, 79  
Trusts, election to treat trust as part of an estate (REG-106542-98) 5, 472  
Withholdings:  
Payments to financial institutions in U.S. possessions (Notice 11) 5, 464  
Qualified intermediary agreements, clarifications (Notice 4) 2, 267

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