Internal Revenue
bulletin

Bulletin No. 2006-21
May 22, 2006

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. 2006–27, page 915.

Down payment assistance; home buyers. This ruling sets forth the applicable rules and standards for determining whether organizations that provide down payment assistance to home buyers qualify as tax-exempt charities. In addition, the ruling addresses whether assistance received for a down payment is treated as a gift and included in a home buyer's basis.

T.D. 9261, page 919.

Final regulations under section 1502 of the Code relate to intercompany transactions. Section 1.1502–13(c)(7)(ii), Example 13, illustrates the treatment of manufacturer incentive payments. This example relies, in part, upon the premise that manufacturer incentive payment is an ordinary and necessary business expense deductible under section 162. Because this treatment is now under reconsideration (see Rev. Rul. 2005–28, 2005–19 I.R.B. 997), these final regulations remove and reserve this example.

Notice 2006–43, page 921.

This notice announces that the Treasury Department and the Service will amend the regulations under section 883 of the Code. The regulations exclude from gross income the income derived from the international operation of a ship or ships or aircraft by a corporation organized in a foreign country that grants an equivalent exemption to U.S. corporations. To receive this benefit, a foreign corporation must also satisfy one of three ownership tests. One such test applies to a controlled foreign corporation (CFC), as defined in section 957(a). To satisfy the CFC ownership test, section 1.883–3(a) requires a CFC to meet an "income inclusion test," as defined in section 1.883–3(b). After the repeal of section 954(a)(4) and (f) (foreign base company shipping income provisions) by the American Jobs Creation Act (AJCA), it is unclear how to apply the income inclusion test. This notice announces that Treasury and the IRS will amend section 1.883–3(b) in light of the repeal of section 954(a) and (f) and provide a new "qualified U.S. person ownership test" that is clear and simple to apply and on which taxpayers may rely until the regulations are amended.

Notice 2006–48, page 922.

This notice provides guidance relating to amendments made by section 415 of the American Jobs Creation Act of 2004 (AJCA), which affect the treatment of certain income and assets related to the leasing of aircraft or vessels in foreign commerce. The Treasury Department and the Service intend to amend the regulations under sections 367(a), 954, and 956 to address the amendments made by section 415 of the AJCA and this notice. Until regulations reflecting these changes are issued, taxpayers may rely upon this notice. This notice also solicits comments on whether any other changes to the regulations under sections 367, 954, and 956 are necessary to implement the purposes of section 415 of the AJCA.

Rev. Proc. 2006–25, page 926.

Specifications are set forth for the private printing of paper and laser-printed substitutes for the January 2006 revisions of Form 941, *Employer's QUARTERLY Federal Tax Return*, and Schedule B (Form 941), *Report of Tax Liability for Semiweekly Schedule Depositors*. This procedure will be reproduced as the next revision of Publication 4436, *General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941)*. Rev. Proc. 2005–21 superseded.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Announcement 2006–34, page 937.
This document withdraws proposed regulations (REG–131264–04, 2004–2 C.B. 506) under section 1502 of the Code regarding intercompany transactions. The regulations provided additional examples in section 1.1502–13(c)(7)(ii), Example 13, to clarify the proper treatment of manufacturer incentive payments. One of these examples relied, in part, upon the premise that the manufacturer incentive payment is an ordinary and necessary business expense deductible under section 162. Because this treatment is now under reconsideration (see Rev. Rul. 2005–28, 2005–19 I.R.B. 997), the proposed regulations are withdrawn.

EXEMPT ORGANIZATIONS

Rev. Rul. 2006–27, page 915.
Down payment assistance; home buyers. This ruling sets forth the applicable rules and standards for determining whether organizations that provide down payment assistance to home buyers qualify as tax-exempt charities. In addition, the ruling addresses whether assistance received for a down payment is treated as a gift and included in a home buyer's basis.

EMPLOYMENT TAX

Rev. Proc. 2006–25, page 926.
Specifications are set forth for the private printing of paper and laser-printed substitutes for the January 2006 revisions of Form 941, *Employer's QUARTERLY Federal Tax Return*, and Schedule B (Form 941), *Report of Tax Liability for Semiweekly Schedule Depositors*. This procedure will be reproduced as the next revision of Publication 4436, *General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941)*. Rev. Proc. 2005–21 superseded.

ADMINISTRATIVE

Rev. Proc. 2006–26, page 936.
This procedure announces the introduction of user fees for requests submitted to the U.S. competent authority for discretionary determinations under limitation on benefits provisions of U.S. income tax treaties. Rev. Proc. 2002–52 modified.

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 compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

The last 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 last Bulletin of each semiannual period.

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

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

Section 61.—Gross Income Defined

Whether certain down payment assistance provided to a home buyer is includible in the recipient's gross income under section 61. See Rev. Rul. 2006-27, page 915.

Section 102.—Gifts and Inheritances

Whether certain down payment assistance provided to a home buyer is excludible from the recipient's gross income as a gift under section 102. See Rev. Rul. 2006-27, page 915.

Section 501.—Exemption From Tax on Corporations, Certain Trusts, etc.

26 CFR 1.501(c)(3)–1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. (Also §§ 61, 102, 1012.)

Down payment assistance; home buyers. This ruling sets forth the applicable rules and standards for determining whether organizations that provide down payment assistance to home buyers qualify as tax-exempt charities. In addition, the ruling addresses whether assistance received for a down payment is treated as a gift and included in a home buyer's basis.

Rev. Rul. 2006–27

ISSUES:

1. Whether organizations that otherwise meet the requirements of § 501(c)(3) of the Internal Revenue Code and are described in the situations below operate exclusively for charitable purposes.

2. Whether home buyers who receive down payment assistance from the organizations may exclude the amount of the assistance from their gross income as gifts under § 102.

3. Whether home buyers who receive down payment assistance from the organizations may include the amount of the assistance in the cost basis of their homes under § 1012.

FACTS

Situation 1

X is a non-profit corporation that helps low-income individuals and families purchase decent, safe and sanitary homes throughout the metropolitan area in which *X* is located. As a substantial part of its activities, *X* makes assistance available exclusively to low-income individuals and families to provide part or all of the funds they need to make a down payment on the purchase of a home. *X* uses standards set by Federal housing statutes and administered by the Department of Housing and Urban Development to determine who is a low-income individual. Individuals are eligible to receive assistance from *X*'s program if they are low-income individuals, have the employment history and financial history necessary to qualify for a mortgage, and would so qualify but for the lack of a down payment. *X* also offers financial counseling seminars and conducts other educational activities to help prepare potential low-income home buyers for the responsibility of home ownership.

X will consider applications for assistance in connection with an applicant's purchase of any home that meets *X*'s standards for habitability. Before making a grant of down payment assistance, *X* requires a home inspection report for the property that the applicant intends to buy to ensure that the house will be habitable.

To fund its down payment assistance program and other activities, *X* conducts a broad based fundraising program that attracts gifts, grants and contributions from several foundations, businesses and the general public.

X's grantmaking process is structured to ensure that *X*'s staff awarding grants on behalf of *X* does not know the identity of the party selling the home to the grant applicant or the identities of any other parties, such as real estate agents or developers, who may receive a financial benefit from the sale. The staff also does not know whether any of the interested parties to the transaction have been solicited for contributions to *X* or have made pledges or actual contributions to *X*. Further, *X* does not accept any contributions contingent on the sale of a particular property or properties.

Situation 2

Y is a nonprofit corporation that is like *X* in all respects as set forth in Situation 1, except as follows. Under *Y*'s grantmaking procedures, *Y*'s staff considering a particular applicant's application knows the identity of the party selling the home to the grant applicant and may also know the identities of other parties, such as real estate agents and developers, who may receive a financial benefit from the sale. Moreover, in substantially all of the cases in which *Y* provides down payment assistance to a home buyer, *Y* receives a payment from the home seller. Further, there is a direct correlation between the amount of the down payment assistance provided by *Y* in connection with each of these transactions and the amount of the home seller's payment to *Y*. Finally, *Y* does not conduct a broad based fundraising campaign to attract financial support. Rather, most of *Y*'s support comes from home sellers and real estate-related businesses that may benefit from the sale of homes to buyers who receive *Y*'s down payment assistance.

Situation 3

Z is a nonprofit corporation formed to combat community deterioration in an economically depressed area that has suffered a major loss of population and jobs. Studies have shown that the average income in the area is below the median level for the State. *Z* cooperates with government agencies and community groups to develop an overall plan to attract new businesses to the area and to provide stable sources of decent, safe and sanitary housing for the area residents without relocating them outside the area. As part of the renewal project, *Z* receives funding from government agencies to build affordable housing units for sale to low and moderate-income families. As a substantial part of its activities, *Z* makes down payment assistance available to eligible home buyers who wish to purchase the newly-constructed units

from *Z*. *Z* also offers financial counseling seminars and conducts other educational activities to help prepare potential low and moderate-income home buyers for the responsibility of home ownership.

To fund its down payment assistance program and other activities, *Z* conducts a broad based fundraising program that attracts gifts, grants and contributions from several foundations, businesses and the general public.

LAW

Section 501 of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings inures to the benefit of any private shareholder or individual. *See* § 501(c)(3).

Section 1.501(c)(3)–1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In *Better Business Bureau of Washington, D.C. v. U.S.*, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

Section 1.501(c)(3)–1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Section 1.501(c)(3)–1(d)(2) defines the term "charitable" as used in § 501(c)(3) as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term "charitable" also includes the advancement of education.

Section 1.501(c)(3)–1(d)(3)(i) provides, in part, that the term "educational" as used in § 501(c)(3) relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)–1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of § 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization's primary purpose does not consist of carrying on an unrelated trade or business.

In *Easter House v. U.S.*, 12 Cl. Ct. 476, 486 (1987), *aff'd*, 846 F.2d 78 (Fed. Cir. 1988), the U.S. Court of Federal Claims considered whether an organization that provided adoption and related health services to pregnant women who agreed to place their newborns for adoption through the organization qualified for exemption under § 501(c)(3). The court concluded that the organization did not qualify for exemption under § 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization did not provide health-related services to unwed mothers who wished to keep their children or who arranged for an adoption independent of the organization. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in § 501(c)(3). *Easter House*, 12 Cl. Ct. at 485–86.

In *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with a particular political party and that most of the organization's graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of § 1.501(c)(3)–1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did "comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner." *American Campaign Academy*, 92 T.C. at 1077.

In *Columbia Park and Recreation Association v. Commissioner*, 88 T.C. 1 (1987), *aff'd* without published opinion, 838 F.2d 465 (4th Cir. 1988), the court held that an association formed in a private real estate development to operate parks, swimming pools, boat docks, and other recreational facilities did not qualify as a § 501(c)(3) organization. Although the organization provided some benefit to the general public, the primary intended beneficiaries were the residents and property owners of the private development. Thus, the organization operated for a substantial non-exempt purpose rather than for exclusively charitable purposes.

Rev. Rul. 67–138, 1967–1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is "charitable" because it relieves the poor and distressed or underprivileged. In Rev. Rul. 67–138, the organization carried on several activities directed to assisting low-income families in obtaining improved housing, including (1) conducting a training course relative to various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building

sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Rev. Rul. 70–585, 1970–2 C.B. 115, discussed four situations of organizations providing housing and analyzed whether each organization qualified as charitable within the meaning of § 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families eligible for loans under a Federal housing program who did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 described an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate-income on an open-occupancy basis. The housing was made available to members of minority groups who were unable to obtain adequate housing because of local discrimination. The housing units were located to help reduce racial and ethnic imbalances in the community. As the activities were designed to eliminate prejudice and discrimination and to lessen neighborhood tensions, the revenue ruling held that the organization was engaged in charitable activities within the meaning of § 501(c)(3).

Situation 3 described an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. The median income level in the area was lower than in other sections of the city and the housing in the area generally was old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area, sponsored a renewal project, and involved residents in the area renewal plan. The organization also purchased an apartment building that it rehabilitated and rented at cost to low and moderate-income families with a preference given to residents of the area. The revenue ruling held that the organization was described in § 501(c)(3) because its purposes and activities combated community deterioration.

Situation 4 described an organization formed to alleviate a shortage of housing for moderate-income families in a particular community. The organization planned to build housing to be rented at cost to moderate-income families. The Service held that the organization failed to qualify for exemption under § 501(c)(3) because the organization's program was not designed to provide relief to the poor or further any other charitable purpose within the meaning of § 501(c)(3) and the regulations.

Rev. Rul. 72–147, 1972–1 C.B. 147, held that an organization that provided housing to low-income families did not qualify for exemption under § 501(c)(3) because it gave preference to employees of a business operated by the individual who also controlled the organization. Although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

Rev. Rul. 72–559, 1972–2 C.B. 247, held that an organization that subsidized recent law graduates during the first three years of their practice to enable them to establish legal practices in economically depressed communities that have a shortage of available legal services, and to provide free legal services to needy members of the community, qualified for exemption under § 501(c)(3). Although the recipients of the subsidies were not themselves members of a charitable class, the resulting benefit to them did not detract from charitable purposes. Rather, the young lawyers were merely the instruments by which the organization accomplished the charitable purpose of providing free legal services for those unable to pay for, or obtain, such services.

Rev. Rul. 74–587, 1974–2 C.B. 162, held that an organization providing low-cost or long-term loans to, or equity investments in, businesses operating in economically depressed areas qualified for exemption under § 501(c)(3). The organization provided financial assistance only to businesses that were unable to obtain funds from conventional sources, and gave preference to businesses that would provide training and employment opportunities for unemployed or under-employed area residents. Although some of the individual business owners receiving financial assistance from the organization were not themselves members of a charitable class, the benefit to them did not detract from the charitable character of the organization's program. As in Rev. Rul. 72–559, the recipients of aid were instruments for accomplishing the organization's charitable purposes.

Rev. Rul. 76–419, 1976–2 C.B. 146, held that an organization that converts blighted land in an economically depressed community to an industrial park and leases space on favorable terms to businesses that agree to hire a significant number of unemployed area residents and train them in needed skills qualifies for exemption under § 501(c)(3). The organization furthered charitable purposes by improving economic conditions for the poor and distressed and combating community deterioration. The organization offered inducements to businesses solely for the purpose of advancing charitable goals.

Section 61 provides that, except as otherwise provided in subtitle A (relating to income taxes), gross income means all income from whatever source derived.

Section 1012 provides, generally, that the basis of property shall be its cost to the taxpayer.

Section 1016(a)(1) provides that proper adjustment shall be made to the basis of property for expenditures, receipts, losses, or other items properly chargeable to capital account.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis for determining gain provided in § 1011. Section 1011(a) provides generally that the adjusted basis for determining gain from the sale or other disposition of property is the basis determined under § 1012, adjusted as provided in § 1016.

Section 102 provides that the value of property acquired by gift is excluded from gross income. A gift "proceeds from a 'detached and disinterested generosity,' . . . 'out of affection, respect, admiration,

charity or like impulses.'" *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960). Payments that proceed from "the constraining force of any moral or legal duty," or from "'the incentive of anticipated benefit' of an economic nature," are not gifts. *Duberstein*, 363 U.S. at 285. Thus, payments attendant to ordinary business or commercial transactions, or that proceed primarily from the moral or legal obligations attendant such transactions, are not gifts. However, a payment made to an individual that responds to the individual's needs, that is made without economic or other consideration being received by the donor, and that does not proceed from any moral or legal duty, is motivated by detached and disinterested generosity, and may be excluded from gross income as a gift under § 102. *See, e.g.*, Rev. Rul. 99–44, 1999–2 C.B. 549.

ANALYSIS

In Situation 1, *X*'s purposes and activities relieve the poor, distressed and underprivileged by enabling low-income individuals and families to obtain decent, safe and sanitary homes. The way *X* conducts its down payment assistance program establishes that *X*'s primary purpose is to address the needs of its low-income grantees. *See* Rev. Rul. 70–585, Sit. 1. As a condition of providing assistance, *X* requires a home inspection to ensure that the house the applicant intends to buy will be habitable. *X*'s financial counseling seminars and other educational programs help to prepare potential home buyers for the responsibility of home ownership. *See* Rev. Rul. 67–138. *X* conducts a broad based fundraising program, and *X* receives support from a wide array of sources. *X*'s policies of ensuring that its grantmaking staff does not know the identity or contributor status of the party selling the home to the grant applicant (or any other party who may receive a financial benefit from the sale), and of not accepting contributions contingent on the sale of any particular properties, ensure that *X* is not beholden to any particular donors or other supporters whose interest may conflict with that of the low-income buyers *X* is working to help.

X's grantmaking procedures combined with its efforts to educate home buyers ensure that *X* is operated primarily to benefit the low-income beneficiaries of its down-payment assistance. The low-income beneficiaries constitute a charitable class. Any benefit to other parties (such as home sellers, real estate agents, or developers) who participate in the transactions does not detract from the charitable purpose of relieving the poor and distressed. *See* Rev. Ruls. 72–559, 74–587, 76–419. Because *X* is operated exclusively for charitable purposes, *X* qualifies for exemption from federal taxation as an organization described in § 501(c)(3).

By contrast, in Situation 2, *Y* does not qualify as an organization described in § 501(c)(3). To finance its down payment assistance activities, *Y* relies on sellers and other real-estate related businesses that stand to benefit from the transactions *Y* facilitates. Furthermore, in deciding whether to provide assistance to a low-income applicant, *Y*'s grantmaking staff knows the identity of the home seller and may also know the identities of other interested parties and is able to take into account whether the home seller or another interested party is willing to make a payment to *Y*. *Y*'s receipt of a payment from the home seller corresponding to the amount of the down payment assistance in substantially all of the transactions, and *Y*'s reliance on these payments for most of its funding indicate that the benefit to the home seller is a critical aspect of *Y*'s operations. In this respect, *Y* is like the organization considered in *Easter House*, which received all of its support from fees charged to adoptive parents, so that the business purpose of the adoption service became its primary goal and overshadowed any educational or charitable purpose. Like the organization considered in *American Campaign Academy*, *Y* is structured and operated to assist private parties who are affiliated with its funders. Like the organizations considered in *American Campaign Academy*, *Easter House*, and *Columbia Park Recreation Association*, *Y* also serves an exempt purpose, but because *Y* is not operated exclusively for exempt purposes, *Y* does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

In Situation 3, although *Z* does not limit its down payment assistance program to low-income recipients, *Z*'s down payment assistance program still serves a charitable purpose described in § 501(c)(3) because it combats community deterioration in a specific, economically depressed area that has suffered a major loss of population and jobs. Through a combination of counseling and financial assistance, *Z* helps low and moderate-income families in that area to acquire decent, safe and sanitary housing and to prepare for the responsibilities of home ownership. In this respect, *Z* is like the organization described in Situation 3 of Rev. Rul. 70–585. Because *Z* is operated exclusively for charitable purposes, *Z* qualifies for exemption from federal taxation as an organization described in § 501(c)(3).

Down payment assistance payments for home buyers in Situations 1 and 3 are made by those organizations out of a detached and disinterested generosity and from charitable or like impulse, rather than to fulfill any moral or legal duty, and thus qualify for exclusion from such home buyers' gross incomes as "gifts" under § 102. The benefits provided to the home buyers in these circumstances are sufficiently removed from the interests of any home sellers or sales agents that they proceed from a detached and disinterested generosity on the part of the donor organization, and such grants lack the *indicia* of a rebate, price adjustment, or *quid pro quo* incident to a sale. Favorable treatment under § 102 is thus appropriate. The home buyer's payment of such amount toward the purchase of the residence will be included in his or her cost basis under § 1012.

In Situation 2, in substantially all of the cases in which *Y* provides down payment assistance to a home buyer, *Y* receives a payment from the home seller that directly correlates to the amount of the down payment assistance *Y* provides to the home buyer. In those cases, the payments received by the home buyers do not qualify for exclusion from gross income as gifts under § 102. The payments do not proceed from detached and disinterested generosity, but rather are in response to an anticipated economic benefit, namely facilitating the sale of a seller's home. Under *Duberstein*, *supra*, such payments are not gifts for purposes of § 102. Unlike in Situations 1 and 3, in Situation 2, the down payment assistance received by those home buyers represents a rebate or purchase price reduction. As a rebate or purchase price reduction, the down payment assistance is not includible in a home

buyer's gross income under § 61 and the amount of the down payment assistance is not included in the home buyer's cost basis under § 1012, as adjusted under § 1016.

HOLDINGS

1. In Situations 1 and 3, the organization is operated exclusively for charitable purposes and qualifies for exemption from federal income tax as an organization described in § 501(c)(3). In Situation 2, the organization is not operated exclusively for charitable purposes, and consequently, does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

2. In Situations 1 and 3, the home buyers may exclude the down payment assistance from their gross income as gifts under § 102. In Situation 2, the home buyers may not exclude the down payment assistance as gifts under § 102. However, in Situation 2, the down payment assistance is excluded from the gross income of home buyers because it represents a rebate or purchase price reduction.

3. In Situations 1 and 3, the home buyers may include the down payment assistance in the cost basis of their homes under § 1012. In Situation 2, the home buyers may not include the amount of the down payment assistance in the cost basis of their homes under § 1012. Rather, the amount of the down payment assistance represents a rebate or purchase price reduction that is excluded from the home buyer's cost basis under § 1012.

DRAFTING INFORMATION

The principal author of this revenue ruling is Elizabeth C. Kastenberg of Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, contact Elizabeth C. Kastenberg at (202) 283–9468 (not a toll-free call).

Section 1012.—Basis of Property—Cost

Whether certain down payment assistance provided to a home buyer is included in the buyer's cost basis under section 1012. See Rev. Rul. 2006-27, page 915.

Section 1502.—Regulations

26 CFR 1.1502–13: Intercompany transactions.

T.D. 9261

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Intercompany Transactions; Manufacturer Incentive Payments

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 1502 of the Internal Revenue Code. *Example 13* of the intercompany transaction regulations illustrates the treatment of manufacturer incentive payments. Because a premise underlying the example is under reconsideration, these final regulations remove and reserve this example. The regulations will affect corporations filing consolidated returns.

DATES: *Effective Date:* These regulations are effective on May 8, 2006.

FOR FURTHER INFORMATION CONTACT: Frances Kelly, (202) 622–7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 1.1502–13 of the consolidated return regulations provides rules for taking into account items of income, gain, deduction, and loss of members from intercompany transactions. In particular, §1.1502–13(c)(7)(ii), *Example 13*, illustrates how the matching rule of the intercompany transaction regulations treats a transaction involving manufacturer incentive payments. On August 13, 2004, the IRS and Treasury Department published a notice of proposed rulemaking (REG–131264–04, 2004–2 C.B. 506) in the **Federal Register** (69 FR 50112) proposing regulations to address additional transactions involving manufacturer incentive payments and to clarify the proper treatment of such incentive payments under the intercompany transaction regulations.

On April 25, 2005, the IRS and Treasury Department published Rev. Rul. 2005–28, 2005–19 I.R.B. 997, which suspends, in part, Rev. Rul. 76–96, 1976–1 C.B. 23. Rev. Rul. 2005–28 states that the IRS will not apply, and taxpayers may not rely upon, the conclusion reached in Rev. Rul. 76–96 that certain rebates made by a manufacturer to retail customers are ordinary and necessary business expenses deductible under section 162, pending the IRS's reconsideration of the issue and publication of subsequent guidance.

Explanation of Provisions

The manufacturer incentive payment transaction described in §1.1502–13(c)(7)(ii), *Example 13* relies, in part, upon the premise that the manufacturer incentive payment is an ordinary and necessary business expense deductible under section 162. To the extent that this premise is correct, this example illustrates the proper application of the intercompany transaction regulations. However, because Rev. Rul. 2005–28 suspends Rev. Rul. 76–96, in pertinent part, these final regulations remove §1.1502–13(c)(7)(ii), *Example 13*, pending further guidance on the section 162 issue considered in Rev. Rul. 76–96.

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. These final regulations do not alter substantive provisions of the intercompany transaction regulations. They merely remove an example which may be misleading and cause confusion for taxpayers. Accordingly, good cause is found for dispensing with prior notice and comment pursuant to 5 U.S.C 553(b), and for dispensing with a delayed effective date pursuant to 5 U.S.C 553(d). Because no notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f)

of the Internal Revenue Code, this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small business.

Drafting Information

The principal author of these regulations is Frances Kelly of the Office of the Associate Chief Counsel (Corporate). 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 1.1502–13 also issued under 26 U.S.C. 1502. * * *

Par. 2. In §1.1502–13, paragraph (c)(7)(ii), *Example 13* is removed and reserved.

Mark E Matthews,
Deputy Commissioner for Services and Enforcement.

Approved April 28, 2006.

Eric Solomon,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 5, 2006, 8:45 a.m., and published in the issue of the Federal Register for May 8, 2006, 71 F.R. 26687)

Part III. Administrative, Procedural, and Miscellaneous

Interim Guidance With Respect to the Application of Treas. Reg. §1.883–3

Notice 2006–43

SECTION I. PURPOSE

This notice announces that the Treasury Department (Treasury) and the Internal Revenue Service (IRS) will amend the regulations under section 883 of the Internal Revenue Code (Code) to provide guidance regarding the proper interpretation of §1.883–3(b) in light of the repeal of section 954(a)(4) and (f) (foreign base company shipping provisions) by section 415 of the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418 (2004) ("AJCA"). Until such regulations are issued, taxpayers may rely on the rules set forth in this notice.

SECTION 2. BACKGROUND

.01 Section 883(a) and (c)

Section 883(a)(1) and (a)(2) of the Code generally provide that income from the international operation of ships or aircraft derived by a corporation organized in a foreign country shall be excluded from gross income and exempt from U.S. taxation if the foreign country in which such corporation is organized grants an equivalent exemption to corporations organized in the United States. Section 883(c)(1) provides that the section 883(a)(1) and (2) exclusion will not apply if 50 percent or more of the value of the stock of the foreign corporation is owned by individuals who are not residents of a country that grants an equivalent exemption to U.S. corporations (the section 883(c)(1) limitation). Under section 883(c)(2), the section 883(c)(1) limitation does not apply to any foreign corporation that is a CFC. Under section 883(c)(3), the section 883(c)(1) limitation does not apply if the stock of the foreign corporation is primarily and regularly traded on an established securities market in the United States or in a foreign country that grants an equivalent exemption to U.S. corporations.

.02 Treasury Regulations under Section 883(a) and (c)

On August 26, 2003, Treasury and the IRS issued Treasury Decision 9087, 2003–2 C.B. 781. Treasury Decision 9087 included final regulations implementing section 883(a) and (c) and provided that the section 883(a)(1) and (2) exclusion is conditioned on the corporation satisfying certain stock ownership and related substantiation and reporting requirements.

Under § 1.883–3(a), a CFC satisfies the stock ownership requirement if it meets the "income inclusion test" of §1.883–3(b) and satisfies certain substantiation and reporting requirements. The income inclusion test requires that more than 50 percent of the CFC's adjusted net foreign base company income (as defined in § 1.954–1(d) and as increased or decreased by section 952(c)) derived from the international operation of ships or aircraft is includible in the gross income of one or more United States citizens, individual residents of the United States, or domestic corporations.

.03 AJCA Shipping Income Provisions

Section 415 of the AJCA eliminated foreign base company shipping income as a type of subpart F income, effective for taxable years of foreign corporations beginning after December 31, 2004, and taxable years of U.S. shareholders with or within which such taxable years of the foreign corporations end. The legislative history to section 415 of the AJCA indicates that Congress believed the elimination of foreign base company shipping income as a type of subpart F income would provide "U.S. shippers the opportunity to be competitive with their tax-advantaged foreign competitors." See H. Rep. No. 548, Part I, 108th Cong., 2nd Sess. 209 (2004).

Commentators requested guidance on the proper interpretation of §1.883–3(b) in light of the repeal of the foreign base company shipping provisions. Commentators also expressed concern that foreign corporations may no longer satisfy the income inclusion test if they no longer derive foreign base company shipping income from the international operation of their ships or aircraft as a result of the statutory amendments to sections 954(a)(4) and (f).

Section 423 of the AJCA delayed the applicability date of the final regulations under section 883(a) and (c) for one year, until taxable years beginning after September 24, 2004.

.04 T.D. 9218

On August 5, 2005, Treasury and the IRS issued T.D. 9218, 2005–37 I.R.B. 503, to conform the applicability date of the section 883(a) and (c) final regulations in light of section 423 of the AJCA. In the preamble to T.D. 9218, Treasury and the IRS also addressed the interpretation of the income inclusion test in light of the AJCA. The preamble stated that the better interpretation of §1.883–3(b) is that a CFC that satisfied the income inclusion test prior to the effective date of the AJCA may continue to satisfy it after the effective date of the legislation, provided the CFC can demonstrate that had section 954(a)(4) and (f) of the Code not been repealed, more than 50 percent of its current earnings and profits derived from its international operation of ships or aircraft would have been attributable to amounts includible in the gross income of one or more U.S. citizens, individual residents of the United States or domestic corporations (pursuant to section 951(a)(1)(A) or another provision of the Code) for the taxable years of such persons in which the taxable year of the CFC ends. The preamble to T.D. 9218 stated that Treasury and the IRS would issue regulations to clarify the application of the income inclusion test and invited comments on the most appropriate way to accomplish this clarification consistent with the principles of the existing section 883 regulations and the AJCA.

Treasury and the IRS received a number of comments in response to T.D. 9218. Generally, commentators suggested that the test proposed in the preamble to T.D. 9218 was too complex because it required CFCs to calculate hypothetical amounts of subpart F income as though sections 954(a)(4) and (f) had not been repealed. Commentators proposed several alternative approaches they viewed as simpler than the approach described in T.D. 9218, including replacing the income

inclusion test with a test that determines whether certain U.S. persons, who are not flow-through entities own, directly or indirectly, more than 50 percent of the value of the CFC for more than half of the days in the CFC's taxable year. Some commentators suggested that CFCs organized in a foreign country that provides a reciprocal exemption to U.S. corporations on their income from the international operation of their ships or aircraft should be eligible for the exclusion under section 883(a)(1) and (2) without further limitation.

SECTION 3. NEW RULE: QUALIFIED U.S. PERSON OWNERSHIP TEST

Treasury and the IRS have considered the comments received in response to T.D. 9218. Treasury and the IRS continue to believe that residents of countries that do not provide a reciprocal exemption to U.S. corporations on their income from the international operation of their ships or aircraft might attempt to use the CFC exception to circumvent the rules of section 883(c)(1) by owning more than 50 percent of the value of a foreign corporation through a U.S. fiscally transparent entity, such as a U.S. partnership. Treasury and the IRS continue to believe that this is contrary to the Congressional intent to ensure that the exclusion provided in section 883(a)(1) and (2) is provided only to foreign corporations that are owned by residents of foreign countries that provide a reciprocal exemption to U.S. corporations. See S. Rep. No. 313, 99th Cong., 2nd Sess. 340–41 (1986); see also Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986, at 927–928. In addition, Treasury and the IRS continue to believe this result is also contrary to the Conference report accompanying the legislation that added the CFC exception, which states that: "corporations are not considered residents of countries that exempt U.S. persons unless 50 percent or more of the ultimate individual owners are U.S. shareholders of controlled foreign corporations." H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. 598 (1986).

However, Treasury and the IRS agree that the income inclusion test, as it was interpreted in T.D. 9218, is overly complex and unnecessary. As a result, based on the comments received and Congressional intent to increase the competitiveness of U.S. shippers through the elimination of foreign base company shipping income as a type of subpart F income, Treasury and the IRS intend to amend §1.883–3 to replace the income inclusion test with a new ownership based test. Under the new test, a foreign corporation will satisfy the stock ownership test of §1.883–1(c)(2) if it meets a "qualified U.S. person ownership test" and satisfies the substantiation and reporting requirements of paragraphs (c) and (d), respectively, of § 1.883–3.

A foreign corporation shall satisfy the "qualified U.S. person ownership test" if, for more than half the days of the corporation's taxable year: (i) it is a CFC, and (ii) more than 50 percent of the total value of all the outstanding stock of the CFC is owned (within the meaning of section 958(a), as modified for purposes of applying this notice) by one or more "qualified U.S. persons."

A "qualified U.S. person" is a U.S. person (as defined in section 7701(a)(30)) that is a U.S. citizen, resident alien, or a domestic corporation. For purposes of applying the "qualified U.S. person ownership test," the value of the stock in the CFC that is owned (directly or indirectly) through bearer shares shall not be considered in the numerator or denominator of the ownership fraction. In addition, for purposes of applying this test, stock owned by a domestic partnership, domestic trust or domestic estate, shall be treated as owned by its partners, beneficiaries or owners, respectively, applying the rules of section 958(a) as if such domestic entity were a foreign partnership, foreign trust, or foreign estate, respectively.

SECTION 4. EFFECTIVE DATE

Regulations to be issued incorporating the guidance set forth in this notice will apply for taxable years beginning after the May 2, 2006. Taxpayers also may apply the provisions of this notice to taxable years beginning before May 2, 2006, but after December 31, 2004. Taxpayers applying this notice, however, must do so consistently for all taxable years for which this notice is applied and for which it is in effect.

SECTION 5. REQUEST FOR COMMENTS

Treasury and the IRS request further comments from interested persons on the rules announced in this notice. Written comments may be submitted to CC:INTL:Br1 (Notice 2006–43), room 4607, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:INTL:Br1 (Notice 2006–43) Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically via the following e-mail address: *Notice.Comments@irscounsel.treas.gov.* Please include "Notice 2006–43" in the subject line of any electronic communications.

DRAFTING INFORMATION

The principal author of this notice is Patricia A. Bray of the Office of Associate Chief Counsel (International). However, other personnel from Treasury and the IRS participated in its development. For further information regarding this notice, contact Patricia A. Bray at (202) 622–3880 (not a toll-free call).

Announcement of Rules Implementing American Jobs Creation Act of 2004 Section 415 Modifications to the Subpart F Treatment of Aircraft and Vessel Leasing Income

Notice 2006–48

SECTION 1. OVERVIEW

This notice provides guidance relating to amendments made by section 415 of the American Jobs Creation Act of 2004 (Public Law 108–357) (October 24, 2004) (AJCA), which affect the treatment of certain income and assets related to the leasing of aircraft or vessels in foreign commerce. The Treasury Department (Treasury) and the Internal Revenue Service

(IRS) intend to amend the regulations under sections 367(a), 954, and 956 of the Internal Revenue Code (Code) to address the amendments made by section 415 of the AJCA and this notice. Until regulations reflecting these changes are issued, taxpayers may rely upon this notice. This notice also solicits comments on whether any other changes to the regulations under sections 367, 954, and 956 are necessary to implement the purposes of section 415 of the AJCA.

SECTION 2. BACKGROUND

.01 In General

Section 415 of the AJCA repealed section 954(a)(4) and (f), the foreign base company shipping income provisions of subpart F. Following repeal of the foreign base company shipping income provisions, rents derived from leasing an aircraft or vessel may be included in subpart F income only if the rents are described in another category of subpart F income such as foreign personal holding company income as defined in section 954(c) (FPHCI). Rents are included in FPHCI under section 954(c)(1)(A). Section 954(c)(2)(A) excludes from FPHCI rents received from unrelated persons and derived in the active conduct of a trade or business.

Rents derived by a controlled foreign corporation (CFC) (*i.e.*, the lessor) are considered to be derived in the active conduct of a trade or business if the rents are derived under any one of four circumstances described in the Income Tax Regulations under section 954(c)(2)(A). One such relevant circumstance, provided in § 1.954–2(c)(1)(iv), is when rents are derived from leasing property that is leased as a result of the performance of marketing functions by the lessor. These rents are considered to be derived in the active conduct of a trade or business if the lessor, through its own officers or employees located in a foreign country, maintains and operates an organization in the foreign country that is regularly engaged in the business of marketing, or of marketing and servicing, the leased property and that is substantial in relation to the amount of rents derived from leasing the property. Section 1.954–2(c)(2)(ii) provides that the determination of whether the foreign organization is substantial in relation to the amount of rents derived is based on all the facts and circumstances. However, under § 1.954–2(c)(ii), the organization will be considered substantial in relation to the amount of rents if active leasing expenses equal or exceed 25 percent of the adjusted leasing profit, as those terms are defined under the regulations.

Section 415 of the AJCA amended section 954(c)(2)(A) to create a new safe harbor for rents derived from leasing an aircraft or vessel in foreign commerce. The amendment to section 954(c)(2)(A) provides that, for purposes of section 954(c)(2)(A):

> [R]ents derived from leasing an aircraft or vessel in foreign commerce shall not fail to be treated as derived in the active conduct of a trade or business if, as determined under regulations prescribed by the Secretary, the active leasing expenses are not less than 10 percent of the profit on the lease.

The legislative history of section 415 of the AJCA provides that the new safe harbor for rents derived from leasing an aircraft or vessel in foreign commerce "is to be applied in accordance with the existing regulations under section 954(c)(2)(A) by comparing the lessor's 'active leasing expenses' for its pool of leased assets to its 'adjusted leasing profit.'" H.R. Rep. No. 548, 108th Cong., 2d Sess. 210 (2004) (*hereinafter* 2004 House Report). The legislative history of section 415 of the AJCA[1] further indicates:

> [T]he requirements of section 954(c)(2)(A) will be met if a lessor regularly and directly performs active and substantial marketing, remarketing, management and operational functions with respect to the leasing of an aircraft or vessel (or component engines). This will be the case regardless of whether the lessor engages in marketing of the lease as a form of financing (versus marketing the property as such) or whether the lease is classified as a finance lease or operating lease for financial accounting purposes. If a lessor acquires, from an unrelated or related party, a ship or aircraft subject to an existing FSC or ETI lease, the requirements of section 954(c)(2)(A) will be satisfied if, following the acquisition, the lessor performs active and substantial management, operational, and remarketing functions with respect to the leased property.

Id.

An aircraft or vessel will qualify for the new safe harbor under section 954(c)(2)(A) only if it is leased in "foreign commerce." The legislative history provides that, for purposes of this safe harbor:

> An aircraft or vessel will be considered to be leased in foreign commerce if it is used for the transportation of property or passengers between a port (or airport) in the United States and one in a foreign country or between foreign ports (or airports), provided the aircraft or vessel is used predominantly outside the United States. An aircraft or vessel will be considered used predominantly outside the United States if more than 50 percent of the miles during the taxable year are traversed outside the United States or the aircraft or vessel is located outside the United States more than 50 percent of the time during such taxable year.

2004 House Report at 210. This definition of "foreign commerce" is similar to the definition of foreign commerce contained in § 1.954–6(b)(3), the regulations under the now repealed foreign base company shipping income provisions, except that this regulation does not include a predominant use standard.

The legislative history directs the Secretary of the Treasury to make conforming changes to current regulations "including guidance that aircraft or vessel leasing activity that satisfies the requirements of section 954(c)(2)(A) shall also satisfy the requirements for avoiding income inclusion under section 956 and section 367(a)." *Id.* This legislative history indicates that Congress anticipated that taxpayers might restructure their operations to take advantage

[1] While the legislative history indicates that the requirements of this provision may be met whether the lease is classified as a finance lease or an operating lease, under other provisions of the Code financing and operating leases are provided different treatment.

of the new benefits under subpart F provided by section 415 of the AJCA, namely the repeal of the foreign base company shipping income provisions and a liberalized safe harbor for excluding active leasing income from aircraft or vessels from foreign personal holding income.

.02 Section 956

Section 956(c)(1)(A) provides that the term "United States property" ("U.S. property") generally includes tangible property located in the United States. Section 956(c)(2) provides exceptions to the general definition of U.S. property. Section 956(c)(2)(D) excludes from the term U.S. property any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States.

Section 1.956–2(b)(1)(vi) provides that whether an aircraft, railroad rolling stock, vessel, motor vehicle, or container is used predominantly outside the United States depends on the facts and circumstances in each case. This regulation also provides that as a general rule, such transportation property will be considered used predominantly outside the United States if 70 percent or more of the miles traversed in the use of such property are traversed outside the United States or if such property is located outside the United States 70 percent of the time during such taxable year.

As noted above, the legislative history of section 415 of the AJCA provides, for purposes of the newly-created section 954(c)(2)(A) safe harbor, an aircraft or vessel will be considered used predominantly outside the United States if more than 50 percent of the miles during the taxable year are traversed outside the United States or the aircraft or vessel is used predominantly outside the United States more than 50 percent of the time during such taxable year. 2004 House Report at 210. In addition, the legislative history indicates that Congress intended to exclude aircraft or vessels from the definition of U.S. property under section 956 if the rents derived from leasing the aircraft or vessels are excluded from foreign personal holding company income under section 954(c)(2)(A). To implement congressional intent with regard to aircraft or vessels leased in foreign commerce, conforming changes must be made to the regulations under section 956.

.03 Section 367(a)

Section 367(a)(1) provides that if, in connection with any exchange described in section 332, 351, 354, 356, or 361, a United States person transfers property to a foreign corporation, the foreign corporation will not, for purposes of determining the extent to which gain will be recognized on such transfer, be considered to be a corporation. The effect of this general rule is that the transfer will not qualify for nonrecognition treatment, and thus, the transferor must recognize gain on the transferred assets. However, under section 367(a)(3)(A), except as provided in regulations, this general rule does not apply to any property transferred to a foreign corporation for use by the foreign corporation in the active conduct of a trade or business outside of the United States. Except as provided in regulations, however, section 367(a)(3)(A) does not apply to property with respect to which the transferor is a lessor at the time of the transfer (unless the transferee is the lessee). I.R.C § 367(a)(3)(B)(v).

Section 1.367(a)–2T(a) provides, in part, that section 367(a)(1) does not apply to property transferred to a foreign corporation if the property is transferred for use by that corporation in the active conduct of a trade or business outside of the United States and certain reporting requirements are met. Section 1.367(a)–2T(b)(3), in turn, provides that "[w]hether a trade or business that produces rents or royalties is actively conducted shall be determined under the principles of § 1.954–2(d)(1) (but without regard to whether the rents or royalties are received from an unrelated person)." Section 1.367(a)–2T(b)(4) provides generally that a foreign corporation conducts a trade or business outside of the United States if the primary managerial and operational activities of the trade or business are located outside of the United States and if immediately after the transfer the transferred assets are located outside of the United States.

Section 1.367(a)–5T(f) then provides that, regardless of use in an active trade or business, section 367(a)(1) applies to a transfer of tangible property with respect to which the transferor is a lessor at the time of the transfer unless: (1) the transferee was the lessee and the transferee will not lease to third persons, or (2) the transferee will lease to third persons and the transferee satisfies the conditions of § 1.367(a)–4T(c)(1) or (2).

Finally, § 1.367(a)–4T(c)(1) provides that if the transferred property will be leased by the transferee foreign corporation, the property generally is considered to be transferred for use in the active conduct of a trade or business outside of the United States only if all three of the following conditions are met: (i) the transferee's leasing constitutes the active conduct of a leasing business; (ii) the lessee does not use the property in the United States; and (iii) the transferee has need for substantial investment in assets of the type transferred.

Even if property qualifies for the active trade or business exception, when a U.S. person transfers U.S. depreciated property to a foreign corporation, that person must include as ordinary income in the year of the transfer the gain realized that would have been included as ordinary income under sections 617(d)(1), 1245(a), 1250(a), 1252(a), or 1254(a) if the taxpayer had sold the property at its fair market value on the date of the transfer. Treas. Reg. § 1.367(a)–4T(b)(1) ("section 367 recapture"). For this purpose, U.S. depreciated property includes property that has been used in the United States or has qualified as section 38 property by virtue of section 48(a)(2)(B). Treas. Reg. § 1.367(a)–4T(b)(2)(ii). Some transferors that qualify for the section 367 trade or business exception under the provisions of this notice may have used depreciated property in the United States prior to the transfer to the foreign corporation and therefore may be subject to section 367 recapture.

The section 367 recapture amount is reduced if the property has been used partly outside the United States. Treas. Reg. § 1.367(a)–4T(b)(3). In this circumstance, the amount of the section 367 depreciation recapture is determined by multiplying the full section 367 recapture amount by a fraction, the numerator of which is the U.S. use of the property and denominator of which is the total use of the property. U.S. use is the number of months that the property either was used within the United States or qualified as section 38 property

by virtue of section 48(a)(2)(B) and was subject to depreciation by the transferor or a related person. Total use is the total number of months that the property was used (or was available for use), and subject to depreciation, by the transferor or a related person. Property is not considered to be used outside the United States during any period in which the property was, for purposes of section 38 or 168, treated as property not used predominately outside the United States pursuant to the provisions of section 48(a)(2)(B).

Therefore, to apply the section 367 recapture provisions, transferors must determine the number of months that the property was used in the United States or qualified as section 38 property. Mobile assets such as airplanes and vessels may enter and leave the United States a number of times during a month, thus raising the issue of how to determine whether such an asset was used predominately outside the United States during that month. Rev. Rul. 71–178, 1971–1 C.B. 6, provides generally that each day an aircraft under foreign registry is physically located in the United States for more than 12 hours is considered a day within the United States for purposes of § 1.48–1(g). There is no guidance under either section 48 or section 367, however, that specifies how to determine whether the aircraft was used predominately outside the United States for a particular month.

SECTION 3. SECTION 954 GUIDANCE

Future guidance will amend the regulations under section 954 to address the determination of whether rents derived from leasing an aircraft or vessel in foreign commerce will be treated as derived in the active conduct of a trade or business under section 954(c)(2)(A), as amended by section 415 of the AJCA. Comments are requested on whether there are issues with regard to this determination that require clarification.

In addition, future guidance will clarify that an aircraft or vessel will be considered to be leased in foreign commerce, for purposes of section 954(c)(2)(A), only if the aircraft or vessel is used in foreign commerce, within the meaning of § 1.954–6(b)(3), and is used predominately outside the United States. For this purpose, an aircraft or vessel will be treated as used predominately outside the United States if it would be so treated under § 1.956–2(b)(1)(vi) with the phrase "more than 50 percent" substituted for the phrases "70 percent or more" or "70 percent."

SECTION 4. SECTION 956 GUIDANCE

Future guidance will provide that, for purposes of applying § 1.956–2(b)(1)(vi), an aircraft or vessel used in the transportation of persons or property in foreign commerce is excluded from U.S. property under § 1.956–2(b)(1)(vi) if rents derived from leasing such aircraft or vessel are excluded from foreign personal holding company income under section 954(c)(2)(A) and such property is considered to be used predominately outside the United States under § 1.956–2(b)(1)(vi), determined by substituting the phrase "more than 50 percent" for the phrases "70 percent or more" or "70 percent." For purposes of determining whether an aircraft or vessel is used in foreign commerce, the definition of "foreign commerce" contained in § 1.954–6(b)(3) shall continue to apply.

SECTION 5. SECTION 367(a) GUIDANCE

.01 Active Conduct of a Trade or Business that Produces Rents or Royalties

In light of section 415 of the AJCA and its legislative history, the regulations under section 367(a) will provide that the principles of section 954(c)(2)(A) (as amended by the AJCA), and the regulations thereunder (as they will be amended pursuant to section 3 of this notice), shall apply to determine whether a trade or business that produces rents or royalties is actively conducted under § 1.367(a)–2T(b)(3). Until those regulations under section 367(a) are issued, taxpayers relying upon this notice must state that they are applying the provisions of this notice to meet the requirement of § 1.6038B–1T(c)(4)(i) and (iv) to specify the reason the transfer qualifies for the active trade or business exception.

.02 Conduct of Trade or Business Outside of the United States

For purposes of applying § 1.367(a)–2T(b)(4) or a similar provision of future regulations, the regulations under section 367(a) will provide that generally the primary managerial and operational activities of the trade or business of leasing an aircraft or vessel must be conducted outside of the United States, and the aircraft or vessel must be used predominantly outside of the United States, as defined above in section 3. A lessee that uses an aircraft or vessel predominantly outside of the United States will satisfy the requirement in § 1.367(a)–4T(c)(1)(ii).

.03 Depreciation Recapture for Certain Section 367 Transfers

Treasury and the IRS are considering future guidance regarding how to determine whether an aircraft or vessel was used predominantly outside the United States for a particular month for purposes of calculating section 367 recapture. Until further guidance is issued, taxpayers are permitted to use any reasonable method to make this determination.

SECTION 6. EFFECTIVE DATE

The future regulations described in this notice will be effective beginning on or after May 2, 2006. Until those regulations are issued, taxpayers may rely upon the provisions of this notice as of May 2, 2006. In addition, taxpayers may elect to apply sections 3 and 4 of this notice retroactively to tax years of foreign corporations beginning after December 31, 2004, and for tax years of United States shareholders with or within which such tax years of foreign corporations end. Taxpayers may elect to apply section 5 of this notice retroactively to transfers of aircraft or vessels occurring on or after October 22, 2004. This election is made by providing the description of the transfer under § 1.6038B–1T(c) as specified in section 5.01 of this notice. No relief under § 301.9100–1 is necessary for this election. Taxpayers electing to apply sections 3 through 5 of this notice retroactively must do so consistently for all transactions.

SECTION 7. COMMENTS

Comments are requested on whether any other changes to the regulations under sections 367, 954, and 956 are necessary to implement the purposes of section 415 of the AJCA. Specifically, Treasury and

the IRS are considering clarifying how the depreciation recapture rules apply to aircraft and vessels that were used both in and outside the United States. Treasury and the IRS request comments on how the depreciation recapture rules under section 367(a) should apply to leased aircraft and vessels.

Written comments on the issues addressed in this notice may be submitted to the Office of Associate Chief Counsel International, Attention: Jason Kleinman (Notice 2006–48), room 4710, CC:INTL:B2, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, D.C., 20224. Alternatively, taxpayers may submit comments electronically to *Notice.comments@ml.irscounsel.treas.gov*. Comments will be available for public inspection and copying.

SECTION 8. DRAFTING INFORMATION

The principal authors of this notice are Jason Kleinman and Daniel McCall of the Office of Associate Chief Counsel (International). For comments or questions regarding sections 954 or 956, contact Mr. Kleinman at (202) 622–3840. For comments or questions regarding section 367, contact Mr. McCall at (202) 622–3860.

Note. This revenue procedure will be reproduced as the next revision of IRS Publication 4436, General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941).

Rev. Proc. 2006–25

TABLE OF CONTENTS

Section 1 – Purpose

.01 The purpose of this publication is to provide general rules and specifications from the Internal Revenue Service (IRS) for paper and computer-generated substitutes for the January 2006 revision of Form 941, Employer's QUARTERLY Federal Tax Return, and Schedule B (Form 941), Report of Tax Liability for Semiweekly Schedule Depositors.

Note. Substitute territorial forms (941-PR, 941-SS, and Anexo B (Forma 941-PR)) should also conform to the specifications outlined in this revenue procedure.

.02 This publication provides measurements and printing specifications for substitute Form 941 and Schedule B (Form 941). If you need more in-depth information on who must complete the forms and how to complete them, see the Instructions for Form 941 and Publication 15 (Circular E), Employer's Tax Guide, or visit the IRS website at *www.irs.gov.*

.03 Forms should not be submitted to the IRS for specific approval. If you are uncertain of any specification and want clarification, do the following.

(1) Submit a letter citing the specification.

(2) State your understanding of the specification.

(3) Enclose an example (if appropriate) of how the form would appear if produced using your understanding.

(4) Use the following address. Be sure to include your name, complete address, phone number, and, if applicable, your email address with your correspondence.

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:T:T:SP, IR-6406
1111 Constitution Avenue, NW
Washington, DC 20224

Note. Allow at least 30 days for the IRS to respond.

.04 However, software developers and form producers should send a blank copy of their substitute Form 941 and Schedule B (Form 941) in pdf format to *Victor.V.Martin@irs.gov*. The purpose is not specifically for approval but to assist the IRS in preparing to scan these forms. Submitters will only receive comments if a significant problem is discovered through this process. Submitters are not expected to delay marketing their forms in order to receive feedback. In no case should submitters include "live" taxpayer data.

Section 2 – What's New

.01 The 2006 revisions of Form 941 and Schedule B (Form 941) have six-digit Form ID codes instead of the four-digit codes used in 2005.

.02 The 2006 revision of Schedule B (Form 941) now includes a calendar year designation area near the top of the form.

.03 There are new 6x10 grid layouts for the 2006 revisions.

Section 3 – General Requirements for Reproducing IRS Official Form 941 and Schedule B (Form 941)

.01 Do not submit substitute Form 941 and Schedule B (Form 941) to the IRS for approval. Substitute Form 941 and Schedule B (Form 941) that **completely conform** to the specifications contained in this revenue procedure do not require prior approval from the IRS. Substitute forms filed with the IRS that do not conform may be returned.

.02 Print the form on paper that is 8.5 inches wide by 11 inches deep.

.03 Use white paper that meets generally-accepted weight, color, and quality standards (minimum 20 lb. white bond paper).

Note. Reclaimed fiber in any percentage is permitted provided that the requirements of this standard are met.

.04 The IRS prefers printing Form 941 on both sides of a single sheet of paper, but it is acceptable to print on one side of each of two separate sheets of paper.

.05 Make substitute paper forms as identical to the official IRS-printed forms as possible.

.06 Print using nonreflective black inks.

.07 Use typefaces that are substantially identical in size and shape to the official forms and use rules and shading that are substantially identical to those on the official forms.

.08 Print the six-digit form ID codes in the upper right-hand corner of each form using nonreflective black, carbon-based, 12-point (minimum 10-point required) OCR-A font. Use the official paper over-the-counter IRS forms to develop your substitute paper forms. Print "950106" on page 1 of Form 941, "950206" on page 2 of Form 941, and "950306" on Schedule B (Form 941) of substitute paper forms. See Section 4 for form ID codes for software-generated forms.

Note. Maintain as much white space as possible around the form ID code. Do not allow character strings to print adjacent to the code.

.09 Print the OMB number in the same location as on the official forms.

.10 Print all entry boxes and checkboxes exactly as shown on the official forms.

.11 Print your IRS-issued three-letter substitute form printer source code in the middle at the bottom of page 1 of Form 941.

Note. You can obtain a three-letter substitute form printer source code by requesting it by email at **taxforms@irs.gov*. (The asterisk must be included in the address.) Please enter "Substitute Forms" on the subject line.

.12 Print "For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher" at the bottom of page 1 of Form 941.

.13 Print "For Paperwork Reduction Act Notice, see separate instructions" at the bottom of Schedule B (Form 941).

.14 Do not print the form catalog number ("Cat. No.") at the bottom of the forms or instructions.

.15 Do not print the Government Printing Office (GPO) symbol at the bottom of the forms or instructions.

.16 See Exhibits A and B in Section 8.

Section 4 – Reproducing Form 941 and Schedule B (Form 941) for Software-Generated Paper Forms

.01 You may use the 6x10 grid exhibits (C and D) at the end of this document to develop a software version of Form 941 and Schedule B (Form 941). Please follow the specifications exactly to develop the fields.

.02 If you are developing software that is designed using the 6x10 grid in the exhibits, you may make the following modifications. See Exhibits C and D in Section 8.

- Use "970106" for page 1 of Form 941, "970206" for page 2 of Form 941, and "970306" for Schedule B (Form 941) as the form ID codes.

  Note. Maintain as much white space as possible around the form ID code. Do not allow character strings to print adjacent to the code.

- Place all boxes and entry spaces in the same field locations as indicated in the 6x10 grid exhibits.
- Use single lines for "Employer Identification Number" (EIN) and other entry areas in the entity section of page 1 of Form 941.
- You do not need to use reverse type as shown on the IRS official form.
- You do not need to pre-print decimal points in the data boxes. However, all amounts should be printed with decimal points and place holders for cents.
- Use a single box for "state abbreviation" in line 14 of Form 941.
- Delete the pre-printed formatting in the "date" box for line 16 and in Parts 5 and 6 of Form 941.
- Delete the pre-printed formatting in the "Phone" box for Parts 4, 5, and 6.
- Use a single box for "Personal Identification Number (PIN)" in Part 4 of Form 941.
- You may delete all shading when using the 6x10 grid format.

.03 If producing both the form and the data or the form only, print your three-letter IRS-issued form printer source code in Row 63, Columns 49-51 on page 1 of Form 941. See Section 3.11.

.04 If producing only the data on the form, print your four-digit software industry form code in Row 4, Columns 58-61 on page 1 of Form 941. See the National Association of Computerized Tax Processors (NACTP) website at *www.nactp.org* for information on these codes.

.05 Print "For Privacy Act and Paperwork Reduction Act Notice, see the Payment Voucher" at the bottom of page 1 of Form 941.

.06 Print "For Paperwork Reduction Act Notice, see separate instructions" at the bottom of Schedule B (Form 941).

.07 Do not print the form catalog number ("Cat. No.") at the bottom of the forms or instructions.

.08 Do not print the Government Printing Office (GPO) symbol at the bottom of the forms or instructions.

.09 To enable accurate scanning and processing, enter data on Form 941 and Schedule B (Form 941) as follows:

- Show name and EIN on all pages and attachments.
- Use 12-point (minimum 10-point) Courier font (if possible).
- Omit dollar signs, but use commas to show amounts.
- Except for lines 1, 2, and 10, leave blank any data field with a value of zero.
- Enter negative amounts with a minus sign.

  Note. The IRS prefers that you use a minus sign for negative amounts instead of parentheses or some other means. The IRS will update the Instructions for Form 941 in 2007 to specify this preference.

Section 5 – OMB Requirements for Substitute Forms

.01 The Paperwork Reduction Act (the Act) of 1995 (Public Law 104-13) requires the following.

- The Office of Management and Budget (OMB) approves all IRS tax forms that are subject to the Act.
- Each IRS form contains the OMB approval number, if assigned. (The official OMB numbers may be found on the official IRS forms and are also shown on the forms in the exhibits.)

- Each IRS form (or its instructions) states:

  (1) Why the IRS needs the information,

  (2) How it will be used, and

  (3) Whether or not the information is required to be furnished to the IRS.

.02 This information must be provided to any users of official or substitute IRS forms or instructions.

.03 The OMB requirements for substitute IRS forms are the following.

- Any substitute form or substitute statement to a recipient must show the OMB number as it appears on the official IRS form.
- For Form 941 and Schedule B (Form 941), the OMB number (1545-0029) must appear exactly as shown on the official IRS form.
- For Form 941 and Schedule B (Form 941), the OMB number must use one of the following formats.

  (1) OMB No. 1545-0029 (preferred) or

  (2) OMB # 1545-0029 (acceptable).

.04 If no instructions are provided to users on your forms, you must furnish to them the exact text of the Privacy Act and Paperwork Reduction Act Notice.

Section 6 – Reproducible Copies of Forms

.01 You can order official IRS forms and information copies of federal tax materials at local IRS offices or by calling the IRS National Distribution Center at 1-800-829-3676. Other ways to get federal tax material include the following.

- The IRS website at *www.irs.gov*.
- The IRS' CD-ROM (Publication 1796).

.02 The IRS also offers an alternative to downloading electronic files and provides current and prior year access to tax forms and instructions through its Federal Tax Forms CD-ROM. Order Publication 1796, IRS Federal Tax Products CD-ROM, by using the IRS website at *www.irs.gov/cdorders* or by calling 1-877-CDFORMS (1-877-233-6767).

Section 7 – Effect on Other Documents

.01 Revenue Procedure 2005-21, 2005-1 C.B. 899 (reproduced as Publication 4436, Rev. 4-2005) is superseded.

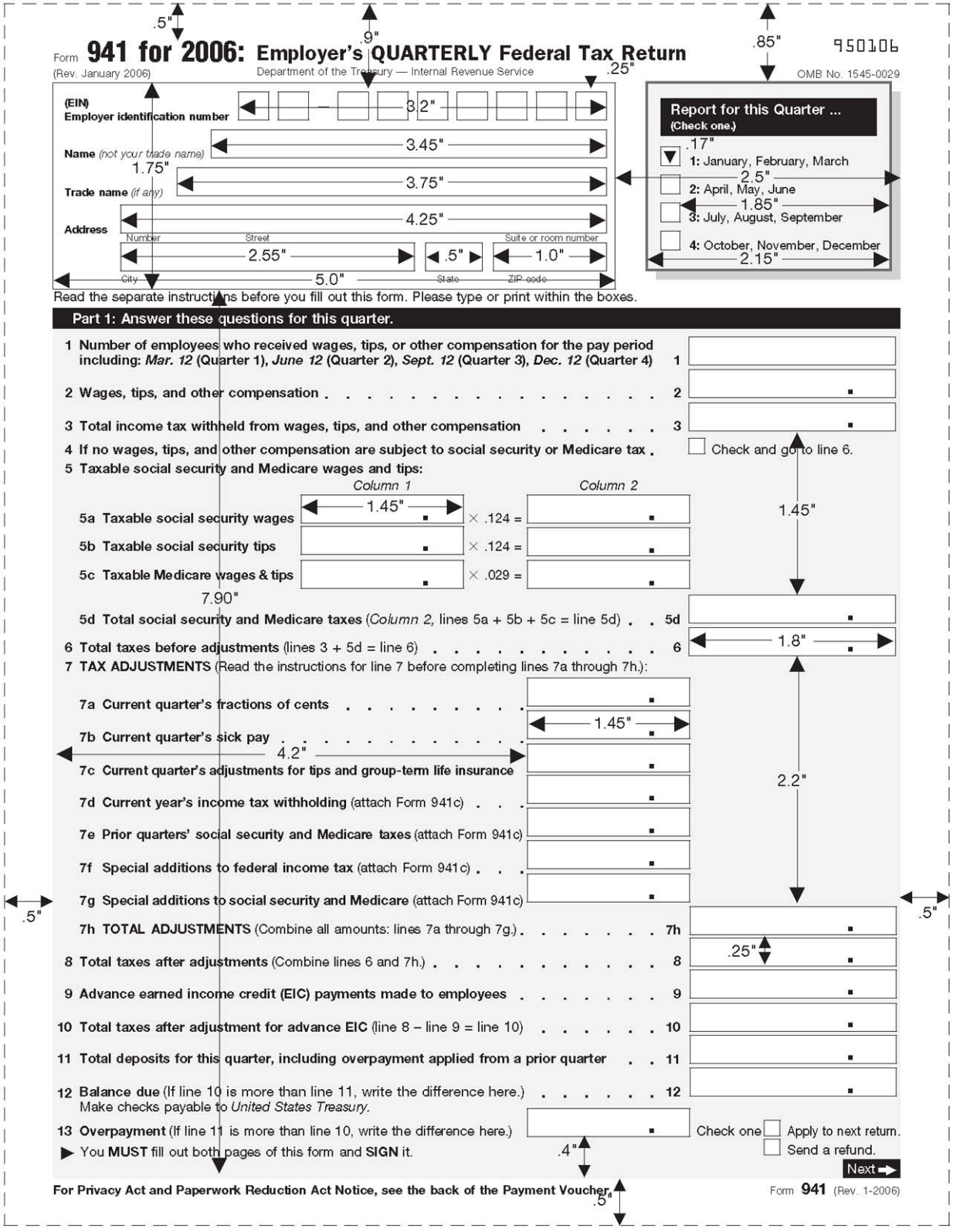
Section 8 – Exhibits

.01 Please follow the specifications indicated in the following exhibits to produce substitute Form 941 and Schedule B (Form 941).

.02 These forms are subject to review and possible change as required. Therefore, employers are cautioned against overstocking supplies of privately-printed substitutes.

.03 Do not submit substitute Form 941 and Schedule B (Form 941) to the IRS for approval. Substitute Form 941 and Schedule B (Form 941) that **completely conform** to the specifications contained in this revenue procedure may be privately printed without prior approval from the IRS. Substitute forms filed with the IRS that do not conform may be returned. See Section 3 of this publication.

Exhibit A, Form 941 (Official Version)



Form **941 for 2006: Employer's QUARTERLY Federal Tax Return**
(Rev. January 2006) Department of the Treasury — Internal Revenue Service
950106
OMB No. 1545-0029

(EIN) Employer identification number

Name *(not your trade name)*

Trade name *(if any)*

Address
Number Street Suite or room number

City State ZIP code

Report for this Quarter ... (Check one.)
1: January, February, March
2: April, May, June
3: July, August, September
4: October, November, December

Read the separate instructions before you fill out this form. Please type or print within the boxes.

Part 1: Answer these questions for this quarter.

1 Number of employees who received wages, tips, or other compensation for the pay period including: *Mar. 12* (Quarter 1), *June 12* (Quarter 2), *Sept. 12* (Quarter 3), *Dec. 12* (Quarter 4) 1

2 Wages, tips, and other compensation 2

3 Total income tax withheld from wages, tips, and other compensation 3

4 If no wages, tips, and other compensation are subject to social security or Medicare tax . ☐ Check and go to line 6.

5 Taxable social security and Medicare wages and tips:

	Column 1		Column 2
5a Taxable social security wages		× .124 =	
5b Taxable social security tips		× .124 =	
5c Taxable Medicare wages & tips		× .029 =	

5d Total social security and Medicare taxes (*Column 2*, lines 5a + 5b + 5c = line 5d) . . 5d

6 Total taxes before adjustments (lines 3 + 5d = line 6) 6

7 TAX ADJUSTMENTS (Read the instructions for line 7 before completing lines 7a through 7h.):

7a Current quarter's fractions of cents . . . . . .

7b Current quarter's sick pay . . . . . .

7c Current quarter's adjustments for tips and group-term life insurance

7d Current year's income tax withholding (attach Form 941c) . . .

7e Prior quarters' social security and Medicare taxes (attach Form 941c)

7f Special additions to federal income tax (attach Form 941c) . . .

7g Special additions to social security and Medicare (attach Form 941c)

7h TOTAL ADJUSTMENTS (Combine all amounts: lines 7a through 7g.) 7h

8 Total taxes after adjustments (Combine lines 6 and 7h.) 8

9 Advance earned income credit (EIC) payments made to employees 9

10 Total taxes after adjustment for advance EIC (line 8 – line 9 = line 10) 10

11 Total deposits for this quarter, including overpayment applied from a prior quarter . . 11

12 Balance due (If line 10 is more than line 11, write the difference here.) 12
Make checks payable to *United States Treasury.*

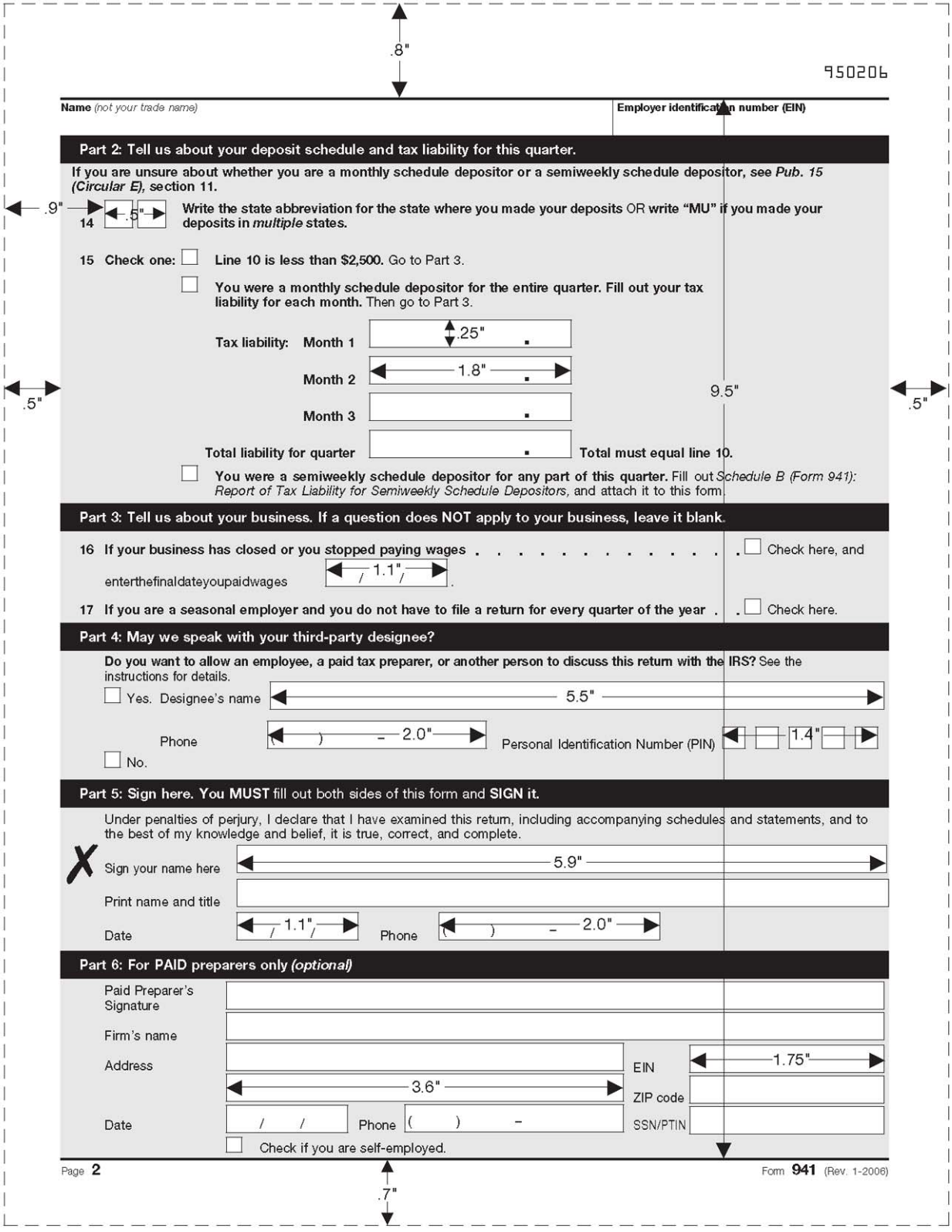
13 Overpayment (If line 11 is more than line 10, write the difference here.) Check one ☐ Apply to next return. ☐ Send a refund.

▶ You **MUST** fill out both pages of this form and **SIGN** it.

Next ➡

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Form **941** (Rev. 1-2006)

Exhibit A, Form 941 (Official Version) (continued)



950206

Name *(not your trade name)* | **Employer identification number (EIN)**

Part 2: Tell us about your deposit schedule and tax liability for this quarter.

If you are unsure about whether you are a monthly schedule depositor or a semiweekly schedule depositor, see *Pub. 15 (Circular E),* section 11.

14 Write the state abbreviation for the state where you made your deposits OR write "MU" if you made your deposits in *multiple* states.

15 Check one:

☐ Line 10 is less than $2,500. Go to Part 3.

☐ You were a monthly schedule depositor for the entire quarter. Fill out your tax liability for each month. Then go to Part 3.

Tax liability: Month 1 .

Month 2 .

Month 3 .

Total liability for quarter . Total must equal line 10.

☐ You were a semiweekly schedule depositor for any part of this quarter. Fill out *Schedule B (Form 941): Report of Tax Liability for Semiweekly Schedule Depositors,* and attach it to this form.

Part 3: Tell us about your business. If a question does NOT apply to your business, leave it blank.

16 If your business has closed or you stopped paying wages . . . . . ☐ Check here, and enter the final date you paid wages / /.

17 If you are a seasonal employer and you do not have to file a return for every quarter of the year . . ☐ Check here.

Part 4: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? See the instructions for details.

☐ Yes. Designee's name

Phone ( ) - Personal Identification Number (PIN)

☐ No.

Part 5: Sign here. You MUST fill out both sides of this form and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

X Sign your name here

Print name and title

Date / / Phone ( ) -

Part 6: For PAID preparers only *(optional)*

Paid Preparer's Signature

Firm's name

Address EIN

ZIP code

Date / / Phone ( ) - SSN/PTIN

☐ Check if you are self-employed.

Exhibit B, Schedule B (Form 941) (Official Version)

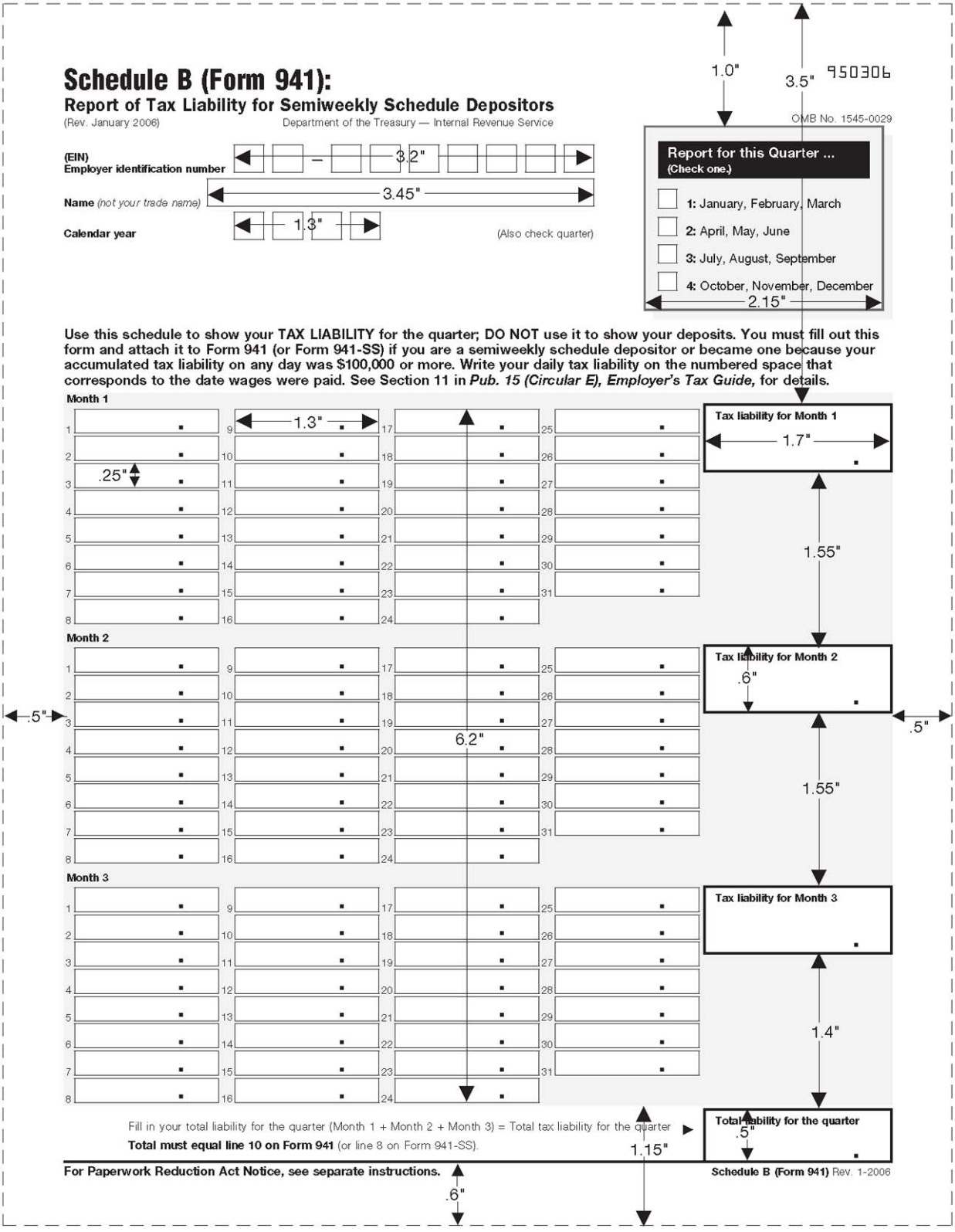
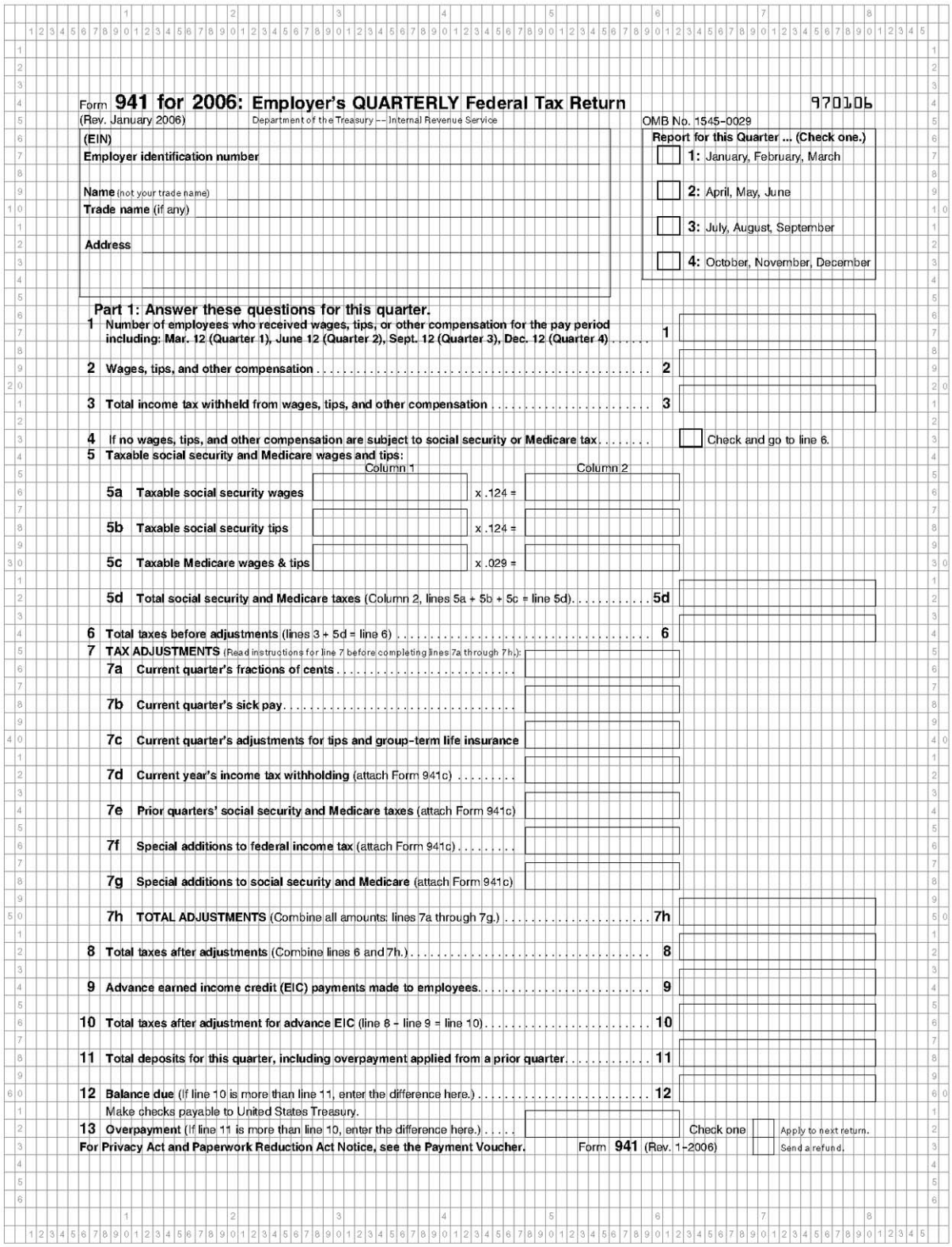


Exhibit C, Form 941 (6 x 10 Grid Version)



Form **941 for 2006: Employer's QUARTERLY Federal Tax Return** 970106

(Rev. January 2006) Department of the Treasury — Internal Revenue Service OMB No. 1545-0029

(EIN)
Employer identification number

Name (not your trade name)
Trade name (if any)

Address

Report for this Quarter ... (Check one.)
- 1: January, February, March
- 2: April, May, June
- 3: July, August, September
- 4: October, November, December

Part 1: Answer these questions for this quarter.

1 Number of employees who received wages, tips, or other compensation for the pay period including: Mar. 12 (Quarter 1), June 12 (Quarter 2), Sept. 12 (Quarter 3), Dec. 12 (Quarter 4) 1

2 Wages, tips, and other compensation 2

3 Total income tax withheld from wages, tips, and other compensation 3

4 If no wages, tips, and other compensation are subject to social security or Medicare tax . . . . . Check and go to line 6.

5 Taxable social security and Medicare wages and tips:

		Column 1		Column 2
5a	Taxable social security wages		x .124 =	
5b	Taxable social security tips		x .124 =	
5c	Taxable Medicare wages & tips		x .029 =	
5d	Total social security and Medicare taxes (Column 2, lines 5a + 5b + 5c = line 5d) 5d			

6 Total taxes before adjustments (lines 3 + 5d = line 6) 6

7 TAX ADJUSTMENTS (Read instructions for line 7 before completing lines 7a through 7h.):

7a	Current quarter's fractions of cents	
7b	Current quarter's sick pay	
7c	Current quarter's adjustments for tips and group-term life insurance	
7d	Current year's income tax withholding (attach Form 941c)	
7e	Prior quarters' social security and Medicare taxes (attach Form 941c)	
7f	Special additions to federal income tax (attach Form 941c)	
7g	Special additions to social security and Medicare (attach Form 941c)	
7h	TOTAL ADJUSTMENTS (Combine all amounts: lines 7a through 7g.) 7h	

8 Total taxes after adjustments (Combine lines 6 and 7h.) 8

9 Advance earned income credit (EIC) payments made to employees 9

10 Total taxes after adjustment for advance EIC (line 8 - line 9 = line 10) 10

11 Total deposits for this quarter, including overpayment applied from a prior quarter 11

12 Balance due (If line 10 is more than line 11, enter the difference here.) 12

Make checks payable to United States Treasury.

13 Overpayment (If line 11 is more than line 10, enter the difference here.) . . . . . Check one: Apply to next return. Send a refund.

For Privacy Act and Paperwork Reduction Act Notice, see the Payment Voucher. Form 941 (Rev. 1-2006)

Exhibit C, Form 941 (6 x 10 Grid Version) (continued)

970206

Form **941** (Rev. 1-2006) Page **2**

Name (not your trade name) | **Employer identification number (EIN)**

Part 2: Tell us about your deposit schedule and tax liability for this quarter.

If you are unsure about whether you are a monthly schedule depositor or a semiweekly schedule depositor, see Pub. 15 (Circular E), section 11.

14 ☐ **Enter the state abbreviation for the state where you made your deposits OR enter "MU" if you made your deposits in multiple states.**

15 **Check one:** ☐ **Line 10 is less than $2,500.** Go to Part 3.

☐ **You were a monthly schedule depositor for the entire quarter. Fill out your tax liability for each month.** Then go to Part 3.

Tax liability: **Month 1**

Month 2

Month 3

Total liability for quarter **Total must equal line 10.**

☐ **You were a semiweekly schedule depositor for any part of this quarter.** Fill out Schedule B (Form 941): Report of Tax Liability for Semiweekly Schedule Depositors, and attach it to this form.

Part 3: Tell us about your business. If a question does NOT apply to your business, leave it blank.

16 **If your business has closed or you stopped paying wages** . . . . . ☐ Check here, and

enter the final date you paid wages .

17 **If you are a seasonal employer and you do not have to file a return for every quarter of the year** . . . . . ☐ Check here.

Part 4: May we speak with your third–party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? See instructions for details.

☐ Yes. Designee's name

Phone Personal Identification Number (PIN)

☐ No.

Part 5: Sign here. You MUST fill out both sides of this form and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Sign your name here

Print name and title

Date Phone

Part 6: For PAID preparers only (optional)

Paid Preparer's Signature

Firm's name

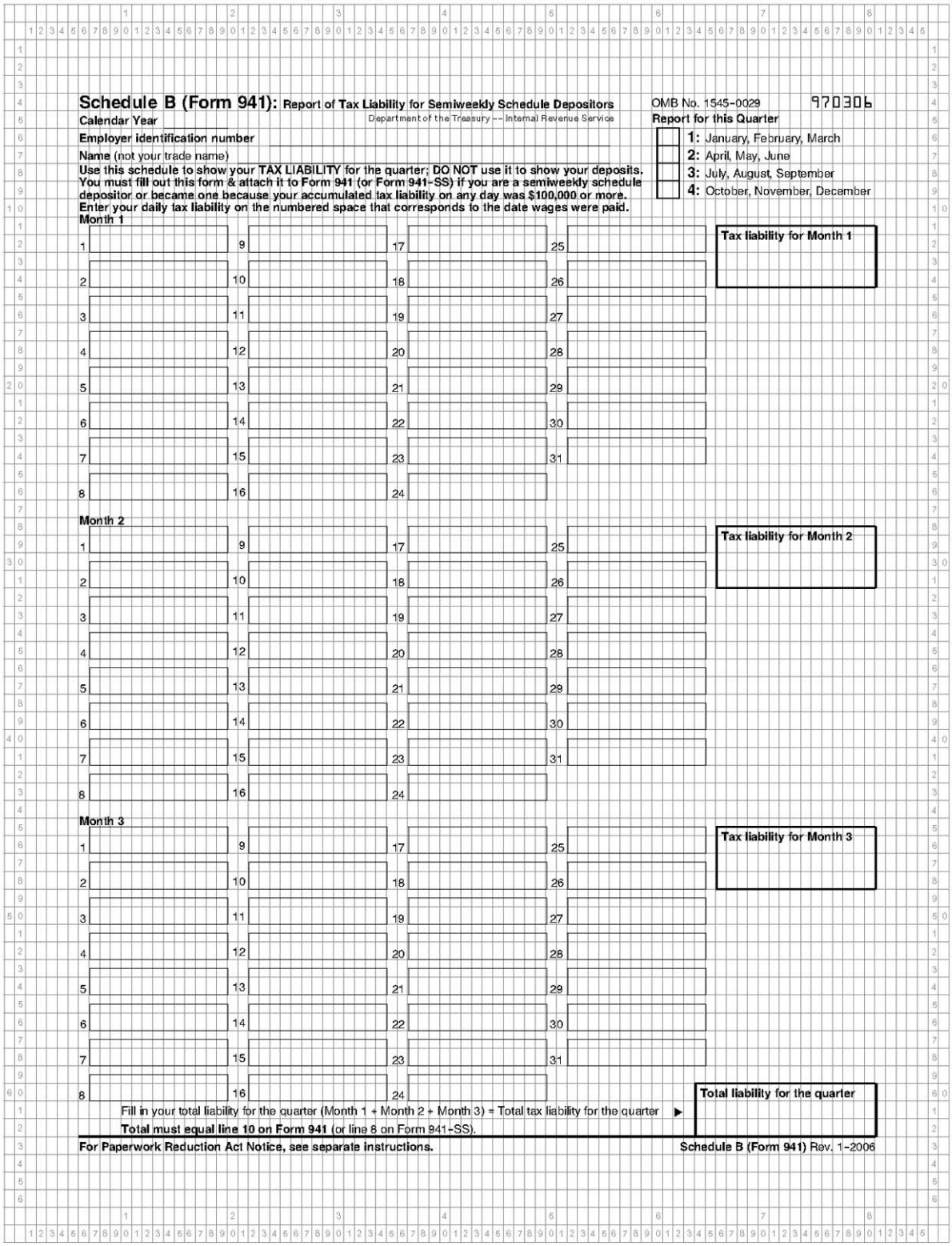
Address EIN

ZIP code

Date Phone SSN/PTIN

☐ Check if you are self-employed.

Exhibit D, Schedule B (Form 941) (6 x 10 Grid Version)



Schedule B (Form 941): Report of Tax Liability for Semiweekly Schedule Depositors
Department of the Treasury -- Internal Revenue Service
OMB No. 1545-0029 970306

Calendar Year

Employer identification number

Name (not your trade name)

Use this schedule to show your TAX LIABILITY for the quarter; DO NOT use it to show your deposits. You must fill out this form & attach it to Form 941 (or Form 941-SS) if you are a semiweekly schedule depositor or became one because your accumulated tax liability on any day was $100,000 or more. Enter your daily tax liability on the numbered space that corresponds to the date wages were paid.

Report for this Quarter

- ☐ **1:** January, February, March
- ☐ **2:** April, May, June
- ☐ **3:** July, August, September
- ☐ **4:** October, November, December

Month 1

1		9		17		25	
2		10		18		26	
3		11		19		27	
4		12		20		28	
5		13		21		29	
6		14		22		30	
7		15		23		31	
8		16		24			

Tax liability for Month 1

Month 2

1		9		17		25	
2		10		18		26	
3		11		19		27	
4		12		20		28	
5		13		21		29	
6		14		22		30	
7		15		23		31	
8		16		24			

Tax liability for Month 2

Month 3

1		9		17		25	
2		10		18		26	
3		11		19		27	
4		12		20		28	
5		13		21		29	
6		14		22		30	
7		15		23		31	
8		16		24			

Tax liability for Month 3

Total liability for the quarter

Fill in your total liability for the quarter (Month 1 + Month 2 + Month 3) = Total tax liability for the quarter ▶

Total must equal line 10 on Form 941 (or line 8 on Form 941-SS).

For Paperwork Reduction Act Notice, see separate instructions. **Schedule B (Form 941)** Rev. 1-2006

26 CFR 601.201: Rulings and determination letters. (Also: Part l, Section 7528.)

Rev. Proc. 2006–26

SECTION 1. PURPOSE

The purpose of this revenue procedure is to announce the introduction of user fees for requests submitted to the U.S. competent authority for discretionary determinations under limitation on benefits provisions of U.S. income tax treaties. This revenue procedure modifies section 14 (Fees) of Rev. Proc. 2002–52, 2002–2 C.B. 242, and will be effective for such requests submitted on or after May 4, 2006.

SECTION 2. BACKGROUND

Almost all U.S. income tax treaties contain a limitation on benefits article. A resident of a Contracting State must satisfy one of the enumerated tests set forth in that article to be entitled to U.S. treaty benefits with respect to an item of income, profit or gain. The U.S. competent authority will not make a determination on whether or not a resident of a Contracting State meets the conditions of one of these enumerated tests. However, if a resident of a Contracting State does not meet one of the tests, most limitation on benefits articles authorize the U.S. competent authority to make a discretionary determination that the resident be entitled to some or all of the benefits of the income tax treaty. Rev. Proc. 2002–52, Procedures for Obtaining Competent Authority Assistance, currently sets forth rules for requesting a discretionary determination under a limitation on benefits provision of an income tax treaty. Section 3.08 of Rev. Proc. 2002–52.

Section 14 of Rev. Proc. 2002–52 currently provides that user fees are not required as a condition to requesting competent authority assistance, including requests for a discretionary determination pursuant to section 3.08. The Internal Revenue Service has recently determined that user fees are appropriate for this limited type of request for competent authority assistance. The rules for these user fees are set forth below and will be incorporated into the next update of Rev. Proc. 2002–52.

SECTION 3. PROCEDURES

.01 Fees

Effective May 4, 2006, a user fee of $15,000 will be charged for each entity requesting a discretionary limitation on benefits determination. The fee will apply regardless of whether the request is for: (1) an initial determination; (2) a renewal of a previously issued determination; or (3) a supplemental determination required, for example, if there is a material change in fact, or the applicant seeks benefits with respect to a different type of income, or requests a lower rate of withholding tax on dividends. If a request is submitted that requires the competent authority to make a discretionary determination for more than one entity, a separate fee will be charged for each entity.

.02 Acceptance of Request

A user fee will not be charged until the U.S. competent authority has formally accepted the request for consideration. Requests should continue to be submitted to the Director, International (LMSB), and include the information required in section 3.08 of Rev. Proc. 2002–52. Within 30 days of receipt of a complete submission, the U.S. competent authority will provide written notice to the applicant as to whether the request will be accepted or rejected for consideration. If a request is accepted, the applicant will be required to mail a check or money order in the appropriate amount, along with a copy of the written notice of acceptance to the IRS office identified below. The check or money order should be payable to the United States Treasury. Substantive consideration of a request for a discretionary determination will not begin until the applicant has submitted the appropriate user fee.

The mailing address for the user fee is:

IRS/BFC
P.O. Box 9002
Beckley, WV 25802

.03 Refunds of user fees

In general, a user fee will not be refunded once the competent authority accepts a request for consideration and the user fee is paid. For example, the Service will not refund the user fee if the request for a discretionary determination is withdrawn by the applicant, or if the applicant fails to submit additional information as requested by the Competent Authority.

A user fee may be refunded, however, if:

(a) A higher user fee is paid than is required; or

(b) Taking into account all the facts and circumstances, including the Service's resources devoted to the request, the Competent Authority declines to rule and, in his or her sole discretion, decides a refund is appropriate.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Section 14 of Rev. Proc. 2002–52, 2002–2 C.B. 242, is modified accordingly.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective May 4, 2006.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Quyen P. Huynh of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Quyen P. Huynh at (202) 622–3880 (not a toll-free call).

Part IV. Items of General Interest

Withdrawal of Proposed Regulations Regarding Intercompany Transactions; Manufacturer Incentive Payments

Announcement 2006–34

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking.

SUMMARY: This document withdraws a notice of proposed rulemaking (REG–131264–04, 2004–38 I.R.B. 506) regarding the treatment of manufacturer incentive payments. The proposed regulations were published in the **Federal Register** on August 13, 2004 (69 FR 50112). After consideration of additional issues, the IRS and Treasury Department have decided to withdraw the proposed regulations.

DATES: These proposed regulations are withdrawn on May 8, 2006.

FOR FURTHER INFORMATION CONTACT: Frances Kelly, (202) 622–7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 13, 2004, the IRS and Treasury Department published a notice of proposed rulemaking (REG–131264–04) in the **Federal Register** (69 FR 50112) proposing regulations to address additional transactions involving manufacturer incentive payments and to clarify the proper treatment of such incentive payments under the intercompany transaction regulations.

On April 25, 2005, the IRS and Treasury Department published Rev. Rul. 2005–28, 2005–19 I.R.B. 997, which suspends, in part, Rev. Rul. 76–96, 1976–1 C.B. 23. Rev. Rul. 2005–28 states that the IRS will not apply, and taxpayers may not rely upon, the conclusion reached in Rev. Rul. 76–96 that certain rebates made by a manufacturer to retail customers are ordinary and necessary business expenses deductible under section 162, pending the IRS's reconsideration of the issue and publication of subsequent guidance.

The example in paragraph (c) of the proposed regulations relies, in part, upon the premise that the manufacturer incentive payment is an ordinary and necessary business expense deductible under section 162. To the extent that this premise is correct, paragraph (d) of the proposed regulations illustrates the proper application of the intercompany transaction regulations. However, because Rev. Rul. 2005–28 suspends Rev. Rul. 76–96, in pertinent part, these paragraphs of the proposed regulations are withdrawn pending further guidance on the section 162 issue considered in Rev. Rul. 76–96.

The example in paragraph (e) of the proposed regulations illustrates the application of the original issue discount rules to the facts described in paragraph (e) and, based on these facts, concludes that the transaction is not an intercompany transaction. This conclusion is not dependent upon the issue being reconsidered in Rev. Rul. 76–96. Nevertheless, because the example in paragraph (e), standing alone, does not provide guidance with respect to the application of the intercompany transaction regulations to an intercompany transaction, paragraph (e) of the proposed regulations is also withdrawn.

* * * * *

Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG–131264–04) that was published in the **Federal Register** on August 13, 2004 (69 FR 50112) is withdrawn.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on May 5, 2006, 8:45 a.m., and published in the issue of the Federal Register for May 8, 2006, 71 F.R. 26721)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2005–27 through 2005–52 is in Internal Revenue Bulletin 2005–52, dated December 27, 2005.

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