

## **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. 2006-59, page 992.**

**LIFO; price indexes; department stores.** The September 2006 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 2006.

**T.D. 9293, page 957.**

**REG-127819-06, page 1013.**

Final, temporary, and proposed regulations under section 199 of the Code concern the amendments made by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) to section 199, which provides a deduction for income attributable to domestic production activities. A public hearing on the proposed regulations is scheduled for February 5, 2007.

**REG-110405-05, page 1004.**

Proposed regulations provide guidance regarding the application of section 362(e)(2) of the Code to determine the bases of assets and stock transferred in certain nonrecognition transactions. They also provide instructions on how to make an election to apply section 362(e)(2)(C).

**Rev. Proc. 2006-52, page 995.**

This procedure informs plan proponents in cases under chapter 12 of Title 11 of the United States Code of the procedures to be followed to request determinations of the income tax effects of proposed plans when such requests are authorized by the bankruptcy courts.

**Rev. Proc. 2006-53, page 996.**

**Cost-of-living adjustments for 2007.** This procedure sets forth the cost-of-living adjustments to certain items for 2007 as required under various provisions of the Code. Rev. Proc. 2002-41 modified.

### **EMPLOYEE PLANS**

**Rev. Rul. 2006-60, page 977.**

**2007 covered compensation tables; permitted disparity.**

The covered compensation tables under section 401 of the Code for the year 2007 are provided for use in determining contributions to defined benefit plans and permitted disparity.

**T.D. 9294, page 980.**

Final regulations under section 401 of the Code set forth standards for electronic systems that make use of an electronic medium to provide a notice to a recipient, or to make a participant election or consent, with respect to a retirement plan, an employee benefit plan, or an individual retirement plan.

**Notice 2006-104, page 995.**

**Weighted average interest rate update; corporate bond indices; 30-year Treasury securities.**

The weighted average interest rate for November 2006 and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution are set forth.

(Continued on the next page)

Announcements of Disbarments and Suspensions begin on page 1017.

Finding Lists begin on page ii.

Index for July through November begins on page vi.



## EXEMPT ORGANIZATIONS

### **Announcement 2006–92, page 1014.**

A list is provided of organizations now classified as private foundations.

### **Announcement 2006–93, page 1017.**

This document explains the procedures that 501(c)(3) tax-exempt organizations may use to request a change in their public charity classification.

## ESTATE TAX

### **Rev. Proc. 2006–53, page 996.**

**Cost-of-living adjustments for 2007.** This procedure sets forth the cost-of-living adjustments to certain items for 2007 as required under various provisions of the Code. Rev. Proc. 2002–41 modified.

## GIFT TAX

### **Rev. Proc. 2006–53, page 996.**

**Cost-of-living adjustments for 2007.** This procedure sets forth the cost-of-living adjustments to certain items for 2007 as required under various provisions of the Code. Rev. Proc. 2002–41 modified.

## EXCISE TAX

### **Rev. Proc. 2006–53, page 996.**

**Cost-of-living adjustments for 2007.** This procedure sets forth the cost-of-living adjustments to certain items for 2007 as required under various provisions of the Code. Rev. Proc. 2002–41 modified.

## ADMINISTRATIVE

### **Rev. Proc. 2006–52, page 995.**

This procedure informs plan proponents in cases under chapter 12 of Title 11 of the United States Code of the procedures to be followed to request determinations of the income tax effects of proposed plans when such requests are authorized by the bankruptcy courts.

### **Rev. Proc. 2006–53, page 996.**

**Cost-of-living adjustments for 2007.** This procedure sets forth the cost-of-living adjustments to certain items for 2007 as required under various provisions of the Code. Rev. Proc. 2002–41 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.

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

## Section 1.—Tax Imposed

The Service provides inflation adjustments to the tax rate tables for individuals, trusts, and estates for taxable years beginning in 2007. In addition, the amounts of certain reductions allowed against the unearned income of minor children in computing the “kiddie tax” are adjusted. Also adjusted are the amounts used to determine whether a parent may elect to report the “kiddie tax” on the parent’s return. See Rev. Proc. 2006-53, page 996.

## Section 23.—Adoption Expenses

The Service provides inflation adjustments to the adoption credit allowed for the adoption of a child for taxable years beginning in 2007. The Service also provides inflation adjustments to the value used in calculating the modified adjusted gross income limitations used to determine the amount of adoption credit that is allowed in taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 24.—Child Tax Credit

The Service provides inflation adjustments for the value used in determining the amount of the credit that may be refundable beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 25A.—Hope and Lifetime Learning Credits

The Service provides inflation adjustments for the amount of qualified tuition and related expenses that are taken into account in determining the amount of the Hope Scholarship Credit for taxable years beginning in 2007, and for the amount of a taxpayer’s modified adjusted gross income that is taken into account in determining the reduction in the amount of the Hope Scholarship and Lifetime Learning Credits otherwise available. See Rev. Proc. 2006-53, page 996.

## Section 25B.—Elective Deferrals and IRA Contributions by Certain Individuals

The Service provides inflation adjustments to the adjusted gross income amounts used to determine the applicable percentage for calculating the qualified retirement savings contributions credit that may be allowed for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 32.—Earned Income

The Service provides inflation adjustments to the limitations on the earned income credit for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 42.—Low-Income Housing Credit

The Service provides inflation adjustments to the amounts used to calculate the State housing credit ceiling used in determining the low-income housing credit for calendar year 2007. See Rev. Proc. 2006-53, page 996.

## Section 59.—Other Definitions and Special Rules

The Service provides an inflation adjustment to the exemption amount used in computing the alternative minimum tax for a minor child subject to the “kiddie tax” for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 62.—Adjusted Gross Income Defined

The Service provides inflation adjustments to the amounts an eligible employer may pay in 2007 to certain welders and heavy equipment mechanics for rig-related expenses that are deemed substantiated under an accountable plan if paid in accordance with Rev. Proc. 2002-41, 2002-1 C.B. 1098. Rev. Proc. 2002-41 modified. See Rev. Proc. 2006-53, page 996.

## Section 63.—Taxable Income Defined

The Service provides inflation adjustments to the standard deduction amounts (including the limitation in the case of certain dependents, and the additional standard deduction for the aged or blind) for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 68.—Overall Limitation on Itemized Deductions

The Service provides inflation adjustments to the overall limitation on itemized deductions for taxable

years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 132.—Certain Fringe Benefits

The Service provides inflation adjustments to the limitations on the exclusion of income for a qualified transportation fringe benefit for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 135.—Income From United States Savings Bonds Used to Pay Higher Education Tuition and Fees

The Service provides inflation adjustments to the limitation on the exclusion of income from United States savings bonds for taxpayers who pay qualified higher education expenses for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 137.—Adoption Assistance Programs

The Service provides inflation adjustments to the maximum amount that can be excluded from an employee’s gross income in connection with a qualified adoption assistance program for taxable years beginning in 2007. The Service also provides inflation adjustments to the amount used to calculate the modified adjusted gross income limitations used to determine the amount that can be excluded from an employee’s gross income for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 146.—Volume Cap

The Service provides inflation adjustments to the amounts used to determine the State ceiling for the volume cap of private activity bonds for calendar year 2007. See Rev. Proc. 2006-53, page 996.

## Section 148.—Arbitrage

26 CFR 1.148-5: Yield and valuation of investments.

The Service provides inflation adjustments for determining in the calendar year 2007 whether a broker’s commission or similar fee with respect to the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is reasonable. See Rev. Proc. 2006-53, page 996.

## Section 151.—Allowance of Deductions for Personal Exemptions

The Service provides inflation adjustments to the personal exemption and to the threshold amounts of adjusted gross income above which the exemption amount phases out for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

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

The Service provides inflation adjustments to the “insubstantial benefit” guidelines for calendar year 2007. Under the guidelines, a charitable contribution is fully deductible even though the contributor receives “insubstantial benefits” from the charity. See Rev. Proc. 2006-53, page 996.

## Section 179.—Election to Expense Certain Depreciable Business Assets

The Service provides inflation adjustments to the aggregate cost of section 179 property that a taxpayer may elect to treat as an expense for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 199.—Income Attributable to Domestic Production Activities

26 CFR 1.199-7: Expanded affiliated groups.

### T.D. 9293

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

#### TIPRA Amendments to Section 199

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations concerning the amendments made by the Tax Increase Prevention and Reconciliation Act of 2005 to section 199 of the Internal Revenue Code. The temporary regulations also contain a rule concerning the

use of losses incurred by members of an expanded affiliated group. Section 199 provides a deduction for income attributable to domestic production activities. The regulations will affect taxpayers engaged in certain domestic production activities. The text of the temporary regulations also serves as the text of the proposed regulations (REG-127819-06) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

**DATES: Effective Date:** These regulations are effective October 19, 2006.

**Applicability Date:** For dates of applicability, see §1.199-8T(i)(5) and (6).

**FOR FURTHER INFORMATION CONTACT:** Concerning §§1.199-2T(e)(2) and 1.199-8T(i)(5), Paul Handleman or Lauren Ross Taylor, (202) 622-3040; concerning §§1.199-3T(i)(7) and (8), and 1.199-5T, Martin Schaffer, (202) 622-3080; and concerning §§1.199-7T(b)(4) and 1.199-8T(i)(6), Ken Cohen, (202) 622-7790 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document provides rules relating to the deduction for income attributable to domestic production activities under section 199 of the Internal Revenue Code (Code). Section 199 was added to the Code by section 102 of the American Jobs Creation Act of 2004 (Public Law 108-357, 118 Stat. 1418), and amended by section 403(a) of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 25) and section 514 of the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109-222, 120 Stat. 345) (TIPRA). On June 1, 2006, the IRS and Treasury Department published final regulations under section 199 (T.D. 9263, 2006-25 I.R.B. 1063 [71 FR 31268]). The preamble to the final regulations states that the IRS and Treasury Department plan on issuing regulations on the amendments made to section 199 by section 514 of TIPRA.

##### General Overview

Section 199(a)(1) allows a deduction equal to 9 percent (3 percent in the case of

taxable years beginning in 2005 or 2006, and 6 percent in the case of taxable years beginning in 2007, 2008, or 2009) of the lesser of (A) the qualified production activities income (QPAI) of the taxpayer for the taxable year, or (B) taxable income (determined without regard to section 199) for the taxable year (or, in the case of an individual, adjusted gross income (AGI)).

Section 199(b)(1) limits the deduction for a taxable year to 50 percent of the W-2 wages paid by the taxpayer during the calendar year that ends in such taxable year. For this purpose, section 199(b)(2)(A) defines the term *W-2 wages* to mean, with respect to any person for any taxable year of such person, the sum of the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Section 514(a) of TIPRA added new section 199(b)(2)(B), which provides that the term *W-2 wages* does not include any amount which is not properly allocable to domestic production gross receipts (DPGR) for purposes of section 199(c)(1). Section 199(b)(2)(C) provides that the term *W-2 wages* does not include any amount that is not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for the return. Section 199(b)(3) provides that the Secretary shall prescribe rules for the application of section 199(b) in the case of an acquisition or disposition of a major portion of either a trade or business or a separate unit of a trade or business during the taxable year.

##### Pass-thru Entities

Section 199(d)(1)(A) provides that, in the case of a partnership or S corporation, (i) section 199 shall be applied at the partner or shareholder level, (ii) each partner or shareholder shall take into account such person's allocable share of each item described in section 199(c)(1)(A) or (B) (determined without regard to whether the items described in section 199(c)(1)(A) exceed the items described in section 199(c)(1)(B)), and (iii), as amended by section 514(b) of TIPRA, each partner or shareholder shall be treated for purposes of section 199(b) as having W-2 wages for the taxable year in an amount equal to

such person's allocable share of the W-2 wages of the partnership or S corporation for the taxable year (as determined under regulations prescribed by the Secretary).

Section 199(d)(1)(B) provides that, in the case of a trust or estate, (i) the items referred to in section 199(d)(1)(A)(ii) (as determined therein) and the W-2 wages of the trust or estate for the taxable year shall be apportioned between the beneficiaries and the fiduciary (and among the beneficiaries) under regulations prescribed by the Secretary, and (ii) for purposes of section 199(d)(2), AGI of the trust or estate shall be determined as provided in section 67(e) with the adjustments described in such section.

Section 199(d)(1)(C) provides that the Secretary may prescribe rules requiring or restricting the allocation of items and wages under section 199(d)(1) and may prescribe such reporting requirements as the Secretary determines appropriate.

#### *Expanded Affiliated Groups*

Section 199(d)(4)(A) provides that all members of an expanded affiliated group (EAG) are treated as a single corporation for purposes of section 199. Section 199(d)(4)(B) provides that an EAG is an affiliated group as defined in section 1504(a), determined by substituting "more than 50 percent" for "at least 80 percent" each place it appears and without regard to section 1504(b)(2) and (4).

#### *Authority to Prescribe Regulations*

Section 199(d)(8) authorizes the Secretary to prescribe such regulations as are necessary to carry out the purposes of section 199, including regulations that prevent more than one taxpayer from being allowed a deduction under section 199 with respect to any activity described in section 199(c)(4)(A)(i).

#### **Explanation of Provisions**

##### *W-2 Wages Properly Allocable to Domestic Production Gross Receipts*

Section 514(a) of TIPRA amended section 199(b)(2) to provide that the term *W-2 wages* does not include any amount that is not properly allocable to DPGR for purposes of section 199(c)(1). The Secretary

is authorized to provide rules for the proper allocation of items (including wages) in determining QPAI. See section 199(d)(8). The temporary regulations provide that for taxable years beginning after May 17, 2006, the term *W-2 wages* includes only amounts described in §1.199-2(e)(1) (paragraph (e)(1) wages) that are properly allocable to DPGR. The temporary regulations provide that a taxpayer may determine the amount of paragraph (e)(1) wages that is properly allocable to DPGR using any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances.

The temporary regulations provide safe harbors for determining the amount of paragraph (e)(1) wages that is properly allocable to DPGR. Under the wage expense safe harbor for taxpayers using either the section 861 method of cost allocation under §1.199-4(d) or the simplified deduction method under §1.199-4(e), a taxpayer may determine the amount of paragraph (e)(1) wages that is properly allocable to DPGR by multiplying the amount of paragraph (e)(1) wages by the ratio of the taxpayer's wage expense included in calculating QPAI for the taxable year to the taxpayer's total wage expense used in calculating the taxpayer's taxable income (or AGI, if applicable) for the taxable year. For purposes of determining the amount of wage expense in cost of goods sold (CGS) under this safe harbor, a taxpayer may determine its wage expense included in CGS using any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances. For example, a reasonable method would include a taxpayer using direct labor included in CGS as wage expense included in CGS. Additionally, a reasonable method would include a taxpayer using the section 263A labor costs used by the taxpayer in its simplified service cost method with labor-based allocation ratio under §1.263-1(h)(4)(ii) as wage expense included in CGS. Because CGS frequently includes goods manufactured in prior years, and thus would frequently include paragraph (e)(1) wages from prior years attributable to DPGR, the amount of paragraph (e)(1) wages in CGS that is properly allocable to DPGR may be difficult to determine. The IRS and Treasury Department request comments on appropriate safe harbors for determining

the amount of paragraph (e)(1) wages in CGS that are properly allocable to DPGR.

A taxpayer that uses the small business simplified overall method of cost allocation under §1.199-4(f) may use the small business simplified overall method safe harbor for determining the amount of paragraph (e)(1) wages that is properly allocable to DPGR. Under that safe harbor, the amount of paragraph (e)(1) wages that is properly allocable to DPGR is equal to the same proportion of paragraph (e)(1) wages that the amount of DPGR bears to the taxpayer's total gross receipts.

As a consequence of the amendment to section 199(b)(2) made by TIPRA and its interplay with the rules in §1.199-7(a) and (b) for the computation of an EAG's section 199 deduction, the section 199 deduction for the members of an EAG may be reduced if one member of an EAG uses employees of another member of the EAG to perform activities attributable to DPGR and does not have paragraph (e)(1) wages. In general, §1.199-7(a) and (b) provides that each member of an EAG calculates its own taxable income or loss, QPAI, and W-2 wages, which are then aggregated in determining the EAG's section 199 deduction. Therefore, prior to the amendment to section 199(b)(2), in determining the wage limitation under section 199(b)(1) (the W-2 wage limitation), it was irrelevant which member of an EAG had the paragraph (e)(1) wages, because there was no requirement that paragraph (e)(1) wages be properly allocable to DPGR to qualify as W-2 wages, and the W-2 wages of all the members of an EAG are aggregated.

For example, assume that X and Y are members of an EAG and do not join in the filing of a consolidated Federal income tax return. X has paragraph (e)(1) wages incurred in connection with Y's DPGR activities, but X has no DPGR itself. Further assume that Y has no paragraph (e)(1) wages. Prior to the amendment to section 199(b)(2), notwithstanding that X has no DPGR, X would have W-2 wages, because there was no requirement that paragraph (e)(1) wages be properly allocable to DPGR. Thus, the EAG would have W-2 wages, the same as if Y, rather than X, had the paragraph (e)(1) wages. Assuming the EAG had QPAI and taxable income, the EAG would receive a section 199 deduction.

After the amendment to section 199(b)(2), to qualify as W-2 wages within the meaning of §1.199-2T(e)(2), paragraph (e)(1) wages must be properly allocable to DPGR to qualify as W-2 wages. Because each member of an EAG separately calculates its own items before they are aggregated by the EAG, the member having the paragraph (e)(1) wages must itself have DPGR to which the wages are properly allocable in order to qualify those wages as W-2 wages. Paragraph (e)(1) wages that are not properly allocable to DPGR of the member having the paragraph (e)(1) wages do not qualify as W-2 wages, even if the paragraph (e)(1) wages were paid in connection with another member's DPGR activities. Thus, after the amendment to section 199(b)(2), X's paragraph (e)(1) wages do not qualify as W-2 wages, because X has no DPGR to which the paragraph (e)(1) wages would be properly allocable. Accordingly, as neither X nor Y has W-2 wages, the EAG has no W-2 wages and no section 199 deduction. If Y had the paragraph (e)(1) wages rather than X, the EAG would have W-2 wages and a section 199 deduction.

However, if X and Y join in the filing of a consolidated Federal income tax return, the results may differ. Section 1.1502-13(c)(1)(i) and (c)(4) requires that the separate entity attributes of X's and Y's intercompany items or corresponding items be redetermined to the extent necessary to produce the effect as if X and Y were divisions of a single corporation. Thus, §1.1502-13(c)(1)(i) and (c)(4) may apply to treat the paragraph (e)(1) wages incurred by X as W-2 wages. The temporary regulations provide examples to demonstrate the described scenarios.

#### *Pass-thru Entities*

Section 514(b) of TIPRA amended section 199(d)(1)(A)(iii) regarding a partner's or shareholder's share of W-2 wages from a partnership or S corporation for taxable years beginning after May 17, 2006. After TIPRA, the section 199(d)(1)(A)(iii) wage limitation for pass-thru entities no longer includes the second prong of a two-prong standard, by which a partner's or shareholder's share of W-2 wages from the partnership or S corporation was limited to the lesser of that person's allocable share of W-2 wages from the entity or a speci-

fied percentage of the person's QPAI, computed by taking into account only the items of the entity allocated to that person for the taxable year of the entity.

Section 1.199-5T(b)(3) and (c)(3) provides guidance regarding a partner's or shareholder's share of W-2 wages of a partnership or an S corporation after the effective date of TIPRA. Except as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b)), the partnership or S corporation must allocate its paragraph (e)(1) wages (including any such wages from a lower-tier partnership of which the partnership or S corporation is a partner) among its partners or shareholders in the same manner that wage expense is allocated among those partners or shareholders. The partner or shareholder must add its share of the paragraph (e)(1) wages from the partnership or S corporation to the partner's or shareholder's paragraph (e)(1) wages from other sources, if any. The partner (other than a partner that itself is a partnership or S corporation) or shareholder then must calculate its W-2 wages (as defined in §1.199-2T(e)(2)) by determining the amount of its paragraph (e)(1) wages properly allocable to DPGR. See §1.199-2T(e)(2) for the computation of W-2 wages.

Section 1.199-5T(e) requires a non-grantor trust or estate to calculate each beneficiary's share (as well as the trust's or estate's share, if any) of QPAI and W-2 wages from the trust or estate at the trust or estate level. The QPAI of a trust or estate and W-2 wages of the trust or estate are allocated to each beneficiary and to the trust or estate based on the relative proportion of the trust's or estate's distributable net income (DNI), as defined by section 643(a), for the taxable year that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate.

Because the second prong of the wage limitation of section 199(d)(1)(A)(iii) was prospectively repealed by TIPRA, there is no longer any need for a special rule for tiered structures (where a pass-thru entity owns an interest in another pass-thru entity). Accordingly, the rule in §1.199-9(g) of the final regulations regarding the section 199(d)(1)(A)(iii) wage limitation and tiered structures has not been included in these temporary regulations.

The temporary regulations provide a transition rule for the situation in which a partner (or shareholder) and a partnership (or S corporation) have different taxable years, only one of which begins on or before the effective date of TIPRA. Under §1.199-5T(b)(4) and (c)(4), the beginning date of the taxable year of the partnership (or S corporation) determines which definition of W-2 wages and which W-2 wage limitation for pass-thru entities apply.

#### *Expanded Affiliated Groups*

After issuance of the final regulations, it was brought to the attention of the IRS and Treasury Department that the combination of the aggregation rules for determining the taxable income of an EAG in §1.199-7(b)(1) and the rules of section 172 for net operating loss (NOL) deductions can result in the same loss being used twice in determining the taxable income limitation under section 199(a)(1)(B). That is, in determining the taxable income limitation under section 199(a)(1)(B), a loss sustained by a member of an EAG could be used in the year the loss is sustained to offset the taxable income of another member of the EAG in determining the EAG's taxable income limitation. However, because the EAG is not a separate taxpaying entity that files its own tax return, the member that sustained the loss would still have an NOL carryover or carryback. Thus, the loss could be used again as an NOL deduction of the member that sustained the loss in a previous or subsequent year to offset its own income, either as a member of the same EAG, a different EAG, or on a stand-alone basis. Because the section 199 deduction is a percentage of the lesser of QPAI or taxable income (subject to the W-2 wage limitation), the use of the same loss twice could potentially reduce the section 199 deduction that should be allowable.

For example, assume that corporations X and Y are the only two members of an EAG and that X and Y do not file a consolidated Federal income tax return. In 2010, X and Y each have \$100 of QPAI which, under §1.199-7(b), are aggregated in determining the EAG's QPAI. X has \$100 of taxable income and Y has a \$100 NOL, which are also aggregated in determining the EAG's taxable income for purposes of the taxable income limitation of section



199(a)(1)(B). Further assume that the EAG has sufficient W-2 wages so that the section 199 deduction is not limited under section 199(b)(1). Thus, although in 2010 the EAG has \$200 of QPAI and sufficient W-2 wages so that the section 199 deduction is not limited under section 199(b)(1), as a result of the use of Y's NOL, the EAG has \$0 of taxable income and no section 199 deduction. However, because the EAG is not a separate taxpaying entity, Y has an NOL of \$100 which is available for carryover or carryback. In 2011, X has \$100 of taxable income and Y, before the deduction allowed under section 172, has \$300 of taxable income. Under section 172, Y reduces its 2011 taxable income of \$300 by its 2010 NOL of \$100, thus reducing Y's taxable income to \$200. Y's loss was effectively used twice, first in 2010 to reduce the EAG's taxable income for purposes of the taxable income limitation of section 199(a)(1)(B) and then in 2011 to reduce Y's own taxable income, which reduces the EAG's aggregate taxable income for purposes of the taxable income limitation.

This result was not intended. Accordingly, §1.199-7T(b)(4) has been added to provide that, to the extent that an NOL was used in the year it was sustained in determining any EAG's taxable income for purposes of the taxable income limitation of section 199(a)(1)(B), such NOL is not treated as an NOL carryover or NOL carryback to any taxable year in determining the taxable income limitation under section 199(a)(1)(B). Thus, in the previous example, solely for purposes of determining the EAG's 2011 taxable income limitation under section 199(a)(1)(B), Y would not have an NOL carryover from 2010, because the entire \$100 NOL was used in 2010 to reduce the EAG's taxable income. Therefore, for purposes of determining the EAG's taxable income limitation in 2011, Y would have taxable income of \$300 and the EAG would have aggregate taxable income of \$400. The temporary regulations provide examples to illustrate this provision.

#### Effective Date

Section 199 applies to taxable years beginning after December 31, 2004. These temporary regulations are applicable for taxable years beginning on or after Oc-

tober 19, 2006. A taxpayer may apply §§1.199-2T(e)(2), 1.199-3T(i)(7) and (8), and 1.199-5T to taxable years beginning after May 17, 2006, and before October 19, 2006 regardless of whether the taxpayer otherwise relied upon Notice 2005-14, 2005-1 C.B. 498 (see §601.601(d)(2)), the provisions of REG-105847-05, 2005-47 I.R.B. 987 (see §601.601(d)(2)), or §§1.199-1 through 1.199-8. A taxpayer may apply §1.199-7T(b)(4) to taxable years beginning after December 31, 2004, and before October 19, 2006 regardless of whether the taxpayer otherwise relied upon Notice 2005-14, the provisions of REG-105847-05, or §§1.199-1 through 1.199-9. The applicability of these temporary regulations expires on October 16, 2009.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), refer to the cross-reference notice of proposed rule-making published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### Drafting Information

The principal authors of these regulations are Paul Handleman and Lauren Ross Taylor, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. 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 entries in numerical order to read in part as follows:

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

Par. 2. Section 1.199-0 is amended by adding the following entries for §§1.199-7(b)(4) and 1.199-8(i)(5) and (6):

§1.199-0 *Table of contents.*

\* \* \* \* \*

§1.199-7 *Expanded affiliated groups.*

\* \* \* \* \*

(b) \* \* \*

(4) Losses used to reduce taxable income of expanded affiliated group. [Reserved].

\* \* \* \* \*

§1.199-8 *Other rules.*

\* \* \* \* \*

(i) \* \* \*

(5) Tax Increase Prevention and Reconciliation Act of 2005. [Reserved].

(6) Losses used to reduce taxable income of expanded affiliated group. [Reserved].

\* \* \* \* \*

Par. 3. Section 1.199-2 is amended by adding a sentence at the end of paragraph (e)(2) to read as follows:

§1.199-2 *Wage limitation.*

\* \* \* \* \*

(e) \* \* \*

(2) *Limitation on W-2 wages for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.* \* \* \* For further guidance, see §1.199-2T(e)(2).

\* \* \* \* \*

Par. 4. Section 1.199-2T is added to read as follows:

§1.199-2T *Wage limitation (temporary).*

(a) through (d) [Reserved]. For further guidance, see §1.199-2(a) through (d).

(e) *Definition of W-2 wages—(1) In general.* [Reserved]. For further guidance, see §1.199-2(e)(1).

(2) *Limitation on W-2 wages for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005—(i) In general.* The term *W-2 wages* includes only amounts described in §1.199-2(e)(1) (paragraph (e)(1) wages) that are properly allocable to domestic production gross receipts (DPGR) (as defined in §1.199-3) for purposes of section 199(c)(1). A taxpayer may determine the amount of paragraph (e)(1) wages that is properly allocable to DPGR using any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances.

(ii) *Wage expense safe harbor—(A) In general.* A taxpayer using either the section 861 method of cost allocation under §1.199-4(d) or the simplified deduction method under §1.199-4(e) may determine the amount of paragraph (e)(1) wages that is properly allocable to DPGR for a taxable year by multiplying the amount of paragraph (e)(1) wages for the taxable year by the ratio of the taxpayer's wage expense included in calculating qualified production activities income (QPAI) (as defined in §1.199-1(c)) for the taxable year to the taxpayer's total wage expense used in calculating the taxpayer's taxable income (or adjusted gross income, if applicable) for the taxable year, without regard to any wage expense disallowed by section 465, 469, 704(d), or 1366(d). A taxpayer that uses the section 861 method of cost allocation under §1.199-4(d) or the simplified deduction method under §1.199-4(e)

to determine QPAI must use the same expense allocation and apportionment methods that it uses to determine QPAI to allocate and apportion wage expense for purposes of this safe harbor. For purposes of this paragraph (e)(2)(ii), the term *wage expense* means wages (that is, compensation paid by the employer in the active conduct of a trade or business to its employees) that are properly taken into account under the taxpayer's method of accounting.

(B) *Wage expense included in cost of goods sold.* For purposes of paragraph (e)(2)(ii)(A) of this section, a taxpayer may determine its wage expense included in cost of goods sold (CGS) using any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances, such as using the amount of direct labor included in CGS or using section 263A labor costs (as defined in §1.263A-1(h)(4)(ii)) included in CGS.

(iii) *Small business simplified overall method safe harbor.* A taxpayer that uses the small business simplified overall method under §1.199-4(f) may use the small business simplified overall method safe harbor for determining the amount of paragraph (e)(1) wages that is properly allocable to DPGR. Under this safe harbor, the amount of paragraph (e)(1) wages that is properly allocable to DPGR is equal to the same proportion of paragraph (e)(1) wages that the amount of DPGR bears to the taxpayer's total gross receipts.

(iv) *Examples.* The following examples illustrate the application of this paragraph (e)(2). See §1.199-5T for an example of

the application of paragraph (e)(2)(ii) of this section to a trust or estate.

*Example 1. Section 861 method and no EAG.* (i) *Facts.* X, a United States corporation that is not a member of an expanded affiliated group (EAG) (as defined in §1.199-7) or an affiliated group as defined in the regulations under section 861, engages in activities that generate both DPGR and non-DPGR. X's taxable year ends on April 30, 2011. For X's taxable year ending April 30, 2011, X has \$3,000 of paragraph (e)(1) wages reported on 2010 Forms W-2. All of X's production activities that generate DPGR are within Standard Industrial Classification (SIC) Industry Group AAA (SIC AAA). All of X's production activities that generate non-DPGR are within SIC Industry Group BBB (SIC BBB). X is able to specifically identify CGS allocable to DPGR and to non-DPGR. X incurs \$900 of research and experimentation expenses (R&E) that are deductible under section 174, \$300 of which are performed with respect to SIC AAA and \$600 of which are performed with respect to SIC BBB. None of the R&E is legally mandated R&E as described in §1.861-17(a)(4) and none of the R&E is included in CGS. X incurs section 162 selling expenses that are not includible in CGS and are definitely related to all of X's gross income. For X's taxable year ending April 30, 2011, the adjusted basis of X's assets is \$50,000, \$40,000 of which generate gross income attributable to DPGR and \$10,000 of which generate gross income attributable to non-DPGR. For X's taxable year ending April 30, 2011, the total square footage of X's headquarters is 8,000 square feet, of which 2,000 square feet is set aside for domestic production activities. For its taxable year ending April 30, 2011, X's taxable income is \$1,380 based on the following Federal income tax items:

DPGR (all from sales of products within SIC AAA) . . . . .	\$3,000
Non-DPGR (all from sales of products within SIC BBB) . . . . .	3,000
CGS allocable to DPGR (includes \$200 of wage expense) . . . . .	(600)
CGS allocable to non-DPGR (includes \$600 of wage expense) . . . . .	(1,800)
Section 162 selling expenses (includes \$600 of wage expense) . . . . .	(840)
Section 174 R&E-SIC AAA (includes \$100 of wage expense) . . . . .	(300)
Section 174 R&E-SIC BBB (includes \$200 of wage expense) . . . . .	(600)
Interest expense (not included in CGS) . . . . .	(300)
Headquarters overhead expense (includes \$100 of wage expense) . . . . .	<u>(180)</u>
X's taxable income . . . . .	1,380

(ii) *X's QPAI.* X allocates and apportions its deductions to gross income attributable to DPGR under the section 861 method in §1.199-4(d). In this case, the section 162 selling expenses and overhead expense are definitely related to all of X's gross income. Based on the facts and circumstances of this specific case, apportionment of the section 162 sell-

ing expenses between DPGR and non-DPGR on the basis of X's gross receipts is appropriate. In addition, based on the facts and circumstances of this specific case, apportionment of the headquarters overhead expense between DPGR and non-DPGR on the basis of the square footage of X's headquarters is appropriate. For purposes of apportioning R&E, X elects to use the

sales method as described in §1.861-17(c). X elects to apportion interest expense under the tax book value method of §1.861-9T(g). X has \$2,400 of gross income attributable to DPGR (DPGR of \$3,000 - CGS of \$600 allocated based on X's books and records). X's QPAI for its taxable year ending April 30, 2011, is \$1,395, as shown in the following table:

DPGR (all from sales of products within SIC AAA) . . . . .	\$3,000
CGS allocable to DPGR . . . . .	(600)
Section 162 selling expenses (\$840 x (\$3,000 DPGR/\$6,000 total gross receipts)) . . . . .	(420)
Section 174 R&E-SIC AAA . . . . .	(300)
Interest expense (not included in CGS) (\$300 x (\$40,000 (X's DPGR assets)/\$50,000 (X's total assets))) . . . . .	(240)
Headquarters overhead expense (\$180 x (2,000 square feet attributable to DPGR activity/total 8,000 square feet)) . . . . .	<u>(45)</u>
X's QPAI . . . . .	1,395

(iii) *W-2 wages.* X chooses to use the wage expense safe harbor under paragraph (e)(2)(ii) of this section to determine its W-2 wages, as shown in the following steps:

(A) *Step one.* X determines that \$625 of wage expense were taken into account in determining its QPAI in paragraph (ii) of this *Example 1*, as shown in the following table:

CGS wage expense . . . . .	\$200
Section 162 selling expenses wage expense (\$600 x (\$3,000 DPGR/\$6,000 total gross receipts)) . . . . .	300
Section 174 R&E-SIC AAA wage expense . . . . .	100
Headquarters overhead wage expense (\$100 x (2,000 square feet attributable to DPGR activity/8,000 total square feet)) . . . . .	<u>25</u>
Total wage expense taken into account . . . . .	625

(B) *Step two.* X determines that \$1,042 of the \$3,000 in paragraph (e)(1) wages are properly alloca-

ble to DPGR, and are therefore W-2 wages, as shown in the following calculation:

<u>Step one wage expense</u>	x	X's paragraph (e)(1) wages	
X's total wage expense for taxable year ending April 30, 2011			
<u>\$625</u>	x	\$3,000	= \$1,042
\$1,800			

(iv) *Section 199 deduction determination.* X's tentative deduction under §1.199-1(a) (section 199 deduction) is \$124 (.09 x (lesser of QPAI of \$1,395 or taxable income of \$1,380)) subject to the wage limitation under section 199(b)(1) (W-2 wage limitation) of \$521 (50% x \$1,042). Accordingly, X's section 199 deduction for its taxable year ending April 30, 2011, is \$124.

*Example 2. Section 861 method and EAG.* (i) *Facts.* The facts are the same as in *Example 1* except that X owns stock in Y, a United States corporation, equal to 75% of the total voting power of stock of Y and 80% of the total value of stock of Y. X and Y are not members of an affiliated group as defined in section 1504(a). Accordingly, the rules of §1.861-14T do not apply to X's and Y's selling

expenses, R&E, and charitable contributions. X and Y are, however, members of an affiliated group for purposes of allocating and apportioning interest expense (see §1.861-11T(d)(6)) and are also members of an EAG. Y's taxable year ends April 30, 2011. For Y's taxable year ending April 30, 2011, Y has \$2,000 of paragraph (e)(1) wages reported on 2010 Forms W-2. For Y's taxable year ending April 30, 2011, the adjusted basis of Y's assets is \$50,000, \$20,000 of which generate gross income attributable to DPGR and \$30,000 of which generate gross income attributable to non-DPGR. All of Y's activities that generate DPGR are within SIC Industry Group AAA (SIC AAA). All of Y's activities that generate non-DPGR are within SIC Industry Group BBB (SIC BBB). None of X's and Y's sales are to each

other. Y is not able to specifically identify CGS allocable to DPGR and non-DPGR. In this case, because CGS is definitely related under the facts and circumstances to all of Y's gross receipts, apportionment of CGS between DPGR and non-DPGR based on gross receipts is appropriate. For Y's taxable year ending April 30, 2011, the total square footage of Y's headquarters is 8,000 square feet, of which, 2,000 square feet is set aside for domestic production activities. Y incurs section 162 selling expenses that are not includible in CGS and are definitely related to all of Y's gross income. For Y's taxable year ending April 30, 2011, Y's taxable income is \$1,710 based on the following Federal income tax items:

DPGR (all from sales of products within SIC AAA) . . . . .	\$3,000
Non-DPGR (all from sales of products within SIC BBB) . . . . .	3,000
CGS allocated to DPGR (includes \$300 of wage expense) . . . . .	(1,200)
CGS allocated to non-DPGR (includes \$300 of wage expense) . . . . .	(1,200)
Section 162 selling expenses (includes \$300 of wage expense) . . . . .	(840)
Section 174 R&E-SIC AAA (includes \$20 of wage expense) . . . . .	(100)
Section 174 R&E-SIC BBB (includes \$60 of wage expense) . . . . .	(200)
Interest expense (not included in CGS and not subject to §1.861-10T) . . . . .	(500)
Charitable contributions . . . . .	(50)
Headquarters overhead expense (includes \$40 of wage expense) . . . . .	<u>(200)</u>
Y's taxable income . . . . .	1,710

(ii) *QPAI*. (A) *X's QPAI*. Determination of X's QPAI is the same as in *Example 1* except that interest is apportioned to gross income attributable to DPGR based on the combined adjusted bases of X's and Y's assets. See §1.861-11T(c). Accordingly, X's QPAI for its taxable year ending April 30, 2011, is \$1,455, as shown in the following table:

DPGR (all from sales of products within SIC AAA) . . . . .	\$3,000
CGS allocated to DPGR . . . . .	(600)
Section 162 selling expenses (\$840 x (\$3,000 DPGR/\$6,000 total gross receipts)) . . . . .	(420)
Section 174 R&E-SIC AAA . . . . .	(300)
Interest expense (not included in CGS and not subject to §1.861-10T) (\$300 x (\$60,000 (tax book value of X's and Y's DPGR assets)/\$100,000 (tax book value of X's and Y's total assets))) . . . . .	(180)
Headquarters overhead expense (\$180 x (2,000 square feet attributable to DPGR activity/total 8,000 square feet)) . . . . .	<u>(45)</u>
X's QPAI . . . . .	1,455

(B) *Y's QPAI*. Y makes the same elections under the section 861 method as does X. Y has \$1,800 of gross income attributable to DPGR (DPGR of \$3,000 receipts). Y's QPAI for its taxable year ending April 30, 2011, is \$905, as shown in the following table:

DPGR (all from sales of products within SIC AAA) . . . . .	\$3,000
CGS allocated to DPGR . . . . .	(1,200)
Section 162 selling expenses (\$840 x (\$3,000 DPGR/\$6,000 total gross receipts)) . . . . .	(420)
Section 174 R&E-SIC AAA . . . . .	(100)
Interest expense (not included in CGS and not subject to §1.861-10T) (\$500 x (\$60,000 (tax book value of X's and Y's DPGR assets)/\$100,000 (tax book value of X's and Y's total assets))) . . . . .	(300)
Charitable contributions (not included in CGS) (\$50 x (\$1,800 gross income attributable to DPGR/\$3,600 total gross income)) . . . . .	(25)
Headquarters overhead expense (\$200 x (2,000 square feet attributable to DPGR activity/total 8,000 square feet)) . . . . .	<u>(50)</u>
Y's QPAI . . . . .	905

(iii) *W-2 wages*. (A) *X's W-2 wages*. X's W-2 wages are \$1,042, the same as in *Example 1*. section to determine its W-2 wages, as shown in the following steps: QPAI in paragraph (ii)(B) of this *Example 2*, as shown in the following table:

(B) *Y's W-2 wages*. Y chooses to use the wage expense safe harbor under paragraph (e)(2)(ii) of this (1) *Step one*. Y determines that \$480 of wage expense were taken into account in determining its

CGS wage expense . . . . .	\$300
Section 162 selling expenses wage expense (\$300 x (\$3,000 DPGR/\$6,000 total gross receipts)) . . . . .	150
Section 174 R&E-SIC AAA wage expense . . . . .	20
Headquarters overhead wage expense (\$40 x (2,000 square feet attributable to DPGR activity/8,000 total square feet)) . . . . .	<u>10</u>
Total wage expense taken into account . . . . .	480

(2) *Step two*. Y determines that \$941 of the \$2,000 paragraph (e)(1) wages are properly allocable to DPGR, and are therefore W-2 wages, as shown in the following calculation:

<u>Step one wage expense</u>	x	Y's paragraph (e)(1) wages	
Y's total wage expense for taxable year ending April 30, 2011			
<u>\$480</u>	x	\$2,000	= \$941
\$1,020			

(iv) *Section 199 deduction determination*. The section 199 deduction of the X and Y EAG is determined by aggregating the separately determined taxable income, QPAI, and W-2 wages of X and Y. See §1.199-7(b). Accordingly, the X and Y EAG's tentative section 199 deduction is \$212 (.09 x (lesser of combined QPAI of X and Y of \$2,360 (X's QPAI of \$1,455 plus Y's QPAI of \$905) or combined taxable incomes of X and Y of \$3,090 (X's taxable income of \$1,380 plus Y's taxable income of \$1,710)) subject to the combined W-2 wage limitation of X and Y of \$992 (50% x (\$1,042 (X's W-2 wages) + \$941 (Y's W-2 wages))). Accordingly, the X and Y EAG's section 199 deduction is \$212. The \$212 is allocated to X and Y in proportion to their QPAI. See §1.199-7(c).

*Example 3. Simplified deduction method.* (i) *Facts*. Z, a corporation that is not a member of an EAG, engages in activities that generate both DPGR and non-DPGR. Z is able to specifically identify CGS allocable to DPGR and to non-DPGR. Z's taxable

year ends on April 30, 2011. For Z's taxable year ending April 30, 2011, Z has \$3,000 of paragraph (e)(1) wages reported on 2010 Forms W-2, and Z's taxable income is \$1,380 based on the following Federal income tax items:

DPGR	\$3,000
Non-DPGR	3,000
CGS allocable to DPGR (includes \$200 of wage expense)	(600)
CGS allocable to non-DPGR (includes \$600 of wage expense)	(1,800)
Expenses, losses, or deductions (deductions) (includes \$1,000 of wage expense)	<u>(2,220)</u>
Z's taxable income	1,380

(ii) Z's QPAI. Z uses the simplified deduction method under §1.199-4(e) to apportion deductions between DPGR and non-DPGR. Z's QPAI for its taxable year ending April 30, 2011, is \$1,290, as shown in the following table:

DPGR	\$3,000
CGS allocable to DPGR	(600)
Deductions apportioned to DPGR (\$2,220 x (\$3,000 DPGR/\$6,000 total gross receipts))	<u>(1,110)</u>
Z's QPAI	1,290

(iii) W-2 wages. Z chooses to use the wage expense safe harbor under paragraph (e)(2)(ii) of this section to determine its W-2 wages, as shown in the following steps:

(A) Step one. Z determines that \$700 of wage expense were taken into account in determining its QPAI in paragraph (ii) of this Example 3, as shown in the following table:

Wage expense included in CGS allocable to DPGR	\$200
Wage expense included in deductions (\$1,000 in wage expense x (\$3,000 DPGR/\$6,000 total gross receipts))	<u>500</u>
Wage expense allocable to DPGR	700

(B) Step two. Z determines that \$1,167 of the \$3,000 paragraph (e)(1) wages are properly allocable to DPGR, and are therefore W-2 wages, as shown in the following calculation:

<u>Step one wage expense</u>	x	Z's paragraph (e)(1) wages	
Z's total wage expense for taxable year ending April 30, 2011			
<u>\$700</u>	x	\$3,000	= \$1,167
\$1,800			

(iv) Section 199 deduction determination. Z's tentative section 199 deduction is \$116 (.09 x (lesser of QPAI of \$1,290 or taxable income of \$1,380)) subject to the W-2 wage limitation of \$584 (50% x \$1,167). Accordingly, Z's section 199 deduction for its taxable year ending April 30, 2011, is \$116.

Example 4. Small business simplified overall method. (i) Facts. Z, a corporation that is not a member of an EAG, engages in activities that generate both DPGR and non-DPGR. Z's taxable year ends on April 30, 2011. For Z's taxable year ending April 30, 2011, Z has \$3,000 of paragraph (e)(1) wages reported on 2010 Forms W-2, and Z's taxable income is \$1,380 based on the following Federal income tax items:

DPGR	\$3,000
Non-DPGR	3,000
CGS and deductions	<u>(4,620)</u>
Z's taxable income	1,380

(ii) Z's QPAI. Z uses the small business simplified overall method under §1.199-4(f) to apportion CGS and deductions between DPGR and non-DPGR. Z's QPAI for its taxable year ending April 30, 2011, is \$690, as shown in the following table:

DPGR	\$3,000
CGS and deductions apportioned to DPGR (\$4,620 x (\$3,000 DPGR/\$6,000 total gross receipts))	<u>(2,310)</u>
Z's QPAI	690

(iii) *W-2 wages.* Z's W-2 wages under paragraph (e)(2)(iii) of this section are \$1,500, as shown in the following calculation:

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\$3,000 in paragraph (e)(1) wages x (\$3,000 DPGR/\$6,000 total gross receipts) . . . . .	\$1,500
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(iv) *Section 199 deduction determination.* Z's tentative section 199 deduction is \$62 (.09 x (lesser of QPAI of \$690 or taxable income of \$1,380)) subject to the W-2 wage limitation of \$750 (50% x \$1,500). Accordingly, Z's section 199 deduction for its taxable year ending April 30, 2011, is \$62.

*Example 5. Corporation uses employees of non-consolidated EAG member.* (i) *Facts.* Corporations S and B are members of the same EAG but are not members of a consolidated group. S and B are both calendar year taxpayers. All the activities described in this example take place during the same taxable year and they are the only activities of S and B. S and B each use the section 861 method described in §1.199-4(d) for allocating and apportioning their deductions. B is a manufacturer but has only three employees of its own. S employs the remainder of the personnel who perform the manufacturing activities for B. S's only receipts are from supplying employees to B. In 2010, B manufactures qualifying production property (QPP) (as defined in §1.199-3(j)(1)), using its three employees and S's employees, and sells the QPP for \$10,000,000. B's total CGS and other deductions are \$6,000,000, including \$1,000,000 paid to S for the use of S's employees and \$100,000 paid to its own employees. B reports the \$100,000 paid to its employees on the 2010 Forms W-2 issued to its employees. S pays its employees \$800,000 that is reported on the 2010 Forms W-2 issued to the employees.

(ii) *B's W-2 wages.* In determining its W-2 wages, B utilizes the wage expense safe harbor described in paragraph (e)(2)(ii) of this section. The entire \$100,000 paid by B to its employees is included in B's wage expense included in calculating its QPAI and is the only wage expense used in calculating B's taxable income. Thus, under the wage expense safe harbor described in paragraph (e)(2)(ii) of this section, B's W-2 wages are \$100,000 (\$100,000 (paragraph (e)(1) wages) x (\$100,000 (wage expense used in calculating B's QPAI)/\$100,000 (wage expense used in calculating B's taxable income))).

(iii) *S's W-2 wages.* In determining its W-2 wages, S utilizes the wage expense safe harbor described in paragraph (e)(2)(ii) of this section. Because S's \$1,000,000 in receipts from B do not qualify as DPGR and are S's only gross receipts, none of the \$800,000 paid by S to its employees is included in S's wage expense included in calculating its QPAI. However, the entire \$800,000 is included in calculating S's taxable income. Thus, under the wage expense safe harbor described in paragraph (e)(2)(ii)(A) of this section, S's W-2 wages are \$0 (\$800,000 (paragraph (e)(1) wages) x (\$0 (wage expense used in calculating S's QPAI)/\$800,000 (wage expense used in calculating S's taxable income))).

(iv) *Determination of EAG's section 199 deduction.* The section 199 deduction of the S and B EAG is determined by aggregating the separately determined taxable income or loss, QPAI, and W-2 wages of S and B. See §1.199-7(b). B's taxable income and QPAI are each \$4,000,000 (\$10,000,000 DPGR

— \$6,000,000 CGS and other deductions). S's taxable income is \$200,000 (\$1,000,000 gross receipts — \$800,000 total deductions). S's QPAI is \$0 (\$0 DPGR — \$0 CGS and other deductions). B's W-2 wages (as calculated in paragraph (ii) of this *Example 5*) are \$100,000 and S's W-2 wages (as calculated in paragraph (iii) of this *Example 5*) are \$0. The EAG's tentative section 199 deduction is \$360,000 (.09 x (lesser of combined QPAI of \$4,000,000 (B's QPAI of \$4,000,000 + S's QPAI of \$0) or combined taxable income of \$4,200,000 (B's taxable income of \$4,000,000 + S's taxable income of \$200,000)) subject to the W-2 wage limitation of \$50,000 (50% x (\$100,000 (B's W-2 wages) + \$0 (S's W-2 wages))). Accordingly, the S and B EAG's section 199 deduction for 2010 is \$50,000. The \$50,000 is allocated to S and B in proportion to their QPAI. See §1.199-7(c). Because S has no QPAI, the entire \$50,000 is allocated to B.

*Example 6. Corporation using employees of consolidated EAG member.* The facts are the same as in *Example 5* except that B and S are members of the same consolidated group. Ordinarily, as demonstrated in *Example 5*, S's \$1,000,000 of receipts would not be DPGR and its \$800,000 paid to its employees would not be W-2 wages (because the \$800,000 would not be properly allocable to DPGR). However, because S and B are members of the same consolidated group, §1.1502-13(c)(1)(i) provides that the separate entity attributes of S's intercompany items or B's corresponding items, or both, may be redetermined in order to produce the same effect as if S and B were divisions of a single corporation. If S and B were divisions of a single corporation, S and B would have QPAI and taxable income of \$4,200,000 (\$10,000,000 DPGR received from the sale of the QPP — \$5,800,000 CGS and other deductions) and, under the wage expense safe harbor described in paragraph (e)(2)(ii) of this section, would have \$900,000 of W-2 wages (\$900,000 (combined paragraph (e)(1) wages of S and B) x (\$900,000 (wage expense used in calculating QPAI)/\$900,000 (wage expense used in calculating taxable income))). The single corporation would have a tentative section 199 deduction equal to 9% of \$4,200,000, or \$378,000, subject to the W-2 wage limitation of 50% of \$900,000, or \$450,000. Thus, the single corporation would have a section 199 deduction of \$378,000. To obtain this same result for the consolidated group, S's \$1,000,000 of receipts from the intercompany transaction are redetermined as DPGR. Thus, S's \$800,000 paid to its employees are costs properly allocable to DPGR and S's W-2 wages are \$800,000. Accordingly, the consolidated group has QPAI and taxable income of \$4,200,000 (\$11,000,000 DPGR (from the sale of the QPP and the redetermined intercompany transaction) — \$6,800,000 CGS and other deductions) and W-2 wages of \$900,000. The consolidated group's section 199 deduction is \$378,000, the same as the single corporation. However, for purposes of allocating the section 199 deduction between S and B, the redetermination of S's income

as DPGR under §1.1502-13(c)(1)(i) is not taken into account. See §1.199-7(d)(5). Accordingly, the consolidated group's entire section 199 deduction of \$378,000 is allocated to B.

Par. 5. Section 1.199-3 is amended by adding a sentence at the end of each of paragraphs (i)(7) and (8) to read as follows:

*§1.199-3 Domestic production gross receipts.*

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

(7) *Qualifying in-kind partnership for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.* \* \* \* For further guidance, see §1.199-3T(i)(7).

(8) *Partnerships owned by members of a single expanded affiliated group for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.* \* \* \* For further guidance, see §1.199-3T(i)(8).

\* \* \* \* \*

Par. 6. Section 1.199-3T is amended by adding paragraphs (i)(7) and (8) to read as follows:

*§1.199-3T Domestic production gross receipts (temporary).*

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

(7) *Qualifying in-kind partnership for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005—(i) In general.* If a partnership is a qualifying in-kind partnership described in paragraph (i)(7)(ii) of this section, then each partner is treated as having manufactured, produced, grown, or extracted (MPGE) (as defined in §1.199-3(e)) or produced the property MPGE or produced by the partnership that is distributed to that partner. If a partner of a qualifying in-kind partnership derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of the property that

was MPGE or produced by the qualifying in-kind partnership and distributed to that partner, then, provided such partner is a partner of the qualifying in-kind partnership at the time the partner disposes of the property, the partner is treated as conducting the MPGE or production activities previously conducted by the qualifying in-kind partnership with respect to that property. With respect to a lease, rental, or license, the partner is treated as having disposed of the property on the date or dates on which it takes into account its gross receipts derived from the lease, rental, or license under its method of accounting. With respect to a sale, exchange, or other disposition, the partner is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes, even if no gain or loss is taken into account.

(ii) *Definition of qualifying in-kind partnership.* For purposes of this paragraph (i)(7), a qualifying in-kind partnership is a partnership engaged solely in—

(A) The extraction, refining, or processing of oil, natural gas (as described in §1.199-3(l)(2)), petrochemicals, or products derived from oil, natural gas, or petrochemicals in whole or in significant part within the United States;

(B) The production or generation of electricity in the United States; or

(C) An activity or industry designated by the Secretary by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).

(iii) *Other rules.* Except as provided in this paragraph (i)(7), a qualifying in-kind partnership is treated the same as other partnerships for purposes of section 199. Accordingly, a qualifying in-kind partnership is subject to the rules of this section regarding the application of section 199 to pass-thru entities, including application of the section 199(d)(1)(A)(iii) wage limitation under §1.199-5T(b)(3). In determining whether a qualifying in-kind partnership or its partners MPGE qualifying production property (QPP) (as defined in §1.199-3(j)) in whole or in significant part within the United States (as defined in §1.199-3(h)), see §1.199-3(g)(2) and (3).

(iv) *Example.* The following example illustrates the application of this paragraph (i)(7). Assume that PRS and X are calendar year taxpayers.

*Example.* X, Y and Z are partners in PRS, a qualifying in-kind partnership described in paragraph (i)(7)(ii) of this section. X, Y, and Z are corporations. In 2007, PRS distributes oil to X that PRS derived from its oil extraction. PRS incurred \$600 of CGS extracting the oil distributed to X, and X's adjusted basis in the distributed oil is \$600. X incurs \$200 of CGS in refining the oil within the United States. In 2007, X, while it is a partner in PRS, sells the oil to a customer for \$1,500. X is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes. Under paragraph (i)(7)(i) of this section, X is treated as having extracted the oil. The extraction and refining of the oil qualify as an MPGE activity under §1.199-3(e)(1). Therefore, X's \$1,500 of gross receipts qualify as DPGR. X subtracts from the \$1,500 of DPGR the \$600 of CGS incurred by PRS and the \$200 of refining costs it incurred. Thus, X's QPAI is \$700 for 2007.

(8) *Partnerships owned by members of a single expanded affiliated group for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005—(i) In general.* For purposes of this section, if all of the interests in the capital and profits of a partnership are owned by members of a single expanded affiliated group (EAG) at all times during the taxable year of the partnership (EAG partnership), then the EAG partnership and all members of that EAG are treated as a single taxpayer for purposes of section 199(c)(4) during that taxable year.

(ii) *Attribution of activities—(A) In general.* If a member of an EAG (disposing member) derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of property that was MPGE or produced by an EAG partnership, all the partners of which are members of the same EAG to which the disposing member belongs at the time that the disposing member disposes of such property, then the disposing member is treated as conducting the MPGE or production activities previously conducted by the EAG partnership with respect to that property. The previous sentence applies only for those taxable years in which the disposing member is a member of the EAG of which all the partners of the EAG partnership are members for the entire taxable year of the EAG partnership. With respect to a lease, rental, or license, the disposing member is treated as having disposed of the property on the date or dates on which it takes into account its gross receipts from the lease, rental, or license under its method of accounting. With respect to a sale, ex-

change, or other disposition, the disposing member is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes, even if no gain or loss is taken into account. Likewise, if an EAG partnership derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of property that was MPGE or produced by a member (or members) of the same EAG (the producing member) to which all the partners of the EAG partnership belong at the time that the EAG partnership disposes of such property, then the EAG partnership is treated as conducting the MPGE or production activities previously conducted by the producing member with respect to that property. The previous sentence applies only for those taxable years in which the producing member is a member of the EAG of which all the partners of the EAG partnership are members for the entire taxable year of the EAG partnership. With respect to a lease, rental, or license, the EAG partnership is treated as having disposed of the property on the date or dates on which it takes into account its gross receipts derived from the lease, rental, or license under its method of accounting. With respect to a sale, exchange, or other disposition, the EAG partnership is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes, even if no gain or loss is taken into account. See paragraph (i)(8)(iv) *Example 3* of this section.

(B) *Attribution between EAG partnerships.* If an EAG partnership (disposing partnership) derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of property that was MPGE or produced by another EAG partnership (producing partnership), then the disposing partnership is treated as conducting the MPGE or production activities previously conducted by the producing partnership with respect to that property, provided that each of these partnerships (the producing partnership and the disposing partnership) is owned for its entire taxable year in which the disposing partnership disposes of such property by members of the same EAG. With respect to a lease, rental, or license, the disposing partnership is treated as having disposed of the property on the date or dates on which it takes into account its gross re-

ceipts from the lease, rental, or license under its method of accounting. With respect to a sale, exchange, or other disposition, the disposing partnership is treated as having disposed of the property on the date it ceases to own the property for Federal income tax purposes, even if no gain or loss is taken into account.

(C) *Exceptions to attribution.* Attribution of activities does not apply for purposes of the construction of real property under §1.199-3(m)(1) and the performance of engineering and architectural services under §1.199-3(n)(2) and (3), respectively.

(iii) *Other rules.* Except as provided in this paragraph (i)(8), an EAG partnership is treated the same as other partnerships for purposes of section 199. Accordingly, an EAG partnership is subject to the rules of this section regarding the application of section 199 to pass-thru entities, including the section 199(d)(1)(A)(iii) wage limitation under §1.199-5T(b)(3). In determining whether a member of an EAG or an EAG partnership MPGE QPP in whole or in significant part within the United States or produced a qualified film or produced utilities within the United States, see §1.199-3(g)(2) and (3) and *Example 5* of paragraph (i)(8)(iv) of this section.

(iv) *Examples.* The following examples illustrate the rules of this paragraph (i)(8). Assume that PRS, X, Y, and Z all are calendar year taxpayers.

*Example 1. Contribution.* X and Y are the only partners in PRS, a partnership, for PRS's entire 2007 taxable year. X and Y are both members of a single EAG for the entire 2007 year. In 2007, X MPGE QPP within the United States and contributes the QPP to PRS. In 2007, PRS sells the QPP for \$1,000. Under this paragraph (i)(8), PRS is treated as having MPGE the QPP within the United States, and PRS's \$1,000 gross receipts constitute DPGR. PRS, X, and Y must apply the rules of this section regarding the application of section 199 to pass-thru entities with respect to the activity of PRS, including the section 199(d)(1)(A)(iii) wage limitation under §1.199-5T(b)(3).

*Example 2. Sale.* X, Y, and Z are the only members of a single EAG for the entire 2007 year. X and Y each own 50% of the capital and profits interests in PRS, a partnership, for PRS's entire 2007 taxable year. In 2007, PRS MPGE QPP within the United States and then sells the QPP to X for \$6,000, its fair market value at the time of the sale. PRS's gross receipts of \$6,000 qualify as DPGR. In 2007, X sells the QPP to customers for \$10,000, incurring selling expenses of \$2,000. Under paragraph (i)(8)(ii)(A) of this section, X is treated as having MPGE the QPP within the United States, and X's \$10,000 of gross receipts qualify as DPGR. PRS, X and Y must

apply the rules of this section regarding the application of section 199 to pass-thru entities with respect to the activity of PRS, including application of the section 199(d)(1)(A)(iii) wage limitation under §1.199-5T(b)(3). The results would be the same if PRS sold the QPP to Z rather than to X. However, if PRS did sell the QPP to Z, and Z was not a member of the EAG for PRS's entire taxable year, the activities previously conducted by PRS with respect to the QPP would not be attributed to Z, and none of Z's \$10,000 of gross receipts would qualify as DPGR.

*Example 3. Lease.* X, Y, and Z are the only members of a single EAG for the entire 2007 year. X and Y each own 50% of the capital and profits interests in PRS, a partnership, for PRS's entire 2007 taxable year. In 2007, PRS MPGE QPP within the United States and then sells the QPP to X for \$6,000, its fair market value at the time of the sale. PRS's gross receipts of \$6,000 qualify as DPGR. In 2007, X rents the QPP it acquired from PRS to customers unrelated to X. X takes the gross receipts attributable to the rental of the QPP into account under its method of accounting in 2007 and 2008. On July 1, 2008, X ceases to be a member of the same EAG to which Y, the other partner in PRS, belongs. For 2007, X is treated as having MPGE the QPP within the United States under paragraph (i)(8)(ii)(A) of this section, and its gross receipts derived from the rental of the QPP qualify as DPGR. For 2008, however, because X and Y, partners in PRS, are no longer members of the same EAG for the entire year, the gross rental receipts X takes into account in 2008 do not qualify as DPGR.

*Example 4. Distribution.* X and Y are the only partners in PRS, a partnership, for PRS's entire 2007 taxable year. X and Y are both members of a single EAG for the entire 2007 year. In 2007, PRS MPGE QPP within the United States, incurring \$600 of CGS, and then distributes the QPP to X. X's adjusted basis in the QPP is \$600. X incurs \$200 of directly allocable costs to further MPGE the QPP within the United States. In 2007, X sells the QPP for \$1,500 to an unrelated customer. X is treated as having disposed of the QPP on the date it ceases to own the QPP for Federal income tax purposes. Under paragraph (i)(8)(ii)(A) of this section, X is treated as having MPGE the QPP within the United States, and X's \$1,500 of gross receipts qualify as DPGR.

*Example 5. Multiple sales.* (i) *Facts.* X and Y are the only partners in PRS, a partnership, for PRS's entire 2007 taxable year. X and Y are both non-consolidated members of a single EAG for the entire 2007 year. PRS produces in bulk form in the United States the active ingredient for a drug. Assume that PRS's own MPGE activity with respect to the active ingredient is not substantial in nature, taking into account all of the facts and circumstances, and PRS's direct labor and overhead to MPGE the active ingredient within the United States are \$15 and account for 15% of PRS's \$100 CGS of the active ingredient. In 2007, PRS sells the active ingredient in bulk form to X. X uses the active ingredient to produce the finished dosage form drug. Assume that X's own MPGE activity with respect to the drug is not substantial in nature, taking into account all of the facts and circumstances, and X's direct labor and overhead to MPGE the drug within the United States are \$12 and account for 10% of X's \$120 CGS of the drug. In 2007, X sells the drug in finished dosage to Y and Y sells the

drug to customers. Assume that Y's own MPGE activity with respect to the drug is not substantial in nature, taking into account all of the facts and circumstances, and Y incurs \$2 of direct labor and overhead and Y's CGS in selling the drug to customers is \$130.

(ii) *Analysis.* PRS's gross receipts from the sale of the active ingredient to X are non-DPGR because PRS's MPGE activity is not substantial in nature and PRS does not satisfy the safe harbor described in §1.199-3(g)(3) because PRS's direct labor and overhead account for less than 20% of PRS's CGS of the active ingredient. X's gross receipts from the sale of the drug to Y are DPGR because X is considered to have MPGE the drug in significant part in the United States pursuant to the safe harbor described in §1.199-3(g)(3) because the \$27 (\$15 + \$12) of direct labor and overhead incurred by PRS and X equals or exceeds 20% of X's total CGS (\$120) of the drug at the time X disposes of the drug to Y. Similarly, Y's gross receipts from the sale of the drug to customers are DPGR because Y is considered to have MPGE the drug in significant part in the United States pursuant to the safe harbor described in §1.199-3(g)(3) because the \$29 (\$15 + \$12 + \$2) of direct labor and overhead incurred by PRS, X, and Y equals or exceeds 20% of Y's total CGS (\$130) of the drug at the time Y disposes of the drug to Y's customers.

Par. 7. Section 1.199-5 is amended by adding a sentence at the end to read as follows:

*§1.199-5 Application of section 199 to pass-thru entities for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005. \* \* \* For further guidance, see §1.199-5T.*

Par. 8. Section 1.199-5T is added to read as follows:

*§1.199-5T Application of section 199 to pass-thru entities for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005 (temporary).*

(a) *In general.* The provisions of this section apply solely for purposes of section 199 of the Internal Revenue Code (Code).

(b) *Partnerships—(1) In general—(i) Determination at partner level.* The deduction with respect to the qualified production activities of the partnership allowable under §1.199-1(a) (section 199 deduction) is determined at the partner level. As a result, each partner must compute its deduction separately. The section 199 deduction has no effect on the adjusted basis of the partner's interest in the partnership. Except as provided by publi-



cation pursuant to paragraph (b)(1)(ii) of this section, for purposes of this section, each partner is allocated, in accordance with sections 702 and 704, its share of partnership items (including items of income, gain, loss, and deduction), cost of goods sold (CGS) allocated to such items of income, and gross receipts that are included in such items of income, even if the partner's share of CGS and other deductions and losses exceeds domestic production gross receipts (DPGR) (as defined in §1.199-3(a)). A partnership may specially allocate items of income, gain, loss, or deduction to its partners, subject to the rules of section 704(b) and the supporting regulations. Guaranteed payments under section 707(c) are not considered allocations of partnership income for purposes of this section. Guaranteed payments under section 707(c) are deductions by the partnership that must be taken into account under the rules of §1.199-4. See §1.199-3(p) and paragraph (b)(6) *Example 5* of this section. Except as provided in paragraph (b)(1)(ii) of this section, to determine its section 199 deduction for the taxable year, a partner aggregates its distributive share of such items, to the extent they are not otherwise disallowed by the Code, with those items it incurs outside the partnership (whether directly or indirectly) for purposes of allocating and apportioning deductions to DPGR and computing its qualified production activities income (QPAI) (as defined in §1.199-1(c)).

(ii) *Determination at entity level.* The Secretary may, by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), permit a partnership to calculate a partner's share of QPAI and W-2 wages as defined in §1.199-2T(e)(2) (W-2 wages) at the entity level, instead of allocating to the partner, in accordance with sections 702 and 704, the partner's share of partnership items (including items of income, gain, loss, and deduction) and amounts described in §1.199-2(e)(1) (paragraph (e)(1) wages). If a partnership does calculate QPAI at the entity level—

(A) Each partner is allocated its share of QPAI (subject to the limitations of paragraph (b)(2) of this section) and W-2 wages from the partnership, which are combined with the partner's QPAI and W-2 wages from other sources, if any;

(B) For purposes of computing QPAI under §§1.199-1 through 1.199-8, a partner does not take into account the items from the partnership (for example, a partner does not take into account items from the partnership in determining whether a threshold or *de minimis* rule applies or in allocating and apportioning deductions in calculating its QPAI from other sources);

(C) A partner generally does not recompute its share of QPAI from the partnership using another method; however, the partner might have to adjust its share of QPAI from the partnership to take into account certain disallowed losses or deductions, or the allowance of suspended losses or deductions; and

(D) A partner's distributive share of QPAI from a partnership may be less than zero.

(2) *Disallowed losses or deductions.* Except as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), losses or deductions of a partnership are taken into account in computing the partner's section 199 deduction for a taxable year only if, and to the extent that, the partner's distributive share of those losses or deductions from all of the partnership's activities is not disallowed by section 465, 469, or 704(d), or any other provision of the Code. If only a portion of the partner's distributive share of the losses or deductions from a partnership is allowed for a taxable year, a proportionate share of those allowable losses or deductions that are allocated to the partnership's qualified production activities, determined in a manner consistent with sections 465, 469, and 704(d), and any other applicable provision of the Code, is taken into account in computing QPAI for that taxable year. To the extent that any of the disallowed losses or deductions are allowed in a later taxable year under section 465, 469, or 704(d), or any other provision of the Code, the partner takes into account a proportionate share of those allowed losses or deductions that are allocated to the partnership's qualified production activities in computing the partner's QPAI for that later taxable year. Losses or deductions of the partnership that are disallowed for taxable years beginning on or before December 31, 2004, are not taken into account in a later taxable year for purposes of computing the partner's QPAI for that later

taxable year, whether or not the losses or deductions are allowed for other purposes.

(3) *Partner's share of paragraph (e)(1) wages.* Under section 199(d)(1)(A)(iii), a partner's share of paragraph (e)(1) wages of a partnership for purposes of determining the partner's wage limitation under section 199(b)(1) (W-2 wage limitation) equals the partner's allocable share of those wages. Except as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), the partnership must allocate the amount of paragraph (e)(1) wages among the partners in the same manner it allocates wage expense among those partners. The partner must add its share of the paragraph (e)(1) wages from the partnership to the partner's paragraph (e)(1) wages from other sources, if any. The partner (other than a partner that itself is a partnership or S corporation) then must calculate its W-2 wages by determining the amount of the partner's total paragraph (e)(1) wages properly allocable to DPGR. If the partner is a partnership or S corporation, the partner must allocate its paragraph (e)(1) wages (including the paragraph (e)(1) wages from a lower-tier partnership) among its partners or shareholders in the same manner it allocates wage expense among those partners or shareholders. See §1.199-2T(e)(2) for the computation of W-2 wages and for the proper allocation of any such wages to DPGR.

(4) *Transition rule for definition of W-2 wages and for W-2 wage limitation.* If a partnership and any partner in that partnership have different taxable years, only one of which begins on or before May 17, 2006, the definition of W-2 wages of the partnership and the section 199(d)(1)(A)(iii) limitation on W-2 wages from that partnership is determined under the law applicable to partnerships based on the beginning date of the partnership's taxable year. Thus, for example, for the taxable year of a partnership beginning on or before May 17, 2006, a partner's share of W-2 wages from the partnership is determined under section 199(d)(1)(A)(iii) as in effect for taxable years beginning on or before May 17, 2006, even if the taxable year of that partner in which those wages are taken into account begins after May 17, 2006.

(5) *Partnerships electing out of subchapter K.* For purposes of §§1.199-1

through 1.199–8, the rules of paragraph (b) of this section apply to all partnerships, including those partnerships electing under section 761(a) to be excluded, in whole or in part, from the application of subchapter K of chapter 1 of the Code.

(6) *Examples.* The following examples illustrate the application of this paragraph (b). Assume that each partner has sufficient adjusted gross income or taxable income so that the section 199 deduction is

not limited under section 199(a)(1)(B). Assume also that the partnership and each of its partners (whether individual or corporate) are calendar year taxpayers.

*Example 1. Section 861 method with interest expense.* (i) *Partnership Federal income tax items.* X and Y, unrelated United States corporations, are each 50% partners in PRS, a partnership that engages in production activities that generate both DPGR and non-DPGR. X and Y share all items of income, gain, loss, deduction, and credit equally. Both X and Y are engaged in a trade or business. PRS is not able

to identify from its books and records CGS allocable to DPGR and non-DPGR. In this case, because CGS is definitely related under the facts and circumstances to all of PRS's gross receipts, apportionment of CGS between DPGR and non-DPGR based on gross receipts is appropriate. For 2010, the adjusted basis of PRS's business assets is \$5,000, \$4,000 of which generate gross income attributable to DPGR and \$1,000 of which generate gross income attributable to non-DPGR. For 2010, PRS has the following Federal income tax items:

DPGR .....	\$3,000
Non-DPGR .....	3,000
CGS .....	3,240
Section 162 selling expenses .....	1,200
Interest expense (not included in CGS) .....	300

(ii) *Allocation of PRS's Federal income tax items.* X and Y each receive the following distributive share of PRS's Federal income tax items, as determined under the principles of §1.704–1(b)(1)(vii):

Gross income attributable to DPGR (\$1,500 (DPGR) — \$810 (allocable CGS)) .....	\$690
Gross income attributable to non-DPGR (\$1,500 (non-DPGR) — \$810 (allocable CGS)) .....	690
Section 162 selling expenses .....	600
Interest expense (not included in CGS) .....	150

(iii) *Determination of QPAI.* (A) *X's QPAI.* Because the section 199 deduction is determined at the partner level, X determines its QPAI by aggregating its distributive share of PRS's Federal income tax items with all other such items from all other, non-PRS-related activities. For 2010, X does not have any other such items. For 2010, the adjusted basis of X's non-PRS assets, all of which are investment

assets, is \$10,000. X's only gross receipts for 2010 are those attributable to the allocation of gross income from PRS. X allocates and apportions its deductible items to gross income attributable to DPGR under the section 861 method of §1.199–4(d). In this case, the section 162 selling expenses are not included in CGS and are definitely related to all of PRS's gross income. Based on the facts and circumstances of this

specific case, apportionment of those expenses between DPGR and non-DPGR on the basis of PRS's gross receipts is appropriate. X elects to apportion its distributive share of interest expense under the tax book value method of §1.861–9T(g). X's QPAI for 2010 is \$366, as shown in the following table:

DPGR .....	\$1,500
CGS allocable to DPGR .....	(810)
Section 162 selling expenses (\$600 x (\$1,500 DPGR/\$3,000 total gross receipts)) .....	(300)
Interest expense (not included in CGS) (\$150 x (\$2,000 (X's share of PRS's DPGR assets)/\$12,500 (X's non-PRS assets (\$10,000) + X's share of PRS assets (\$2,500)))) .....	(24)
X's QPAI .....	366

(B) *Y's QPAI.* (1) For 2010, in addition to the activities of PRS, Y engages in production activities that generate both DPGR and non-DPGR. Y is able to identify from its books and records CGS allocable

to DPGR and to non-DPGR. For 2010, the adjusted basis of Y's non-PRS assets attributable to its production activities that generate DPGR is \$8,000 and to other production activities that generate non-DPGR

is \$2,000. Y has no other assets. Y has the following Federal income tax items relating to its non-PRS activities:

Gross income attributable to DPGR (\$1,500 (DPGR) — \$900 (allocable CGS)) .....	\$600
Gross income attributable to non-DPGR (\$3,000 (other gross receipts) — \$1,620 (allocable CGS)) .....	1,380
Section 162 selling expenses .....	540
Interest expense (not included in CGS) .....	90

(2) Y determines its QPAI in the same general manner as X. However, because Y has other trade or business activities outside of PRS, Y must aggregate its distributive share of PRS's Federal income tax items with its own such items. Y allocates and apportions its deductible items to gross income at-

tributable to DPGR under the section 861 method of §1.199–4(d). In this case, Y's distributive share of PRS's section 162 selling expenses, as well as those selling expenses from Y's non-PRS activities, are definitely related to all of its gross income. Based on the facts and circumstances of this specific case,

apportionment of those expenses between DPGR and non-DPGR on the basis of Y's gross receipts (including Y's share of PRS's gross receipts) is appropriate. Y elects to apportion its distributive share of interest expense under the tax book value method of §1.861–9T(g). Y has \$1,290 of gross income attrib-

utable to DPGR (\$3,000 DPGR (\$1,500 from PRS and \$1,500 from non-PRS activities) – \$1,710 CGS (\$810 from PRS and \$900 from non-PRS activities)).

Y's QPAI for 2010 is \$642, as shown in the following table:

DPGR (\$1,500 from PRS and \$1,500 from non-PRS activities) . . . . .	\$3,000
CGS allocable to DPGR (\$810 from PRS and \$900 from non-PRS activities) . . . . .	(1,710)
Section 162 selling expenses	
(\$1,140 (\$600 from PRS and \$540 from non-PRS activities) x \$3,000 (\$1,500 PRS DPGR + \$1,500 non-PRS DPGR)/ \$7,500 (\$3,000 PRS total gross receipts + \$4,500 non-PRS total gross receipts)) . . . . .	(456)
Interest expense (not included in CGS)	
(\$240 (\$150 from PRS and \$90 from non-PRS activities) x \$10,000 (Y's non-PRS DPGR assets (\$8,000) + Y's share of PRS DPGR assets (\$2,000))/\$12,500 (Y's non-PRS assets (\$10,000) + Y's share of PRS assets (\$2,500))) . . . . .	<u>(192)</u>
Y's QPAI . . . . .	642

(iv) *Determination of section 199 deduction.* X's tentative section 199 deduction is \$33 (.09 x \$366, that is, QPAI determined at the partner level) subject to the W-2 wage limitation (50% of W-2 wages). Y's tentative section 199 deduction is \$58 (.09 x \$642) subject to the W-2 wage limitation.

*Example 2. Section 861 method with R&E expense.* (i) *Partnership Federal income tax items.* X and Y, unrelated United States corporations each of which is engaged in a trade or business, are partners in PRS, a partnership that engages in production activ-

ities that generate both DPGR and non-DPGR. Neither X nor Y is a member of an affiliated group. X and Y share all items of income, gain, loss, deduction, and credit equally. All of PRS's domestic production activities that generate DPGR are within Standard Industrial Classification (SIC) Industry Group AAA (SIC AAA). All of PRS's production activities that generate non-DPGR are within SIC Industry Group BBB (SIC BBB). PRS is not able to identify from its books and records CGS allocable to DPGR and to non-DPGR. In this case, because CGS is definitely

related under the facts and circumstances to all of PRS's gross receipts, apportionment of CGS between DPGR and non-DPGR based on gross receipts is appropriate. PRS incurs \$900 of research and experimentation expenses (R&E) that are deductible under section 174, \$300 of which are performed with respect to SIC AAA and \$600 of which are performed with respect to SIC BBB. None of the R&E is legally mandated R&E as described in §1.861-17(a)(4) and none is included in CGS. For 2010, PRS has the following Federal income tax items:

DPGR (all from sales of products within SIC AAA) . . . . .	\$3,000
Non-DPGR (all from sales of products within SIC BBB) . . . . .	3,000
CGS . . . . .	2,400
Section 162 selling expenses . . . . .	840
Section 174 R&E-SIC AAA . . . . .	300
Section 174 R&E-SIC BBB . . . . .	600

(ii) *Allocation of PRS's Federal income tax items.* X and Y each receive the following distributive share of PRS's Federal income tax items, as determined under the principles of §1.704-1(b)(1)(vii):

Gross income attributable to DPGR (\$1,500 (DPGR) – \$600 (CGS)) . . . . .	\$900
Gross income attributable to non-DPGR (\$1,500 (other gross receipts) – \$600 (CGS)) . . . . .	900
Section 162 selling expenses . . . . .	420
Section 174 R&E-SIC AAA . . . . .	150
Section 174 R&E-SIC BBB . . . . .	300

(iii) *Determination of QPAI.* (A) *X's QPAI.* Because the section 199 deduction is determined at the partner level, X determines its QPAI by aggregating its distributive share of PRS's Federal income tax items with all other such items from all other, non-PRS-related activities. For 2010, X does not have any other such tax items. X's only gross receipts for 2010 are those attributable to the allocation of gross income from PRS. As stated, all of PRS's domestic

production activities that generate DPGR are within SIC AAA. X allocates and apportions its deductible items to gross income attributable to DPGR under the section 861 method of §1.199-4(d). In this case, the section 162 selling expenses are definitely related to all of PRS's gross income. Based on the facts and circumstances of this specific case, apportionment of those expenses between DPGR and non-DPGR on the basis of PRS's gross receipts is appropriate. For

purposes of apportioning R&E, X elects to use the sales method as described in §1.861-17(c). Because X has no direct sales of products, and because all of PRS's SIC AAA sales attributable to X's share of PRS's gross income generate DPGR, all of X's share of PRS's section 174 R&E attributable to SIC AAA is taken into account for purposes of determining X's QPAI. Thus, X's total QPAI for 2010 is \$540, as shown in the following table:

DPGR (all from sales of products within SIC AAA) . . . . .	\$1,500
CGS . . . . .	(600)
Section 162 selling expenses (\$420 x (\$1,500 DPGR/\$3,000 total gross receipts)) . . . . .	(210)
Section 174 R&E-SIC AAA . . . . .	<u>(150)</u>
X's QPAI . . . . .	540

(B) *Y's QPAI.* (I) For 2010, in addition to the activities of PRS, Y engages in domestic production

activities that generate both DPGR and non-DPGR. With respect to those non-PRS activities, Y is not able

to identify from its books and records CGS allocable to DPGR and to non-DPGR. In this case, because

non-PRS CGS is definitely related under the facts and circumstances to all of Y's non-PRS gross receipts,

apportionment of non-PRS CGS between DPGR and non-DPGR based on Y's non-PRS gross receipts is

appropriate. For 2010, Y has the following non-PRS Federal income tax items:

DPGR (from sales of products within SIC AAA) .....	\$1,500
DPGR (from sales of products within SIC BBB) .....	1,500
Non-DPGR (from sales of products within SIC BBB) .....	3,000
CGS (allocated to DPGR within SIC AAA) .....	750
CGS (allocated to DPGR within SIC BBB) .....	750
CGS (allocated to non-DPGR within SIC BBB) .....	1,500
Section 162 selling expenses .....	540
Section 174 R&E-SIC AAA .....	300
Section 174 R&E-SIC BBB .....	450

(2) Because Y has DPGR as a result of activities outside PRS, Y must aggregate its distributive share of PRS's Federal income tax items with such items from all its other, non-PRS-related activities. Y allocates and apportions its deductible items to gross income attributable to DPGR under the section 861 method of §1.199-4(d). In this case, the section 162 selling expenses are definitely related to all of Y's gross income. Based on the facts and circumstances of the specific case, apportionment of such expenses

between DPGR and non-DPGR on the basis of Y's gross receipts (including Y's share of PRS's gross receipts) is appropriate. For purposes of apportioning R&E, Y elects to use the sales method as described in §1.861-17(c).

(3) With respect to sales that generate DPGR, Y has gross income of \$2,400 (\$4,500 DPGR (\$1,500 from PRS and \$3,000 from non-PRS activities) — \$2,100 CGS (\$600 from sales of products by PRS and \$1,500 from non-PRS activities)). Because all of the

sales in SIC AAA generate DPGR, all of Y's share of PRS's section 174 R&E attributable to SIC AAA and the section 174 R&E attributable to SIC AAA that Y incurs in its non-PRS activities are taken into account for purposes of determining Y's QPAI. Because only a portion of the sales within SIC BBB generate DPGR, only a portion of the section 174 R&E attributable to SIC BBB is taken into account in determining Y's QPAI. Thus, Y's QPAI for 2010 is \$1,282, as shown in the following table:

DPGR (\$4,500 DPGR (\$1,500 from PRS and \$3,000 from non-PRS activities)) .....	\$4,500
CGS (\$600 from sales of products by PRS and \$1,500 from non-PRS activities) .....	(2,100)
Section 162 selling expenses (\$960 (\$420 from PRS + \$540 from non-PRS activities) x (\$4,500 DPGR/\$9,000 total gross receipts)) .....	(480)
Section 174 R&E-SIC AAA (\$150 from PRS and \$300 from non-PRS activities) .....	(450)
Section 174 R&E-SIC BBB (\$750 (\$300 from PRS + \$450 from non-PRS activities) x (\$1,500 DPGR/\$6,000 total gross receipts allocated to SIC BBB (\$1,500 from PRS + \$4,500 from non-PRS activities)) .....	(188)
Y's QPAI .....	1,282

(iv) *Determination of section 199 deduction.* X's tentative section 199 deduction is \$49 (.09 x \$540, that is, QPAI determined at the partner level) subject to the W-2 wage limitation (50% of W-2 wages). Y's tentative section 199 deduction is \$115 (.09 x \$1,282) subject to the W-2 wage limitation.

*Example 3. Partnership with special allocations.* (i) *In general.* X and Y are unrelated corporate partners in PRS and each is engaged in a trade or business. PRS is a partnership that engages in a domestic production activity and other activities. In general, X and Y share all partnership items of income, gain, loss, deduction, and credit equally, except that 80% of the wage expense of PRS and 20% of PRS's other expenses are specially allocated to X. Under all the facts and circumstances, these special allocations have substantial economic effect under section 704(b). In the 2010 taxable year, PRS's only wage expense is \$2,000 for marketing, which is not included in CGS. PRS has \$8,000 of gross receipts (\$6,000 of which is DPGR), \$4,000 of CGS (\$3,500 of which is allocable to DPGR), and \$3,000 of deductions (comprised of \$2,000 of wage expense for marketing and \$1,000 of other expenses). X qualifies for and uses the simplified deduction method under §1.199-4(e). Y does not qualify to use that method and, therefore, must use the section 861 method under §1.199-4(d). In the 2010 taxable year, X has gross receipts attributable to non-partnership trade or business activities of \$1,000 and wage expense of \$200. None of X's non-PRS gross receipts is DPGR. For

purposes of this example, with regard to both X and PRS, paragraph (e)(1) wages equal wage expense for the 2010 taxable year.

(ii) *Allocation and apportionment of costs.* Under the partnership agreement, X's distributive share of the Federal income tax items of PRS is \$1,250 of gross income attributable to DPGR (\$3,000 DPGR — \$1,750 allocable CGS), \$750 of gross income attributable to non-DPGR (\$1,000 non-DPGR — \$250 allocable CGS), and \$1,800 of deductions (comprised of X's special allocations of \$1,600 of wage expense (\$2,000 x 80%) for marketing and \$200 of other expenses (\$1,000 x 20%). Under the simplified deduction method, X apportions \$1,200 of other deductions to DPGR (\$2,000 (\$1,800 from the partnership and \$200 from non-partnership activities) x (\$3,000 DPGR/\$5,000 total gross receipts)). Accordingly, X's QPAI is \$50 (\$3,000 DPGR — \$1,750 CGS — \$1,200 of deductions). X has \$1,800 of paragraph (e)(1) wages (\$1,600 (X's 80% share) from PRS + \$200 (X's own non-PRS paragraph (e)(1) wages)). To calculate its W-2 wages, X must determine how much of this \$1,800 is properly allocable under §1.199-2T(e)(2) to X's total DPGR (including X's share of DPGR from PRS). Thus, X's tentative section 199 deduction for the 2010 taxable year is \$5 (.09 x \$50), subject to the W-2 wage limitation (50% of X's W-2 wages).

*Example 4. Partnership with no paragraph (e)(1) wages.* (i) *Facts.* A and B, both individuals, are partners in PRS. PRS is a partnership that engages

in manufacturing activities that generate both DPGR and non-DPGR. A and B share all items of income, gain, loss, deduction, and credit equally. For the 2010 taxable year, PRS has total gross receipts of \$2,000 (\$1,000 of which is DPGR), CGS of \$400 and deductions of \$800. PRS has no paragraph (e)(1) wages. Each partner's distributive share of PRS's Federal income tax items is \$500 DPGR, \$500 non-DPGR, \$200 CGS, and \$400 of deductions. A has trade or business activities outside of PRS (non-PRS activities). With respect to those activities, A has total gross receipts of \$1,000 (\$500 of which is DPGR), CGS of \$400 (including \$50 of paragraph (e)(1) wages), and deductions of \$200 for the 2010 taxable year. B has no trade or business activities outside of PRS. A and B each use the small business simplified overall method under §1.199-4(f).

(ii) *A's QPAI.* A's total CGS and deductions apportioned to DPGR equal \$600 ((\$1,200 (\$200 PRS CGS + \$400 non-PRS CGS + \$400 PRS deductions + \$200 non-PRS trade or business deductions)) x (\$1,000 total DPGR (\$500 from PRS + \$500 from non-PRS activities)/\$2,000 total gross receipts (\$1,000 from PRS + \$1,000 from non-PRS activities))). Accordingly, A's QPAI is \$400 (\$1,000 DPGR (\$500 from PRS + \$500 from non-PRS activities) — \$600 CGS and deductions).

(iii) *A's W-2 wages and section 199 deduction.* A has \$50 of paragraph (e)(1) wages (\$0 from PRS + \$50 from A's non-PRS activities). To calculate A's W-2 wages, A determines, under a reasonable

method satisfactory to the Secretary, that \$40 of this \$50 is properly allocable under §1.199-2T(e)(2) to A's DPGR from PRS and non-PRS activities. A's tentative section 199 deduction is \$36 (.09 x \$400), subject to the W-2 wage limitation of \$20 (50% of W-2 wages of \$40). Thus, A's section 199 deduction is \$20.

(iv) *B's QPAI and section 199 deduction.* B's CGS and deductions apportioned to DPGR equal \$300 ((\$200 PRS CGS + \$400 PRS deductions) x (\$500 DPGR from PRS/\$1,000 total gross receipts from PRS)). Accordingly, B's QPAI is \$200 (\$500 DPGR - \$300 CGS and deductions). B's tentative section 199 deduction is \$18 (.09 x \$200), subject to the W-2 wage limitation. In this case, however, the limitation is \$0, because B has no paragraph (e)(1) wages. Thus, B's section 199 deduction is \$0.

*Example 5. Guaranteed payment.* (i) *Facts.* The facts are the same as in *Example 4*, except that in 2010 PRS also makes a guaranteed payment of \$200 to A for services rendered by A (see section 707(c)), and PRS incurs \$200 of wage expense for employees' salary, which is included within the \$400 of CGS (in this case the wage expense of \$200 equals PRS's paragraph (e)(1) wages). The guaranteed payment is taxable to A as ordinary income and is properly deducted by PRS under section 162. Pursuant to §1.199-3(p), A may not treat any part of this payment as DPGR. Accordingly, PRS has total gross receipts of \$2,000 (\$1,000 of which is DPGR), CGS of \$400 (including \$200 of wage expense) and deductions of \$1,000 (including the \$200 guaranteed payment) for the 2010 taxable year. Each partner's distributive share of the items of the partnership is \$500 DPGR, \$500 non-DPGR, \$200 CGS (including \$100 of wage expense), and \$500 of deductions.

(ii) *A's QPAI and W-2 wages.* A's total CGS and deductions apportioned to DPGR equal \$591 (\$1,300 (\$200 PRS CGS + \$400 non-PRS CGS + \$500 PRS deductions + \$200 non-PRS trade or business deductions) x (\$1,000 total DPGR (\$500 from PRS + \$500 from non-PRS activities)/\$2,200 total gross receipts (\$1,000 from PRS + \$200 guaranteed payment + \$1,000 from non-PRS activities))). Accordingly, A's QPAI is \$409 (\$1,000 DPGR - \$591 CGS and other deductions). A's total paragraph (e)(1) wages are \$150 (\$100 from PRS + \$50 from non-PRS activities). To calculate its W-2 wages, A must determine how much of this \$150 is properly allocable under §1.199-2T(e)(2) to A's total DPGR from PRS and non-PRS activities. A's tentative section 199 deduction is \$37 (.09 x \$409), subject to the W-2 wage limitation (50% of W-2 wages).

(iii) *B's QPAI and W-2 wages.* B's QPAI is \$150 (\$500 DPGR - \$350 CGS and other deductions). B has \$100 of paragraph (e)(1) wages (all from PRS). To calculate its W-2 wages, B must determine how much of this \$100 is properly allocable under §1.199-2T(e)(2) to B's total DPGR. B's tentative section 199 deduction is \$14 (.09 x \$150), subject to the W-2 wage limitation (50% of B's W-2 wages).

(c) *S corporations—(1) In general—(i) Determination at shareholder level.* The section 199 deduction with respect to the qualified production activities of an S corporation is determined at the shareholder level. As a result, each shareholder must compute its deduction separately. The sec-

tion 199 deduction has no effect on the adjusted basis of a shareholder's stock in an S corporation. Except as provided by publication pursuant to paragraph (c)(1)(ii) of this section, for purposes of this section, each shareholder is allocated, in accordance with section 1366, its *pro rata* share of S corporation items (including items of income, gain, loss, and deduction), CGS allocated to such items of income, and gross receipts included in such items of income, even if the shareholder's share of CGS and other deductions and losses exceeds DPGR. Except as provided by publication under paragraph (c)(1)(ii) of this section, to determine its section 199 deduction for the taxable year, the shareholder aggregates its *pro rata* share of such items, to the extent they are not otherwise disallowed by the Code, with those items it incurs outside the S corporation (whether directly or indirectly) for purposes of allocating and apportioning deductions to DPGR and computing its QPAI.

(ii) *Determination at entity level.* The Secretary may, by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), permit an S corporation to calculate a shareholder's share of QPAI and W-2 wages at the entity level, instead of allocating to the shareholder, in accordance with section 1366, the shareholder's *pro rata* share of S corporation items (including items of income, gain, loss, and deduction) and paragraph (e)(1) wages. If an S corporation does calculate QPAI at the entity level—

(A) Each shareholder is allocated its share of QPAI (subject to the limitations of paragraph (c)(2) of this section) and W-2 wages from the S corporation, which are combined with the shareholder's QPAI and W-2 wages from other sources, if any;

(B) For purposes of computing QPAI under §§1.199-1 through 1.199-8, a shareholder does not take into account the items from the S corporation (for example, a shareholder does not take into account items from the S corporation in determining whether a threshold or *de minimis* rule applies or in allocating and apportioning deductions in calculating its QPAI from other sources);

(C) A shareholder generally does not recompute its share of QPAI from the S corporation using another method; however, the shareholder might have to adjust

its share of QPAI from the S corporation to take into account certain disallowed losses or deductions, or the allowance of suspended losses or deductions; and

(D) A shareholder's share of QPAI from an S corporation may be less than zero.

(2) *Disallowed losses or deductions.* Except as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), losses or deductions of the S corporation are taken into account in computing the shareholder's section 199 deduction for a taxable year only if, and to the extent that, the shareholder's *pro rata* share of the losses or deductions from all of the S corporation's activities is not disallowed by section 465, 469, or 1366(d), or any other provision of the Code. If only a portion of the shareholder's share of the losses or deductions from an S corporation is allowed for a taxable year, a proportionate share of those allowable losses or deductions that are allocated to the S corporation's qualified production activities, determined in a manner consistent with sections 465, 469, and 1366(d), and any other applicable provision of the Code, is taken into account in computing QPAI for that taxable year. To the extent that any of the disallowed losses or deductions are allowed in a later taxable year under section 465, 469, or 704(d), or any other provision of the Code, the shareholder takes into account a proportionate share of those allowed losses or deductions that are allocated to the S corporation's qualified production activities in computing the shareholder's QPAI for that later taxable year. Losses or deductions of the S corporation that are disallowed for taxable years beginning on or before December 31, 2004, are not taken into account in a later taxable year for purposes of computing the shareholder's QPAI for that later taxable year, whether or not the losses or deductions are allowed for other purposes.

(3) *Shareholder's share of paragraph (e)(1) wages.* Under section 199(d)(1)(A)(iii), an S corporation shareholder's share of the paragraph (e)(1) wages of the S corporation for purposes of determining the shareholder's W-2 wage limitation equals the shareholder's allocable share of those wages. Except as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), the S corporation must

allocate the paragraph (e)(1) wages among the shareholders in the same manner it allocates wage expense among those shareholders. The shareholder then must add its share of the paragraph (e)(1) wages from the S corporation to the shareholder's paragraph (e)(1) wages from other sources, if any, and then must determine the portion of those total paragraph (e)(1) wages allocable to DPGR to compute the shareholder's W-2 wages. See §1.199-2T(e)(2) for the computation of W-2 wages and for the proper allocation of such wages to DPGR.

(4) *Transition rule for definition of W-2 wages and for W-2 wage limitation.* If an S corporation and any of its shareholders have different taxable years, only one of which begins on or before May 17, 2006, the definition of W-2 wages of the S corporation and the section 199(d)(1)(A)(iii) limitation on W-2 wages from that S corporation is determined under the law applicable to S corporations based on the beginning date of the S corporation's taxable year. Thus, for example, for the short taxable year of an S corporation beginning after May 17, 2006, and ending in 2006, a shareholder's share of W-2 wages from the S corporation is determined under section 199(d)(1)(A)(iii) for taxable years beginning after May 17, 2006, even if that shareholder's taxable year began on or before May 17, 2006.

(d) *Grantor trusts.* To the extent that the grantor or another person is treated as owning all or part (the owned portion) of a trust under sections 671 through 679, such person (owner) computes its QPAI with respect to the owned portion of the trust as if that QPAI had been generated by activities performed directly by the owner. Similarly, for purposes of the W-2 wage limitation, the owner of the trust takes into account the owner's share of the paragraph (e)(1) wages of the trust that are attributable to the owned portion of the trust. The provisions of paragraph (e) of this section do not apply to the owned portion of a trust.

(e) *Non-grantor trusts and estates—(1) Allocation of costs.* The trust or estate calculates each beneficiary's share (as well as the trust's or estate's own share, if any) of QPAI and W-2 wages from the trust or estate at the trust or estate level. The beneficiary of a trust or estate may not recompute its share of QPAI or W-2 wages from the trust or estate by using another method to reallocate the trust's or estate's

qualified production costs or paragraph (e)(1) wages, or otherwise. Except as provided in paragraph (d) of this section, the QPAI of a trust or estate must be computed by allocating expenses described in section 199(d)(5) in one of two ways, depending on the classification of those expenses under §1.652(b)-3. Specifically, directly attributable expenses within the meaning of §1.652(b)-3 are allocated pursuant to §1.652(b)-3, and expenses not directly attributable within the meaning of §1.652(b)-3 (other expenses) are allocated under the simplified deduction method of §1.199-4(e) (unless the trust or estate does not qualify to use the simplified deduction method, in which case it must use the section 861 method of §1.199-4(d) with respect to such other expenses). For this purpose, depletion and depreciation deductions described in section 642(e) and amortization deductions described in section 642(f) are treated as other expenses described in section 199(d)(5). Also for this purpose, the trust's or estate's share of other expenses from a lower-tier pass-thru entity is not directly attributable to any class of income (whether or not those other expenses are directly attributable to the aggregate pass-thru gross income as a class for purposes other than section 199). A trust or estate may not use the small business simplified overall method for computing its QPAI. See §1.199-4(f)(5).

(2) *Allocation among trust or estate and beneficiaries—(i) In general.* The QPAI of a trust or estate (which will be less than zero if the CGS and deductions allocated and apportioned to DPGR exceed the trust's or estate's DPGR) and W-2 wages of a trust or estate are allocated to each beneficiary and to the trust or estate based on the relative proportion of the trust's or estate's distributable net income (DNI), as defined by section 643(a), for the taxable year that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate. To the extent that the trust or estate has no DNI for the taxable year, any QPAI and W-2 wages are allocated entirely to the trust or estate. A trust or estate is allowed the section 199 deduction in computing its taxable income to the extent that QPAI and W-2 wages are allocated to the trust or estate. A beneficiary of a trust or estate is allowed the section 199 deduction in computing its taxable income based on its share

of QPAI and W-2 wages from the trust or estate, which are aggregated with the beneficiary's QPAI and W-2 wages from other sources, if any.

(ii) *Treatment of items from a trust or estate reporting qualified production activities income.* When, pursuant to this paragraph (e), a taxpayer must combine QPAI and W-2 wages from a trust or estate with the taxpayer's total QPAI and W-2 wages from other sources, the taxpayer, when applying §§1.199-1 through 1.199-8 to determine the taxpayer's total QPAI and W-2 wages from such other sources, does not take into account the items from such trust or estate. Thus, for example, a beneficiary of an estate that receives QPAI from the estate does not take into account the beneficiary's distributive share of the estate's gross receipts, gross income, or deductions when the beneficiary determines whether a threshold or *de minimis* rule applies or when the beneficiary allocates and apportions deductions in calculating its QPAI from other sources. Similarly, in determining the portion of the beneficiary's paragraph (e)(1) wages from other sources that is attributable to DPGR (thus, the W-2 wages from other sources), the beneficiary does not take into account DPGR and non-DPGR from the trust or estate.

(3) *Transition rule for definition of W-2 wages and for W-2 wage limitation.* The definition of W-2 wages of a trust or estate and the section 199(d)(1)(A)(iii) limitation on W-2 wages from that trust or estate, and thus the beneficiary's share of W-2 wages from that trust or estate, is determined under the law applicable to pass-thru entities based on the beginning date of the taxable year of the trust or estate, regardless of the beginning date of the taxable year of the beneficiary.

(4) *Example.* The following example illustrates the application of this paragraph (e). Assume that the partnership, trust, and trust beneficiary all are calendar year taxpayers.

*Example.* (i) *Computation of DNI and inclusion and deduction amounts.* (A) *Trust's distributive share of partnership items.* Trust, a complex trust, is a partner in PRS, a partnership that engages in activities that generate DPGR and non-DPGR. In 2010, PRS distributes \$10,000 cash to Trust. PRS properly allocates (in the same manner as wage expense) paragraph (e)(1) wages of \$3,000 to Trust. Trust's distributive share of PRS items, which are properly included in Trust's DNI, is as follows:

Gross income attributable to DPGR (\$15,000 DPGR – \$5,000 CGS (including wage expense of \$1,000))	\$10,000
Gross income attributable to non-DPGR (\$5,000 other gross receipts – \$0 CGS)	5,000
Selling expenses attributable to DPGR (includes wage expense of \$2,000)	3,000
Other expenses (includes wage expense of \$1,000)	2,000

(B) *Trust's direct activities.* Trust has direct paragraph (e)(1) wages of \$2,000 for the 2010 tax-

able year. In addition to its cash distribution in 2010

from PRS, Trust also directly has the following items which are properly included in Trust's DNI:

Dividends	\$10,000
Tax-exempt interest	10,000
Rents from commercial real property operated by Trust as a business	10,000
Real estate taxes	1,000
Trustee commissions	3,000
State income and personal property taxes	5,000
Wage expense for rental business	2,000
Other business expenses	1,000

(C) *Allocation of deductions under §1.652(b)-3.*

(1) *Directly attributable expenses.* In computing Trust's DNI for the taxable year, the distributive share of expenses of PRS are directly attributable under §1.652(b)-3(a) to the distributive share of income of PRS. Accordingly, the \$5,000 of CGS, \$3,000 of selling expenses, and \$2,000 of other expenses are subtracted from the gross receipts from PRS (\$20,000), resulting in net income from PRS of \$10,000. With respect to the Trust's direct expenses, \$1,000 of the trustee commissions, the \$1,000 of real estate taxes, and the \$2,000 of wage expense are directly attributable under §1.652(b)-3(a) to the rental income.

(2) *Non-directly attributable expenses.* Under §1.652(b)-3(b), the trustee must allocate a portion of the sum of the balance of the trustee commissions (\$2,000), state income and personal property taxes (\$5,000), and the other business expenses (\$1,000) to the \$10,000 of tax-exempt interest. The portion to be attributed to tax-exempt interest is \$2,222 (\$8,000 x (\$10,000 tax exempt interest/\$36,000 gross receipts net of direct expenses)), resulting in \$7,778 (\$10,000 – \$2,222) of net tax-exempt interest. Pursuant to its authority recognized under §1.652(b)-3(b), the trustee allocates the entire amount of the remaining \$5,778 of trustee commissions, state income and personal property taxes, and other business expenses to the \$6,000 of net rental income, resulting in \$222 (\$6,000 – \$5,778) of net rental income.

(D) *Amounts included in taxable income.* For 2010, Trust has DNI of \$28,000 (net dividend income of \$10,000 + net PRS income of \$10,000 + net rental income of \$222 + net tax-exempt income of \$7,778). Pursuant to Trust's governing instrument, Trustee distributes 50%, or \$14,000, of that DNI to B, an individual who is a discretionary beneficiary of Trust. Assume that there are no separate shares under Trust, and no distributions are made to any other ben-

eficiary that year. Consequently, with respect to the \$14,000 distribution B receives from Trust, B properly includes in B's gross income \$5,000 of income from PRS, \$111 of rents, and \$5,000 of dividends, and properly excludes from B's gross income \$3,889 of tax-exempt interest. Trust includes \$20,222 in its adjusted total income and deducts \$10,111 under section 661(a) in computing its taxable income.

(ii) *Section 199 deduction.* (A) *Simplified deduction method.* For purposes of computing the section 199 deduction for the taxable year, assume Trust qualifies for the simplified deduction method under §1.199-4(e). The determination of Trust's QPAI under the simplified deduction method requires multiple steps to allocate costs. First, the Trust's expenses directly attributable to DPGR under §1.652(b)-3(a) are subtracted from the Trust's DPGR. In this step, the directly attributable \$5,000 of CGS and selling expenses of \$3,000 are subtracted from the \$15,000 of DPGR from PRS. Second, the Trust's expenses directly attributable under §1.652(b)-3(a) to non-DPGR from a trade or business are subtracted from the Trust's trade or business non-DPGR. In this step, \$4,000 of Trust expenses directly allocable to the real property rental activity (\$1,000 of real estate taxes, \$1,000 of Trustee commissions, and \$2,000 of wages) are subtracted from the \$10,000 of rental income. Third, Trust must identify the portion of its other expenses that is attributable to Trust's trade or business activities, if any, because expenses not attributable to trade or business activities are not taken into account in computing QPAI. In this step, in this example, the portion of the trustee commissions not directly attributable to the rental operation (\$2,000) are directly attributable to non-trade or business activities. In addition, the state income and personal property taxes are not directly attributable under §1.652(b)-3(a) to either trade or business or non-trade or business activities, so the portion

of those taxes not attributable to either the PRS interests or the rental operation are not trade or business expenses and, thus, are not taken into account in computing QPAI. The portion of the state income and personal property taxes that is treated as other trade or business expenses is \$3,000 (\$5,000 x \$30,000 total trade or business gross receipts/\$50,000 total gross receipts). Fourth, Trust then allocates its other trade or business expenses (not directly attributable under §1.652(b)-3(a)) between DPGR and non-DPGR on the basis of its total gross receipts from the conduct of a trade or business (\$20,000 from PRS + \$10,000 rental income). Thus, Trust combines its non-directly attributable (other) business expenses (\$2,000 from PRS + \$4,000 (\$1,000 of other business expenses + \$3,000 of income and property taxes allocated to a trade or business) from its own activities) and then apportions this total (\$6,000) between DPGR and other receipts on the basis of Trust's total trade or business gross receipts (\$6,000 of such expenses x \$15,000 DPGR/\$30,000 total trade or business gross receipts = \$3,000). Thus, for purposes of computing Trust's and B's section 199 deduction, Trust's QPAI is \$4,000 (\$7,000 – \$3,000). Because the distribution of Trust's DNI to B equals one-half of Trust's DNI, Trust and B each has QPAI from PRS for purposes of the section 199 deduction of \$2,000. B has \$1,000 of QPAI from non-Trust activities that is added to the \$2,000 QPAI from Trust for a total of \$3,000 of QPAI.

(B) *W-2 wages.* For the 2010 taxable year, Trust chooses to use the wage expense safe harbor under §1.199-2T(e)(2)(ii) to determine its W-2 wages. For its taxable year ending December 31, 2010, Trust has \$5,000 of paragraph (e)(1) wages reported on 2010 Forms W-2. Trust's W-2 wages are \$2,917, as shown in the following table:

Wage expense included in CGS directly attributable to DPGR . . . . .	\$1,000
Wage expense included in selling expense directly attributable to DPGR . . . . .	2,000
Wage expense included in non-directly attributable deductions (\$1,000 in wage expense x (\$15,000 DPGR/\$30,000 total trade or business gross receipts)) . . . . .	<u>500</u>
Wage expense allocable to DPGR . . . . .	3,500
W-2 wages ((\$3,500 of wage expense allocable to DPGR/\$6,000 of total wage expense) x \$5,000 in paragraph (e)(1) wages) . . . . .	\$2,917

(C) *Section 199 deduction computation.* (1) *B's computation.* B is eligible to use the small business simplified overall method. Assume that B has sufficient adjusted gross income so that the section 199 deduction is not limited under section 199(a)(1)(B). Because the \$14,000 Trust distribution to B equals one-half of Trust's DNI, B has W-2 wages from Trust of \$1,459 (50% x \$2,917). B has W-2 wages of \$100 from non-Trust trade or business activities (computed without regard to B's interest in Trust pursuant to §1.199-2(e)) for a total of \$1,559 of W-2 wages. B has \$1,000 of QPAI from non-Trust activities that is added to the \$2,000 QPAI from Trust for a total of \$3,000 of QPAI. B's tentative deduction is \$270 (.09 x \$3,000), limited under the W-2 wage limitation to \$780 (50% x \$1,559 W-2 wages). Accordingly, B's section 199 deduction for 2010 is \$270.

(2) *Trust's computation.* Trust has sufficient adjusted gross income so that the section 199 deduction is not limited under section 199(a)(1)(B). Because the \$14,000 Trust distribution to B equals one-half of Trust's DNI, Trust has W-2 wages of \$1,459 (50% x \$2,917). Trust's tentative deduction is \$180 (.09 x \$2,000 QPAI), limited under the W-2 wage limitation to \$730 (50% x \$1,459 W-2 wages). Accordingly, Trust's section 199 deduction for 2010 is \$180.

(f) *Gain or loss from the disposition of an interest in a pass-thru entity.* DPGR generally does not include gain or loss recognized on the sale, exchange, or other disposition of an interest in a pass-thru entity. However, with respect to a partnership, if section 751(a) or (b) applies, then gain or loss attributable to assets of the partnership giving rise to ordinary income under section 751(a) or (b), the sale, exchange, or other disposition of which would give rise to DPGR, is taken into account in computing the partner's section 199 deduction. Accordingly, to the extent that cash or property received by a partner in a sale or exchange of all or part of its partnership interest is attributable to unrealized receivables or inventory items within the meaning of section 751(c) or (d), respectively, and the sale or exchange of the unrealized receivable or inventory items would give rise to DPGR if sold, exchanged, or otherwise disposed of by the partnership, the cash or property received by the partner is taken into account by the partner in determining its DPGR for the taxable year. Likewise, to the extent that a dis-

tribution of property to a partner is treated under section 751(b) as a sale or exchange of property between the partnership and the distributee partner, and any property deemed sold or exchanged would give rise to DPGR if sold, exchanged, or otherwise disposed of by the partnership, the deemed sale or exchange of the property must be taken into account in determining the partnership's and distributee partner's DPGR to the extent not taken into account under the qualifying in-kind partnership rules. See §§1.751-1(b) and 1.199-3T(i)(7).

(g) *No attribution of qualified activities.* Except as provided in §1.199-3T(i)(7) regarding qualifying in-kind partnerships and §1.199-3T(i)(8) regarding EAG partnerships, an owner of a pass-thru entity is not treated as conducting the qualified production activities of the pass-thru entity, and vice versa. For example, if a partnership manufactures QPP within the United States, or produces a qualified film or produces utilities in the United States, and distributes or leases, rents, licenses, sells, exchanges, or otherwise disposes of such property to a partner who then, without performing its own qualifying activity, leases, rents, licenses, sells, exchanges, or otherwise disposes of such property, then the partner's gross receipts from this latter lease, rental, license, sale, exchange, or other disposition are treated as non-DPGR. In addition, if a partner manufactures QPP within the United States, or produces a qualified film or produces utilities in the United States, and contributes or leases, rents, licenses, sells, exchanges, or otherwise disposes of such property to a partnership which then, without performing its own qualifying activity, leases, rents, licenses, sells, exchanges, or otherwise disposes of such property, then the partnership's gross receipts from this latter disposition are treated as non-DPGR.

Par. 9. Section 1.199-7 is amended by adding new paragraph (b)(4) to read as follows:

*§1.199-7 Expanded affiliated groups.*

\* \* \* \* \*

(b) \* \* \*

(4) *Losses used to reduce taxable income of expanded affiliated group.* [Reserved]. For further guidance, see §1.199-7T(b)(4).

\* \* \* \* \*

Par. 10. Section 1.199-7T is added to read as follows:

*§1.199-7T Expanded affiliated groups (temporary).*

(a) [Reserved]. For further guidance, see §1.199-7(a).

(b) *Computation of expanded affiliated group's section 199 deduction.*

(1) through (3) [Reserved]. For further guidance, see §1.199-7(b)(1) through (3).

(4) *Losses used to reduce taxable income of expanded affiliated group—(i) In general.* The amount of a net operating loss (NOL) sustained by any member of an expanded affiliated group (EAG) (as defined in §1.199-7) that is used in the year sustained in determining an EAG's taxable income limitation under section 199(a)(1)(B) is not treated as an NOL carryover or NOL carryback to any taxable year in determining the taxable income limitation under section 199(a)(1)(B). For purposes of this paragraph (b)(4), an NOL is considered to be used if it reduces an EAG's aggregate taxable income, regardless of whether the use of the NOL actually reduces the amount of the deduction under §1.199-1(a) (section 199 deduction) that the EAG would otherwise derive. An NOL is not considered to be used to the extent that it reduces an EAG's aggregate taxable income to an amount less than zero. If more than one member of an EAG has an NOL used in the same taxable year to reduce the EAG's taxable income, the members' respective NOLs are deemed used in proportion to the amount of their NOLs.



(ii) *Examples.* The following examples illustrate the application of this paragraph (b)(4). For purposes of these examples, assume that all relevant parties have sufficient W-2 wages so that the section 199 deduction is not limited under section 199(b)(1).

*Example 1.* (i) *Facts.* Corporations A and B are the only two members of an EAG. A and B are both calendar year taxpayers and they do not join in the filing of a consolidated Federal income tax return. Neither A nor B had taxable income or loss prior to 2010. In 2010, A has qualified production activities income (QPAI) (as defined in §1.199-1(c)) and taxable income of \$1,000 and B has QPAI of \$1,000 and an NOL of \$1,500. In 2011, A has QPAI of \$2,000 and taxable income of \$1,000 and B has QPAI of \$2,000 and taxable income prior to the NOL deduction allowed under section 172 of \$2,000.

(ii) *Section 199 deduction for 2010.* In determining the EAG's section 199 deduction for 2010, A's \$1,000 of QPAI and B's \$1,000 of QPAI are aggregated, as are A's \$1,000 of taxable income and B's \$1,500 NOL. Thus, for 2010, the EAG has QPAI of \$2,000 and taxable income of (\$500). The EAG's section 199 deduction for 2010 is 9% of the lesser of its QPAI or its taxable income. Because the EAG has a taxable loss in 2010, the EAG's section 199 deduction is \$0.

(iii) *Section 199 deduction for 2011.* In determining the EAG's section 199 deduction for 2011, A's \$2,000 of QPAI and B's \$2,000 of QPAI are aggregated, giving the EAG QPAI of \$4,000. Also, \$1,000 of B's NOL from 2010 was used in 2010 to reduce the EAG's taxable income to \$0. The remaining \$500 of B's 2010 NOL is not considered to have been used in 2010 because it reduced the EAG's taxable income below \$0. Accordingly, for purposes of determining the EAG's taxable income limitation under section 199(a)(1)(B) in 2011, B is deemed to have only a \$500 NOL carryover from 2010 to offset a portion of its 2011 taxable income. Thus, B's taxable income in 2011 is \$1,500 which is aggregated with A's \$1,000 of taxable income. The EAG's taxable income limitation in 2011 is \$2,500. The EAG's section 199 deduction is 9% of the lesser of its QPAI of \$4,000 or its taxable income of \$2,500. Thus, the EAG's section 199 deduction in 2011 is 9% of \$2,500, or \$225. The results would be the same if neither A nor B had QPAI in 2010.

*Example 2.* The facts are the same as in *Example 1* except that in 2010 B was not a member of the same EAG as A, but instead was a member of an EAG with Corporation X, which had QPAI and taxable income of \$1,000 in 2010, and had neither taxable income nor loss in any other year. There were no other members of the EAG in 2010 besides B and X, and B and X did not file a consolidated Federal income tax return. As \$1,000 of B's NOL was used in 2010 to reduce the B and X EAG's taxable income to \$0, B is considered to have only a \$500 NOL carryover from 2010 to offset a portion of its 2011 taxable income for purposes of the taxable income limitation under section 199(a)(1)(B), just as in *Example 1*. Accordingly, the results for the A and B EAG in 2011 are the same as in *Example 1*.

*Example 3.* The facts are the same as in *Example 1* except that B is not a member of any EAG in 2011.

Because \$1,000 of B's NOL was used in 2010 to reduce the EAG's taxable income to \$0, B is considered to have only a \$500 NOL carryover from 2010 to offset a portion of its 2011 taxable income for purposes of the taxable income limitation under section 199(a)(1)(B), just as in *Example 1*. Thus, for purposes of determining B's taxable income limitation in 2011, B is considered to have taxable income of \$1,500, and B has a section 199 deduction of 9% of \$1,500, or \$135.

*Example 4.* Corporations A, B, and C are the only members of an EAG. A, B, and C are all calendar year taxpayers and they do not join in the filing of a consolidated Federal income tax return. None of the EAG members (A, B, or C) had taxable income or loss prior to 2010. In 2010, A has QPAI of \$2,000 and taxable income of \$1,000, B has QPAI of \$1,000 and an NOL of \$1,000, and C has QPAI of \$1,000 and an NOL of \$3,000. In 2011, prior to the NOL deduction allowed under section 172, A and B each has taxable income of \$200 and C has taxable income of \$5,000. In determining the EAG's section 199 deduction for 2010, A's QPAI of \$2,000, B's QPAI of \$1,000, and C's QPAI of \$1,000 are aggregated, as are A's taxable income of \$1,000, B's NOL of \$1,000, and C's NOL of \$3,000. Thus, for 2010, the EAG has QPAI of \$4,000 and taxable income of (\$3,000). In determining the EAG's taxable income limitation under section 199(a)(1)(B) in 2011, \$1,000 of B's and C's aggregate NOLs in 2010 of \$4,000 are considered to have been used in 2010 to reduce the EAG's taxable income to \$0, in proportion to their NOLs. Thus, \$250 of B's NOL from 2010 (\$1,000 x \$1,000/\$4,000) and \$750 of C's NOL from 2010 (\$1,000 x \$3,000/\$4,000) are deemed to have been used in 2010. The remaining \$750 of B's NOL and the remaining \$2,250 of C's NOL are not deemed to have been used because so doing would have reduced the EAG's taxable income in 2010 below \$0. Accordingly, for purposes of determining the EAG's taxable income limitation in 2011, B is deemed to have a \$750 NOL carryover from 2010 and C is deemed to have a \$2,250 NOL carryover from 2010. Thus, for purposes of determining the EAG's taxable income limitation, B's taxable income in 2011 is \$0 and C's taxable income in 2011 is \$2,750, which are aggregated with A's \$200 taxable income. B's unused NOL carryover from 2010 cannot be used to reduce either A's or C's 2011 taxable income. Thus, the EAG's taxable income limitation in 2011 is \$2,950, A's taxable income of \$200 plus B's taxable income of \$0 plus C's taxable income of \$2,750.

Par. 11. Section 1.199-8 is amended by adding new paragraphs (i)(5) and (6) to read as follows:

*§1.199-8 Other rules.*

\* \* \* \* \*

(i) \* \* \*  
(5) *Tax Increase Prevention and Reconciliation Act of 2005.* [Reserved]. For further guidance, see §1.199-8T(i)(5).

(6) *Losses used to reduce taxable income of expanded affiliated group.*

[Reserved]. For further guidance, see §1.199-8T(i)(6).

Par. 12. Section 1.199-8T is amended by adding new paragraphs (i)(5) and (6) to read as follows:

*§1.199-8T Other rules (temporary).*

\* \* \* \* \*

(i) \* \* \*  
(5) *Tax Increase Prevention and Reconciliation Act of 2005.* Sections 1.199-2T(e)(2), 1.199-3T(i)(7) and (8), and 1.199-5T are applicable for taxable years beginning on or after October 19, 2006. A taxpayer may apply §§1.199-2T(e)(2), 1.199-3T(i)(7) and (8), and 1.199-5T to taxable years beginning after May 17, 2006, and before October 19, 2006 regardless of whether the taxpayer otherwise relied upon Notice 2005-14, 2005-1 C.B. 498 (see §601.601(d)(2) of this chapter), the provisions of REG-105847-05, 2005-47 I.R.B. 987 (see §601.601(d)(2) of this chapter), or §§1.199-1 through 1.199-8. The applicability of §§1.199-2T(e)(2), 1.199-3T(i)(7) and (8), and 1.199-5T expires on October 16, 2009.

(6) *Losses used to reduce taxable income of expanded affiliated group.* Section 1.199-7T(b)(4) is applicable for taxable years beginning on or after October 19, 2006. A taxpayer may apply §1.199-7T(b)(4) to taxable years beginning after December 31, 2004, and before October 19, 2006 regardless of whether the taxpayer otherwise relied upon Notice 2005-14, 2005-1 C.B. 498 (see §601.601(d)(2) of this chapter), the provisions of REG-105847-05, 2005-47 I.R.B. 987 (see §601.601(d)(2) of this chapter), or §§1.199-1 through 1.199-9. The applicability of §1.199-7T(b)(4) expires on October 16, 2009.

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

Approved October 12, 2006.

Eric Solomon,  
Acting Deputy Assistant  
Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 18, 2006, 8:45 a.m., and published in the issue of the Federal Register for October 19, 2006, 71 F.R. 61662)

## Section 213.—Medical, Dental, etc., Expenses

The Service provides inflation adjustments to the limitation on the amount of eligible long-term care premiums includible in the term “medical care” for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 219.—Retirement Savings

The Service provides inflation adjustments to the applicable dollar amounts used to calculate the amount by which active participants must reduce the amount allowed as a deduction for qualified retirement contributions for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 220.—Archer MSAs

The Service provides inflation adjustments to the amounts used to determine whether a health plan is a “high deductible health plan” for purposes of determining whether an individual is eligible for a deduction for cash paid to a medical savings account for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 221.—Interest on Education Loans

The Service provides inflation adjustments to the income limitations used to determine the allowable deduction for interest on education loans for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## Section 223.—Health Savings Accounts

The Service provides inflation adjustments for calendar year 2007 to the monthly limitations on deductions under a high deductible plan and to the amounts

used in defining a high deductible plan. See Rev. Proc. 2006-53, page 996.

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

*26 CFR 1.401(l)-1: Permitted disparity in employer-provided contributions or benefits.*

**2007 covered compensation tables; permitted disparity.** The covered compensation tables under section 401 of the Code for the year 2007 are provided for use in determining contributions to defined benefit plans and permitted disparity.

### Rev. Rul. 2006-60

This revenue ruling provides tables of covered compensation under § 401(l)(5)(E) of the Internal Revenue Code (the “Code”) and the Income Tax Regulations, thereunder, for the 2007 plan year.

Section 401(l)(5)(E)(i) defines covered compensation with respect to an employee, as the average of the contribution and benefit bases in effect under section 230 of the Social Security Act (the “Act”) for each year in the 35-year period ending with the year in which the employee attains social security retirement age.

Section 401(l)(5)(E)(ii) of the Code states that the determination for any year preceding the year in which the employee attains social security retirement age shall be made by assuming that there is no increase in covered compensation after the determination year and before the employee attains social security retirement age.

Section 1.401(l)-1(c)(34) defines the taxable wage base as the contribution and benefit base under section 230 of the Act.

Section 1.401(l)-1(c)(7)(i) defines covered compensation for an employee as the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35-year period ending with the last day of the calendar year in which the employee attains (or will attain) social security retirement age. A 35-year period is used for all individuals regardless of the year of birth of the individual. In determining an employee’s covered compensation for a plan year, the taxable wage base for all calendar years beginning after the first day of the plan year is assumed to be the same as the taxable wage base in effect as of the beginning of the plan year.

An employee’s covered compensation for a plan year beginning after the 35-year period applicable under § 1.401(l)-1(c)(7)(i) is the employee’s covered compensation for a plan year during which the 35-year period ends. An employee’s covered compensation for a plan year beginning before the 35-year period applicable under § 1.401(l)-1(c)(7)(i) is the taxable wage base in effect as of the beginning of the plan year.

Section 1.401(l)-1(c)(7)(ii) provides that, for purposes of determining the amount of an employee’s covered compensation under § 1.401(l)-1(c)(7)(i), a plan may use tables, provided by the Commissioner, that are developed by rounding the actual amounts of covered compensation for different years of birth.

For purposes of determining covered compensation for the 2007 year the taxable wage base is \$97,500.

The following tables provide covered compensation for 2007:

2007 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2007 COVERED COMPENSATION TABLE II
1907	1972	\$4,488
1908	1973	4,704
1909	1974	5,004
1910	1975	5,316
1911	1976	5,664
1912	1977	6,060

## 2007 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2007 COVERED COMPENSATION TABLE II
1913	1978	6,480
1914	1979	7,044
1915	1980	7,692
1916	1981	8,460
1917	1982	9,300
1918	1983	10,236
1919	1984	11,232
1920	1985	12,276
1921	1986	13,368
1922	1987	14,520
1923	1988	15,708
1924	1989	16,968
1925	1990	18,312
1926	1991	19,728
1927	1992	21,192
1928	1993	22,716
1929	1994	24,312
1930	1995	25,920
1931	1996	27,576
1932	1997	29,304
1933	1998	31,128
1934	1999	33,060
1935	2000	35,100
1936	2001	37,212
1937	2002	39,444
1938	2004	43,992
1939	2005	46,344
1940	2006	48,816
1941	2007	51,348
1942	2008	53,820
1943	2009	56,232
1944	2010	58,608
1945	2011	60,960
1946	2012	63,276
1947	2013	65,556
1948	2014	67,680
1949	2015	69,732
1950	2016	71,664
1951	2017	73,524
1952	2018	75,300
1953	2019	77,004
1954	2020	78,660
1955	2022	81,780
1956	2023	83,280
1957	2024	84,684
1958	2025	86,004
1959	2026	87,264
1960	2027	88,464
1961	2028	89,604
1962	2029	90,660
1963	2030	91,704

2007 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2007 COVERED COMPENSATION TABLE II
1964	2031	92,700
1965	2032	93,612
1966	2033	94,440
1967	2034	95,160
1968	2035	95,760
1969	2036	96,252
1970	2037	96,612
1971	2038	96,912
1972	2039	97,188
1973	2040	97,404
1974 and later	2041	97,500

2007 Rounded Covered Compensation Table

Year of Birth	Covered Compensation
1937	39,000
1938 - 1939	45,000
1940	48,000
1941	51,000
1942	54,000
1943	57,000
1944 - 1945	60,000
1946	63,000
1947	66,000
1948 - 1949	69,000
1950	72,000
1951 - 1952	75,000
1953 - 1954	78,000
1955	81,000
1956 - 1957	84,000
1958 - 1960	87,000
1961 - 1962	90,000
1963 - 1966	93,000
1967 - 1970	96,000
1971 and later	97,500

**Drafting Information**

The principal author of this revenue ruling is Lawrence Isaacs of the Employee Plans, Tax Exempt and Government Enti-

ties Division. For further information regarding this revenue ruling, please contact the Employee Plans taxpayer assistance telephone service at 877-829-5500, between the hours of 8:30 a.m. and 4:30 p.m.

Eastern time, Monday through Friday (a toll-free number). Mr. Isaacs's telephone number is (202) 283-9710 (not a toll-free number).

26 CFR 1.401(a)-21: Rules relating to the use of an electronic medium to provide applicable notices and to make participant elections.

## T.D. 9294

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 35, and 54

#### Use of Electronic Media for Providing Employee Benefit Notices and Making Employee Benefit Elections and Consents

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations setting forth standards for electronic systems that make use of an electronic medium to provide a notice to a recipient, or to make a participant election or consent, with respect to a retirement plan, an employee benefit arrangement, or an individual retirement plan. These regulations reflect the provisions of the Electronic Signatures in Global and National Commerce Act (E-SIGN). These final regulations generally affect sponsors of, and individuals entitled to benefits under, certain retirement plans, employee benefit arrangements, and individual retirement plans.

DATES: *Effective Date:* These regulations are effective on October 20, 2006.

*Applicability Date:* These regulations generally apply to applicable notices provided, and participant elections made, on or after January 1, 2007. See §1.401(a)-21(g).

FOR FURTHER INFORMATION CONTACT: Pamela R. Kinard at (202) 622-6060 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Paperwork Reduction Act

The collections of information referenced in these final regulations were previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1632, in conjunction with the Treasury Decision (T.D. 8873, 2000-1 C.B. 713), relating to New Technologies in Retirement Plans, published on February 8, 2000 in the **Federal Register** (65 FR 6001), and control number 1545-1780, in conjunction with the Treasury Decision (T.D. 9052, 2003-1 C.B. 879), relating to Notice of Significant Reduction in the Rate of Future Benefit Accrual, published on April 9, 2003 in the **Federal Register** (68 FR 17277). Responses to these collections of information are mandatory.

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

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

##### Background

This document contains amendments to 26 CFR parts 1, 35, and 54 under section 401 of the Internal Revenue Code (Code) and other sections of the Code relating to retirement plans, employee benefit arrangements, and individual retirement plans. This Treasury Decision adds §1.401(a)-21 to the Treasury regulations, which sets forth standards for the use of an electronic medium to provide applicable notices to recipients, or to make participant elections, with respect to a retirement plan, an employee benefit arrangement, or an individual retirement plan. These final regulations reflect the applicable provisions of the Electronic Signatures in Global and National Commerce Act, Public Law 106-229 (114 Stat.

464 (2000)) (E-SIGN) as it relates to the electronic delivery of notices.

The Code and regulations thereunder, and the parallel provisions of the Employee Retirement Income Security Act of 1974 (ERISA), include a number of rules that require certain notices, elections, or consents to be written or in writing. Examples of notices, elections, or consents required to be written or in writing include a section 402(f) notice (describing rollover rights), a section 411(a)(11) notice (describing a participant's benefit commencement rights), a spousal consent under section 417(a)(2), and a section 204(h) notice (notice to participants of significant reduction in rate of future benefit accrual). For a more in-depth description of retirement plan notices, elections, or consents that are required to be written or in writing, see the background section to the preamble of the 2005 proposed regulations (REG-138362-04, 2005-33 I.R.B. 299 [70 FR 40675]).

##### E-SIGN

E-SIGN, signed into law on June 30, 2000, generally provides that electronic records and signatures are given the same legal effect as their paper counterparts. Section 101(a) of E-SIGN provides that, with respect to a transaction in or affecting interstate or foreign commerce, notwithstanding any statute, regulation, or rule of law, a signature, contract, or other record may not be denied legal effect, validity, or enforceability solely because it is in electronic form and a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.<sup>1</sup>

Section 101(b) of E-SIGN provides that E-SIGN does not limit, alter, or otherwise affect any requirement imposed by a statute, regulation, or rule of law relating to a person's rights or obligations under any statute, regulation, or rule of law except with respect to a requirement that contracts or other records be written, signed, or in non-electronic form, and also provides that E-SIGN generally does not require any person to agree to use or accept electronic signatures or records.

<sup>1</sup> The rules of section 101 of E-SIGN do not apply to certain consumer notices. These include consumer notices that are necessary for the protection of a consumer's health, safety, or shelter (e.g., cancellation of health benefits or life insurance and foreclosure on a credit agreement secured by an individual's primary residence). See section 103(b)(2)(B) and (C) of E-SIGN.

Section 101(c) of E-SIGN sets forth special protections that apply when a statute, regulation, or other rule of law requires that information relating to a transaction be provided or made available to a consumer<sup>2</sup> in writing. Under section 101(c) of E-SIGN, before the required information can be provided or made available electronically, a consumer must first affirmatively consent to receive the information electronically and the consent must be made in a manner that reasonably demonstrates the consumer's ability to access the information in electronic form (or, if the consent is not provided in such a manner, confirmation of the consent must be made electronically in a manner that reasonably demonstrates the consumer's ability to access the information in electronic form). Prior to consent, the consumer must receive certain specified disclosures. The disclosures must include, among other items, the hardware or software requirements for access to, and retention of, the electronic records, the consumer's right to withdraw his or her consent to receive the information electronically (and the consequences that follow the withdrawal of consent), the procedures for requesting a paper copy of the electronic record, and the cost, if any, of obtaining a paper copy. Section 101(c)(6) of E-SIGN generally provides that, for purposes of the consumer consent rules of section 101(c), an oral communication or a recording of an oral communication does not qualify as an electronic record.

Section 101(e) of E-SIGN provides rules relating to the electronic retention of contracts and other records that are required to be written or in writing. Section 101(e) of E-SIGN provides that if a statute, regulation, or other rule of law requires that a contract or other record relating to a transaction in or affecting interstate or foreign commerce be in writing, the legal effect, validity, or enforceability of an electronic record of the contract or other record may be denied if the contract or other record is not in a form that is capable of being retained and accurately

reproduced for later reference by all parties or persons who are entitled to retain the contract or other record.

Section 104(b)(1) of E-SIGN generally provides that a Federal regulatory or State regulatory agency that is responsible for rulemaking under any other statute has interpretative authority to issue guidance interpreting section 101 of E-SIGN with respect to that other statute. However, as a limitation on that authority, section 104(b)(2) of E-SIGN prohibits the issuance of any guidance that is not consistent with section 101 or that adds to the requirements of that section. Section 104(b)(2) of E-SIGN also requires that any agency issuing guidance interpreting E-SIGN find that there is a substantial justification for the guidance and that the methods selected to carry out the purpose of the guidance are substantially equivalent to the requirements imposed on records that are not electronic, do not impose unreasonable costs on the acceptance and use of electronic records, and do not require or accord greater legal status to a specific technology.

Section 104(d)(1) of E-SIGN authorizes a Federal regulatory agency to exempt, without condition, a specified category or type of record from the consumer consent requirements in section 101(c). The exemption may be issued only if the exemption is necessary to eliminate a substantial burden on electronic commerce and will not increase the material risk of harm to consumers.

In accordance with section 104(b)(2)(C) of E-SIGN, the Treasury Department and IRS find that there is substantial justification for these final regulations, that, for the reasons explained below, the requirements imposed on the use of electronic media under these regulations are substantially equivalent to those imposed on non-electronic records, that the requirements will not impose unreasonable costs on the acceptance and use of electronic records, and that these regulations do not require (or accord

greater legal status or effect to) the use of any specific technology.

#### *Prior Guidance Relating to Electronic Communications*

The Treasury Department and IRS have issued several items of guidance relating to the use of electronic media with respect to retirement plans and individual retirement plans.<sup>3</sup> Section 1510 of the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788, 1068) (TRA '97), provides for the Secretary of Treasury to issue guidance designed to interpret the notice, election, consent, disclosure, and timing requirements (include related recordkeeping requirements) under the Code and ERISA relating to retirement plans as applied to the use of new technologies by plan sponsors and administrators. Section 1510 of TRA '97 further provides that the guidance should maintain the protection of the rights of participants and beneficiaries.

Final regulations (T.D. 8873) relating to the use of electronic media for transmissions of participant notices and consents under sections 402(f), 411(a)(11), and 3405(e)(10)(B) were published in the **Federal Register** (65 FR 6001) on February 8, 2000 (the 2000 regulations). The 2000 regulations set forth standards for the electronic transmission of certain notices and consents that are required in connection with distributions from retirement plans.

Those regulations provide that a plan may provide a notice required under section 402(f), 411(a)(11), or 3405(e)(10)(B) either on a written paper document or through an electronic medium that is reasonably accessible to the participant. In addition, the 2000 regulations provide that any electronic system must be reasonably designed to provide the notice in a manner no less understandable to the participant than a written paper document. Furthermore, the participant must be advised of the right to request and receive a paper copy of the written paper document at no charge, and, upon request, the document

<sup>2</sup> Section 106(1) of E-SIGN generally defines a consumer as an individual who obtains products or services used primarily for personal, family, or household purposes.

<sup>3</sup> The Treasury Department and IRS have also issued guidance regarding the use of electronic media with respect to tax reporting and other tax requirements with respect to employee benefit plans. For example, Announcement 99-6, 1999-1 C.B. 352, authorizes payers of pensions, annuities, and other employee benefits to establish a system for payees to submit electronically Forms W-4P, *Withholding Certificate for Pension or Annuity Payments*, W-4S, *Request for Federal Income Tax Withholding From Sick Pay*, and W-4V, *Voluntary Withholding Request*, if certain requirements, including signature and recordkeeping requirements, are satisfied. In addition, Notice 2004-10, 2004-1 C.B. 433, authorizes the electronic delivery of certain forms relating to the reporting of contributions and distributions of pensions, simplified employee pensions, traditional IRAs, Roth IRAs, qualified tuition programs, Coverdell education savings accounts, and Archer Medical Savings Accounts. See also §§31.6051-1(j) and 1.6039-1(f).

must be provided to the participant without charge.

The 2000 regulations also permit an electronic system to satisfy the requirement of section 411(a)(11) that a participant provide written consent to a distribution if certain requirements are satisfied. First, the electronic medium must be reasonably accessible to the participant. Second, the electronic system must be reasonably designed to preclude anyone other than the participant from giving the consent. Third, the system must provide the participant with a reasonable opportunity to review and to confirm, modify, or rescind the terms of the consent before it becomes effective. Fourth, the system must provide the participant, within a reasonable time after the consent is given, a confirmation of the terms (including the form) of the distribution through either a written paper document or in an electronic format that satisfies the requirements for providing applicable notices. Thus, the participant must be advised of the right to request and to receive a confirmation copy of the consent on a written paper document without charge. The 2000 regulations did not permit the use of electronic media for any notice or election required under section 417 with respect to a waiver of a qualified joint and survivor annuity (QJSA).

The Treasury Department and IRS have issued other guidance applying the standards set forth in the 2000 regulations to other retirement plan notices and elections. For example, §1.7476-2(c)(2) provides that a notice to an interested party is deemed to be provided in a manner that satisfies the delivery requirements of §1.7476-2(c)(1) if the notice is delivered using an electronic medium under a system that satisfies the requirements of §1.402(f)-1, Q&A-5. Q&A-7 of Notice 2000-3, 2000-1 C.B. 413, provides that, until the issuance of further guidance, a plan is permitted to use electronic media to provide notices required under sections 401(k)(12) and 401(m)(11) (relating to safe harbors for section 401(k) and section 401(m) plans) if the employee receives the notice through an electronic medium that is reasonably accessible, the system is designed to provide the notice in a manner no less understandable to the employee than a written paper document, and, at the time the notice is provided, the employee is advised that the employee may request and

receive the notice on a written paper document at no charge. Similarly, §1.72(p)-1, Q&A-3(b), requires a loan from a plan to a participant to be set forth in a written paper document, in an electronic medium that satisfies standards that are the same as the standards in the 2000 regulations, or in such other form as may be approved by the Commissioner. In addition, Notice 99-1, 1999-1 C.B. 269, provides guidance relating to qualified retirement plans permitting the use of electronic media for plan participants or beneficiaries conducting account transactions for which there is no specific writing requirement, such as plan enrollments, direct rollover elections, beneficiary designations, investment change allocations, elective and after-tax contribution designations, and general plan or specific account inquiries.

In 2003, final regulations (T.D. 9052) under section 4980F were published in the **Federal Register** (68 FR 17277). Under Q&A-13 of §54.4980F-1, for a plan to provide a section 204(h) notice electronically, the section 204(h) notice must actually be received by the applicable individual or the plan administrator must take appropriate and necessary measures reasonably calculated to ensure that the method for providing the section 204(h) notice results in actual receipt. Further, the plan administrator must provide the applicable individual with a clear and conspicuous statement that the individual has a right to receive a paper version of the section 204(h) notice without the imposition of fees and, if the individual requests a paper copy of the section 204(h) notice, the paper copy must be provided without charge. The regulations under section 4980F also provide a safe harbor method for delivering a section 204(h) notice electronically, which is substantially the same as the consumer consent rules of E-SIGN.

The Department of Labor (DOL) and the Pension Benefit Guaranty Corporation (PBGC) have also issued regulations relating to the use of electronic media to furnish notices, reports, statements, disclosures, and other documents to participants, beneficiaries, and other individuals under titles I and IV of ERISA. See 29 CFR 2520.104b-1 and 29 CFR 4000.14.

On July 14, 2005, a notice of proposed rulemaking (REG-138362-04) under section 401 of the Code was published in the **Federal Register** (70 FR 40675) (the

2005 proposed regulations). On November 2, 2005, the IRS held a public hearing on the proposed regulations. Written comments responding to the notice of proposed rulemaking were also received. Although commentators raised issues with respect to certain provisions in the 2005 proposed regulations, the comments were generally positive. After consideration of all the comments, the 2005 proposed regulations are adopted, as amended by this Treasury Decision. The significant revisions are discussed below.

## Explanation of Provisions

### I. Overview.

#### A. In General.

This Treasury Decision adds §1.401(a)-21 and modifies a number of existing regulations (including the 2000 regulations and other regulations described above). These regulations set forth the standards by which a retirement plan, an employee benefit arrangement, or an individual retirement plan is permitted to use an electronic medium to provide applicable notices or for individuals in such a plan to make participant elections.

For any requirement under the Code or regulations that an employee benefit notice or election be in writing or in written form, the standards set forth in these regulations are generally the exclusive rules for providing such communication through the use of an electronic medium. Thus, for example, a retirement plan providing a section 402(f) notice through the use of an electronic medium must satisfy the rules set forth in these regulations.

For any employee benefit notice or election that is not required to be in writing or in written form, the standards set forth in these regulations function as a safe harbor. Thus, a retirement plan, an employee benefit arrangement, or individual retirement plan is permitted to satisfy either these regulations or any other applicable guidance issued by the IRS. For example, with respect to creating an electronic system to accept electronic transmissions of beneficiary designations, a retirement plan is permitted to use the rules under these regulations or continue to follow the standards set forth in Notice 99-1, which is not affected by E-SIGN.

#### B. Application of Standards.

Like the 2005 proposed regulations, these regulations apply to any notice, election, or similar communication provided to or made by a participant or beneficiary in the following retirement plans: a section 401(a) plan; a section 403(a) plan; a section 403(b) plan; a simplified employee pension (SEP) under section 408(k); a simple retirement plan under section 408(p); and an eligible governmental plan under section 457(b). In response to a comment, these regulations also provide that they apply to any notice, election, or similar communication provided to or made by an individual entitled to benefits in an individual retirement plan, including a Roth IRA under section 408A or a deemed IRA under section 408(q).

In addition, these final regulations apply to any notice, election, or similar communication provided to or made by a participant or beneficiary under the following employee benefit arrangements: an accident or health plan or arrangement under sections 104(a)(3) or 105; a cafeteria plan under section 125; an educational assistance program under section 127; a qualified transportation fringe program under section 132; an Archer MSA under section 220; and a health savings account under section 223.

These regulations do not apply to any notice, election, consent, disclosure, or obligation required under the provisions of title I or IV of ERISA over which the DOL or the PBGC has interpretative and enforcement authority.<sup>4</sup> For example, the rules in 29 CFR 2520.104b-1 of the Labor Regulations apply with respect to an employee benefit plan furnishing disclosure documents, such as a summary plan description or a summary annual report. These regulations also do not apply to Code section 411(a)(3)(B) (relating to suspension of benefits), Code section 4980B(f)(6) (relating to an individual's COBRA rights), or any other Code provision over which the DOL or the PBGC has similar interpretative authority.

In addition, the rules in these regulations apply only with respect to notices and elections relating to an individual's rights under a retirement plan, an employee benefit arrangement, or an individual retirement plan. Thus, these regulations do not apply with respect to other requirements under the Code, such as requirements relating to tax reporting, tax records, or substantiation of expenses.<sup>5</sup>

### C. Requirements for Using Electronic Media to Provide Notices and Make Elections.

These final regulations generally retain from the 2005 proposed regulations the requirement that any communication that is provided using an electronic medium satisfy all the otherwise applicable requirements (including the applicable timing and content rules) relating to that communication. Thus, for example, a section 204(h) notice provided using an electronic medium must be delivered on or before the time period required under Q&A-9 of §54.4980F-1, must satisfy the content requirements set forth in Q&A-11 of §54.4980F-1, and must satisfy the delivery requirements under these regulations.

These regulations provide that an electronic system used to provide a notice or to make an election must satisfy certain requirements. First, with respect to the content of an applicable notice, the electronic system must be reasonably designed to provide the information to a recipient in a manner no less understandable to the recipient than if provided on a written paper document. For example, a plan delivering a lengthy section 402(f) notice would not satisfy this requirement if the plan chose to provide the notice through a pre-recorded message on an automated phone system.<sup>6</sup> However, a plan with few distribution options is permitted to provide a section 411(a)(11) notice through the use of a pre-recorded message on an automated phone system. Second, the regulations require that the electronic system be reasonably designed to alert the recipi-

ent, at the time the applicable notice is provided, to the significance of the information in the notice (including the identification of the subject matter of the notice), and provide any instructions needed to access the notice, in a manner that is as readily understandable and accessible as an applicable notice provided using a written paper document. These requirements are necessary in order for the notice to fulfill their intended purpose, are substantially equivalent to the requirements imposed on non-electronic notices, and do not impose unreasonable costs on the acceptance or use of electronic records. Moreover, they do not require or accord greater legal status to a particular technology since each technology must satisfy the same standards with respect to each notice. Third, the final regulations clarify that, pursuant to section 101(e) of E-SIGN, if an electronic record of an applicable notice or a participant election is not maintained in a form that is capable of being retained and accurately reproduced for later reference, then the legal effect, validity, or enforceability of such electronic record may be denied.

## II. Use of an Electronic Medium to Provide an Applicable Notice.

A. Two Methods for Providing Applicable Notices. These regulations provide two methods by which a retirement plan, employee benefit arrangement, or an individual retirement plan is permitted to provide an applicable notice to a recipient through the use of an electronic medium. Under the first method, an applicable notice is permitted to be provided to a recipient using an electronic medium after the recipient consents to the electronic delivery of the notice (the consumer consent method). The rules under the consumer consent method reflect the consumer consent requirements at section 101(c) in E-SIGN. The Treasury Department and IRS continue to believe that an individual entitled to benefits under a retirement plan, an employee benefit arrangement, or

<sup>4</sup> See generally Reorganization Plan No. 4 of 1978 (43 FR 47713). Pursuant to section 101(a) of the Reorganization Plan No. 4 of 1978, 29 U.S.C. 1001nt, the Secretary of the Treasury has authority to issue regulations under parts 2 and 3 of subtitle B of title I of ERISA with certain exceptions. Under section 104 of the Reorganization Plan No. 4, the Secretary of Labor retains enforcement authority with respects to parts 2 and 3 of subtitle B of title 1 of ERISA, but, in exercising that authority, is bound by the regulations issued by the Secretary of Treasury.

<sup>5</sup> Code section 6001 provides rules relating to the maintenance of records, statements, and special returns. The IRS has issued guidance on electronic recordkeeping under section 6001. This guidance applies to retirement plans, employee benefits plans, and individual retirement plans. Rev. Proc. 98-25, 1998-1 C.B. 689, sets forth standards for a taxpayer maintaining records on an Automated Data Processing system. Under section 3.01 of Rev. Proc. 98-25, those standards apply to employee plans. Rev. Proc. 97-22, 1997-1 C.B. 652, provides guidance to taxpayers using an electronic storage system to maintain books and records required under section 6001. Under section 3.02 of Rev. Proc. 97-22, those requirements apply to employee plans. See also footnote 3 above.

<sup>6</sup> Note that a section 204(h) notice cannot be provided using oral communication or a recording of an oral communication. See §54.4980F-1, A-13(c)(1).



an individual retirement plan is generally a consumer, within the meaning of section 106(1) of E-SIGN, when receiving a notice that could affect the individual's benefits or other rights.<sup>7</sup> The second method (the alternative method) provides rules that are intended generally to replicate the requirements in the 2000 regulations that apply to notices required under sections 402(f), 411(a)(11), and 3405, and thereby allow plans to continue to provide these notices electronically using electronic systems that satisfy the standards in the 2000 regulations.

#### B. Consumer Consent Method for Providing Applicable Notices.

Under the consumer consent method, before an applicable notice is provided to a recipient using an electronic medium, the participant must consent to receive the communication electronically. The consent generally must be made in a manner that reasonably demonstrates that the participant can access the notice in the electronic form that will be used to provide the notice. Alternatively, the consent may be made using a written paper document, but only if the participant confirms the consent in a manner that reasonably demonstrates that the participant can access the notice in the electronic form to be provided. Prior to consenting, the participant must receive a disclosure statement that outlines the scope of the consent, the participant's right to withdraw his or her consent to receive the communication electronically (including any conditions, consequences, or fees in the event of the withdrawal), and the right to receive the communication using paper and any fees imposed for receiving paper. The disclosure must also specify the hardware and software requirements for accessing the electronic media and the procedures for updating information to contact the participant electronically. In the event the hardware or software requirements change, new consent must be obtained from the participant, generally following the rules of section 101(c) of E-SIGN. In addition, under

the consumer consent method, the applicable notice cannot be provided through the use of oral communication or a recording of an oral communication.<sup>8</sup>

Commentators requested several modifications to the rules under the consumer consent method in these regulations, including requiring plans to give recipients the opportunity to review their consumer consent elections every five years and permitting plans to use oral communications or recordings of oral communications when providing applicable notices under the consumer consent rules. Other commentators recommended that the regulations be revised to provide that, under the consumer consent method, if a participant does not have the effective ability to access the electronic medium used to provide an applicable notice or if the participant does not consent to receive the notice through the use of an electronic medium, such participant would have the right to a free paper copy of the notice.

The consumer consent method under these regulations interprets the rules of section 101(c) of E-SIGN, and section 104(b)(2) of E-SIGN restricts an agency's ability to interpret E-SIGN in any manner that is inconsistent with section 101 of E-SIGN or that adds to the requirements of that section. Accordingly, the rules under the consumer consent method of these final regulations are retained without substantive change. However, many of the issues raised by the commentators are ameliorated by the availability of the alternative method for providing applicable notices, as discussed below in *Alternative Method for Providing Applicable Notices*.

#### C. Alternative Method for Providing Applicable Notices.

These regulations exempt applicable notices from the consumer consent requirements of E-SIGN and provide an alternative method of complying with the requirement that an applicable notice be in writing or in written form if certain conditions are satisfied. This alternative method of compliance, which is based

on the 2000 regulations previously issued under section 1510 of TRA '97, satisfies the requirements of section 104(d)(1) of E-SIGN, including the requirement that any exemption from the consumer consent requirements not increase the material risk of harm to consumers.

This exemption is based on the judgment that, if the consumer consent method were the only method available to satisfy the requirements for providing an applicable notice through the use of an electronic medium, it would impose a substantial burden on electronic commerce with respect to retirement plans, employee benefit arrangements, and individual retirement plans, and that the requirements and safeguards in the 2000 regulations provide a less burdensome method without increasing the material risk of harm to recipients.

Under the alternative method, at the time the applicable notice is provided, the recipient must be advised that he or she may request and receive the applicable notice in writing on paper at no charge. In addition, any recipient of the notice must be "effectively able" to access the electronic medium used to provide the notice. This is a change in wording from the 2000 regulations, which required that the electronic medium be "reasonably accessible" to the recipient. As explained in the preamble to the 2005 proposed regulations, this change is not intended to reflect a substantive change in the rules, but rather to avoid confusion with Department of Labor Regulations interpreting the words *reasonably accessible* as used in section 101(i)(2)(D) of ERISA, as added by section 306 of the Sarbanes-Oxley Act of 2002, Public Law 107-204 (116 Stat. 745).<sup>9</sup>

One commentator requested that the regulations provide a rule under which an e-mail sent to the last known e-mail address would be deemed to have been successfully delivered. These regulations do not include such a rule.

<sup>7</sup> See also 12 CFR 202.16, 205.17, 213.6, and 2226.36, treating electronic disclosures in connection with certain credit transactions as consumer information for purposes of E-SIGN.

<sup>8</sup> See section 101(c)(6) of E-SIGN.

<sup>9</sup> Section 101(i) of ERISA sets forth a requirement for a plan administrator to notify plan participants and beneficiaries of a blackout period with respect to an individual account plan. Section 101(i)(2)(D) provides that the required blackout notice "shall be in writing, except that such notice may be in electronic or other form to the extent that such form is reasonably accessible to the recipient." Section 2520.101-3(b)(3) of the Labor Regulations interpreting this requirement provides for this notice to be in writing and furnished in any manner consistent with the requirements of section 2520.104b-1 of the Labor Regulations, including the provisions in that section relating to the use of electronic media. Those regulations also deem a notice requirement to be satisfied if certain measures are taken. Section 1.401(a)-21 of these final regulations only provides rules for satisfying, through the use of electronic media, a requirement that a notice or election be in writing.

### III. Use of an Electronic Medium to Make a Participant Election.

#### A. In General.

These regulations also set forth the requirements that apply if a consent or election is made by a person using an electronic system. The participant election rules, which are also based on the standards in the 2000 regulations, generally retain the requirements that (1) the participant be effectively able to access the electronic medium in order to make the participant election, (2) the electronic system be reasonably designed to preclude any person other than the appropriate individual from making a participant election, (3) the electronic system provide the participant making a participant election with a reasonable opportunity to review, confirm, modify, or rescind the terms of the election before it becomes effective, and (4) the individual making a participant election, within a reasonable time period, receive a confirmation of the election through either a written paper document or an electronic medium under a system that satisfies the applicable notice requirements of either the consumer consent delivery method or the alternative delivery method. Section 101(c) of E-SIGN does not apply to participant elections.

These regulations require that a participant be effectively able to access the electronic medium under an electronic system used to make a participant election, but, like the 2000 regulations, do not require that a plan also permit the election to be made by paper as an alternative to using an electronic system that is available to the participant. However, these regulations do not apply with respect to a participant who is not effectively able to access the electronic medium or media in order to make a participant election. Accordingly, the plan must offer each such participant the right to make an election in another medium that is accessible to the participant (such as a paper election). A plan that fails to offer paper or an electronic medium that a participant is effectively able to access will fail to comply with the participant election requirements and would likely violate other qualification requirements, such as the requirements that a plan to operate in accordance with its terms (by actually making available all distribution options provided by the plan) and the requirements

of §1.401(a)(4)–4 under which benefits, rights, and features (including the right to early distribution) must be made available in a nondiscriminatory manner.

#### B. Use of Electronic Media for QJSA Notices and Elections.

The participant election rules in these regulations extend the use of electronic media to the notice and election rules applicable to plans that are subject to the QJSA requirements of section 417. Accordingly, a plan subject to the QJSA requirements is permitted to provide the notice required by section 417 to a participant through the use of electronic media as long as the plan complies with either of the two methods described above for providing electronic notices. Similarly, a participant's consent to a distribution is permitted to be provided through the use of electronic media if the plan complies with the standards described below, subject to obtaining a valid spousal consent.

Section 417 requires any spousal consent to a waiver of a QJSA to be witnessed by a plan representative or a notary public. In accordance with section 101(g) of E-SIGN, these regulations authorize the use of an electronic acknowledgment or notarization if the standards of section 101(g) of E-SIGN and State law applicable to notary publics are satisfied. These regulations retain the requirement from the 2005 proposed regulations that the signature of a spouse be witnessed in the physical presence of the plan representative or notary public. Several comments were received on the participant election rules, particularly as they relate to spousal consents. The comments generally fall into two categories: (1) commentators who favored retaining the pen-and-ink signature and physical presence requirements for spousal consents; and (2) commentators who favored extending the use of electronic media to spousal consents, and eliminating the physical presence requirement.

Commentators in the first category raised issues with rules in the 2005 proposed regulations relating to the authentication requirement and the requirement that a spousal consent of a waiver of a QJSA be witnessed in the physical presence of a notary public or a plan representative. In general, these commentators recommended that the regulations be revised to provide additional safeguards for

spousal consents because, unlike other participant elections, a spousal consent could involve a conflict of interest between the parties involved in the election. With respect to the authentication requirement, these commentators argued that the authentication requirement would be vague and not require an evidentiary record. According to the commentators, requiring a pen-and-ink signature and maintaining the physical presence requirement would provide necessary additional safeguards for spousal consents by creating an evidentiary record for later disputes regarding the validity of the consent and reducing the likelihood of fraud.

Commentators who favored extending the use of electronic media for all participant elections, including spousal consents, generally recommended that the final regulations eliminate the physical presence requirement for spousal consents. These commentators argued that protections are already available to protect a spouse making a participant election using electronic media. For example, a retirement plan could require a separate PIN for the spouse to which the participant would not have access.

In light of these comments, these regulations clarify that the determination of whether an electronic system used in making participant elections is reasonably designed to preclude any person other than the appropriate individual from making a participant election is based on facts and circumstances, and that a relevant factor is whether the participant election has the potential for a conflict of interest between the individuals involved in the election. See *Example 3* in §1.401(a)–21(f) of these regulations for an illustration of the participant election rules when a spousal consent is required. These regulations also clarify that if an applicable notice or participant election is recorded electronically, the electronic record must be in a form that is capable of being reproduced for later reference (see discussion of the general rules under the heading *Requirements for Using Electronic Media to Provide Notices and Make Elections*).

The requirement that the signature of a spouse to be witnessed in the physical presence of a plan representative or notary public coordinates with the authentication requirement because the physical presence requirement increases the likelihood that

the electronic system is reasonably designed to preclude any person other than the appropriate individual from making the election. In contrast, an electronic system that permits the use of a spousal PIN to sign a spousal consent electronically creates greater risk that the spousal consent may be fraudulently signed. Because of the potential risk that two spouses could share information regarding PINs, the Treasury Department and IRS believe that any electronic system that relies solely on separate PINs would not provide the same level of safeguards as provided by the physical presence requirement and would not be reasonably designed to preclude any person other than the appropriate individual from making the election. Accordingly these regulations do not adopt the suggestion that spousal PINs be permitted in lieu of the physical presence requirement, and instead retain from the 2005 proposed regulations the physical presence requirement for electronic notarization of spousal consents. The Treasury Department and IRS believe that permitting electronic notarization of spousal consents under the participant election rules, in conjunction with the physical presence requirement, reflects the appropriate interpretation of section 417 and properly balances minimizing the burden of plan administration with protecting the rights of spouses.

Technology is constantly evolving and, at some point in the future, technology could exist that would provide the same safeguards as the physical presence requirement. Therefore, in light of the comments received, these regulations add a delegation to the Commissioner. Under this delegation, the Commissioner may provide that the use of procedures under an electronic system with respect to an electronic medium is deemed to satisfy the physical presence requirement, but only if those procedures with respect to the electronic system provide the same safeguards for participant elections as provided through the physical presence requirement.

#### *C. Conforming Amendments to Other Rules in Law.*

These regulations modify a number of existing regulations (including the 2000 regulations) that have previously provided rules relating to the use of new technologies in providing applicable notices or making participant elections that are

required to be in writing or in written form. These modifications, which merely add the consumer consent requirements of E-SIGN, are not expected to affect adversely the existing administrative practices of plan sponsors designed to comply with the 2000 regulations.

In addition, these regulations apply to categories of applicable notices that were not previously addressed in the 2000 regulations or subsequent regulations. As such, these regulations apply whenever there is a requirement that an applicable notice under one of the covered sections be provided in written form or in writing, without regard to whether that other requirement specifically cross-references these regulations. Thus, safe harbor notices under sections 401(k)(12)(D) and 401(m)(11), which are required to be in writing, can be provided electronically if the requirements of section 1.401(a)-21 of this chapter are satisfied.

#### **Effective Date**

The rules provided in §1.401(a)-21 apply to applicable notices provided, and to participant elections made, on or after January 1, 2007. However, a retirement plan, an employee benefit arrangement, or an individual retirement plan that provides an applicable notice or makes a participant election that complies with the requirements set forth in these regulations on or after October 1, 2000, and before January 1, 2007, will not be treated as failing to provide an applicable notice or to make a participant election merely because the notice or election was not in writing or written form.

#### **Special Analyses**

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore a regulatory assessment is not required. It has also been determined that the provisions of 5 U.S.C. 553(b) and (d) do not apply to this Treasury Decision. It is hereby certified that the collection of information in these regulations will not have a significant impact on a substantial number of small entities. This certification is based on the fact that these regulations only provide guidance on how to satisfy existing collection of information requirements through the use of electronic me-

dia. Accordingly, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the NPRM preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### **Drafting Information**

The principal author of these regulations is Pamela R. Kinard of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in their development.

\* \* \* \* \*

#### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR parts 1, 35, and 54 are amended as follows:

#### **PART 1—INCOME TAXES**

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

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

Section 1.401(a)-21 also issued under 26 U.S.C. 401 and section 104 of the Electronic Signatures in Global and National Commerce Act, Public Law 106-229 (114 Stat. 464). \* \* \*

Par. 2. Section 1.72(p)-1, Q&A-3, is amended by revising the text of paragraph (b) to read as follows:

*§1.72(p)-1 Loans treated as distributions.*

\* \* \* \* \*

A-3. \* \* \*

(b) \* \* \* A loan does not satisfy the requirements of this paragraph unless the loan is evidenced by a legally enforceable agreement (which may include more than one document) and the terms of the agreement demonstrate compliance with the requirements of section 72(p)(2) and this section. Thus, the agreement must specify the amount and date of the loan and the repayment schedule. The agreement does not have to be signed if the agreement is enforceable under applicable law without being signed. The agreement must be set forth either—

- (1) In a written paper document; or
- (2) In a document that is delivered through an electronic medium under an electronic system that satisfies the requirements of §1.401(a)–21 of this chapter.

\* \* \* \* \*

Par. 3. Section 1.132–9(b), Q&A–12, is amended by adding a sentence to the end of the text in paragraph (b) to read as follows:

*§1.132–9 Qualified transportation fringes.*

\* \* \* \* \*

A–12. \* \* \* \*

(b) \* \* \* See §1.401(a)–21 of this chapter for rules permitting the use of electronic media to make participant elections with respect to employee benefit arrangements.

\* \* \* \* \*

Par. 4. Section 1.401(a)–21 is added to read as follows:

*§1.401(a)–21 Rules relating to the use of an electronic medium to provide applicable notices and to make participant elections.*

(a) *Introduction*—(1) *In general*—(i) *Permission to use an electronic medium.* This section provides rules relating to the use of an electronic medium to provide applicable notices and to make participant elections as defined in paragraph (e)(1) and (6) of this section with respect to retirement plans, employee benefit arrangements, and individual retirement plans described in paragraph (a)(2) of this section. The rules in this section reflect the provisions of the Electronic Signatures in Global and National Commerce Act, Public Law 106–229 (114 Stat. 464 (2000) (E-SIGN)).

(ii) *Notices and elections required to be in writing or in written form*—(A) *In general.* The rules of this section must be satisfied in order to use an electronic medium to provide an applicable notice or to make a participant election if the notice or election is required to be in writing or in written form under the Internal Revenue Code, Department of Treasury regulations, or other guidance issued by the Commissioner.

(B) *Rules relating to applicable notices.* An applicable notice that is provided using an electronic medium is treated as being provided in writing or in written form if

and only if the requirements of paragraph (a)(5) of this section are satisfied and either the consumer consent requirements of paragraph (b) of this section or the requirements for exemption from the consumer consent requirements under paragraph (c) of this section are satisfied. For example, in order to provide a section 402(f) notice electronically, a qualified plan must satisfy either the consumer consent requirements of paragraph (b) of this section or the requirements for exemption under paragraph (c) of this section. If a plan fails to satisfy either of these requirements, the plan must provide the section 402(f) notice using a written paper document in order to satisfy the requirements of section 402(f).

(C) *Rules relating to participant elections.* A participant election that is made using an electronic medium is treated as being provided in writing or in written form if and only if the requirements of paragraphs (a)(5) and (d) of this section are satisfied.

(iii) *Safe harbor method for applicable notices and participant elections that are not required to be in writing or written form.* For an applicable notice or a participant election that is not required to be in writing or in written form, the rules of this section provide a safe harbor method for using an electronic medium to provide the applicable notice or to make the participant election.

(2) *Application of rules*—(i) *Notices, elections, or consents under retirement plans.* The rules of this section apply to any applicable notice or any participant election relating to the following retirement plans: a qualified retirement plan under section 401(a) or 403(a); a section 403(b) plan; a simplified employee pension (SEP) under section 408(k); a simple retirement plan under section 408(p); or an eligible governmental plan under section 457(b).

(ii) *Notices, elections, or consents under other employee benefit arrangements.* The rules of this section also apply to any applicable notice or any participant election relating to the following employee benefit arrangements: an accident and health plan or arrangement under sections 104(a)(3) and 105; a cafeteria plan under section 125; an educational assistance program under section 127; a qualified transportation fringe program under section 132; an Archer MSA under section

220; or a health savings account under section 223.

(iii) *Notices, elections, or consents under individual retirement plans.* The rules of this section also apply to any applicable notice or any participant election relating to individual retirement plans, including a Roth IRA under section 408A; or a deemed IRA under a qualified employer plan described in section 408(q).

(3) *Limitation on application of rules*—(i) *In general.* The rules of this section do not apply to any notice, election, consent, disclosure, or obligation required under the provisions of title I or IV of the Employee Retirement Income Security Act of 1974, as amended (ERISA), over which the Department of Labor or the Pension Benefit Guaranty Corporation has interpretative and enforcement authority. For example, the rules in 29 CFR 2520.104b–1 of the Department of Labor Regulations apply with respect to an employee benefit plan providing disclosure documents, such as a summary plan description or a summary annual report. The rules in this section also do not apply to Internal Revenue Code section 411(a)(3)(B) (relating to suspension of benefits), Internal Revenue Code section 4980B(f)(6) (relating to an individual’s COBRA rights), or any other Internal Revenue Code provision over which Department of Labor or the Pension Benefit Guaranty Corporation has similar interpretative authority.

(ii) *Recordkeeping and other requirements.* The rules in this section only apply with respect to applicable notices and participant elections relating to an individual’s rights under a retirement plan, an employee benefit arrangement, or an individual retirement plan. Thus, the rules in this section do not alter the otherwise applicable requirements under the Internal Revenue Code, such as the requirements relating to tax reporting, tax records, or substantiation of expenses. See section 6001 for rules relating to the maintenance of records, statements, and special returns. See also section 101(e) of E-SIGN, which provides that if an electronic record of an applicable notice or a participant election is not maintained in a form that is capable of being retained and accurately reproduced for later reference, then the legal effect, validity, or enforceability of such electronic record may be denied.

(4) *General requirements related to applicable notices and participant elections.* The rules of this section supplement the general requirements related to each applicable notice and participant election. Thus, in addition to satisfying the rules for timing and content, the rules in this section must be satisfied.

(5) *Requirements related to the design of an electronic system used to deliver applicable notices and to make participant elections—(i) The electronic system must take into account the content of a notice.* With respect to the content of an applicable notice, the electronic system must be reasonably designed to provide the information in the notice to a recipient in a manner that is no less understandable to the recipient than a written paper document.

(ii) *Identification of the significance of information in the notice.* The electronic system must be designed to alert the recipient, at the time an applicable notice is provided, to the significance of the information in the notice (including identification of the subject matter of the notice), and provide any instructions needed to access the notice, in a manner that is readily understandable.

(b) *Consumer consent requirements—(1) Requirements.* With respect to an applicable notice, the consumer consent requirements of this paragraph (b) are satisfied if—

(i) The requirements in paragraphs (b)(2) through (4) of this section are satisfied; and

(ii) In accordance with section 101(c)(6) of E-SIGN, the applicable notice is not provided through the use of oral communication or a recording of an oral communication.

(2) *Consent—(i) In general.* The recipient must affirmatively consent to the delivery of the applicable notice using an electronic medium. This consent must be either—

(A) Made electronically in a manner that reasonably demonstrates that the recipient can access the applicable notice in the electronic medium in the form that will be used to provide the notice; or

(B) Made using a written paper document (or using another form not described in paragraph (b)(2)(i)(A) of this section), but only if the recipient confirms the consent electronically in a manner that reasonably demonstrates that the recipient can ac-

cess the applicable notice in the electronic medium in the form that will be used to provide the notice.

(ii) *Withdrawal of consumer consent.* The consent to receive electronic delivery requirement of this paragraph (b)(2) is not satisfied if the recipient withdraws his or her consent before the applicable notice is delivered.

(3) *Required disclosure statement.* The recipient, prior to consenting under paragraph (b)(2)(i) of this section, must be provided with a clear and conspicuous statement containing the disclosures described in paragraphs (b)(3)(i) through (v) of this section:

(i) *Right to receive paper document—(A) In general.* The statement informs the recipient of any right to have the applicable notice be provided using a written paper document or other nonelectronic form.

(B) *Post-consent request for paper copy.* The statement informs the recipient how, after having provided consent to receive the applicable notice electronically, the recipient may, upon request, obtain a paper copy of the applicable notice and whether any fee will be charged for such copy.

(ii) *Right to withdraw consumer consent.* The statement informs the recipient of the right to withdraw consent to receive electronic delivery of an applicable notice on a prospective basis at any time and explains the procedures for withdrawing that consent and any conditions, consequences, or fees in the event of the withdrawal.

(iii) *Scope of the consumer consent.* The statement informs the recipient whether the consent to receive electronic delivery of an applicable notice applies only to the particular transaction that gave rise to the applicable notice or to other identified transactions that may be provided or made available during the course of the parties' relationship. For example, the statement may provide that a recipient's consent to receive electronic delivery will apply to all future applicable notices of the recipient relating to the employee benefit arrangement until the recipient is no longer a participant in the employee benefit arrangement (or withdraws the consent).

(iv) *Description of the contact procedures.* The statement describes the proced-

dures to update information needed to contact the recipient electronically.

(v) *Hardware or software requirements.* The statement describes the hardware and software requirements needed to access and retain the applicable notice.

(4) *Post-consent change in hardware or software requirements.* If, after a recipient provides consent to receive electronic delivery, there is a change in the hardware or software requirements needed to access or retain the applicable notice and such change creates a material risk that the recipient will not be able to access or retain the applicable notice in electronic format—

(i) The recipient must receive a statement of—

(A) The revised hardware or software requirements for access to and retention of the applicable notice; and

(B) The right to withdraw consent to receive electronic delivery without the imposition of any fees for the withdrawal and without the imposition of any condition or consequence that was not previously disclosed in paragraph (b)(3) of this section; and

(ii) The recipient must reaffirm consent to receive electronic delivery in accordance with the requirements of paragraph (b)(2) of this section.

(c) *Exemption from consumer consent requirements—(1) In general.* This paragraph (c) is satisfied if the conditions in paragraphs (c)(2) and (3) of this section are satisfied. This paragraph (c) constitutes an exemption from the consumer consent requirements of section 101(c) of E-SIGN pursuant to the authority granted in section 104(d)(1) of E-SIGN.

(2) *Effective ability to access.* For purposes of this paragraph (c), the electronic medium used to provide an applicable notice must be a medium that the recipient has the effective ability to access.

(3) *Free paper copy of applicable notice.* At the time the applicable notice is provided, the recipient must be advised that he or she may request and receive the applicable notice in writing on paper at no charge, and, upon request, that applicable notice must be provided to the recipient at no charge.

(d) *Special rules for participant elections—(1) In general.* This paragraph (d) is satisfied if the conditions described in

the following paragraphs (d)(2) through (6) are satisfied:

(2) *Effective ability to access.* The electronic medium under an electronic system used to make a participant election must be a medium that the person who is eligible to make the election is effectively able to access. If the appropriate individual is not effectively able to access the electronic medium for making the participant election, the participant election will not be treated as made available to that individual. Thus, for example, the participant election will not be treated as made available to that individual for purposes of the rules under section 401(a)(4).

(3) *Authentication.* The electronic system used in making participant elections is reasonably designed to preclude any person other than the appropriate individual from making the election. Whether this condition is satisfied is based on facts and circumstances, including whether the participant election has the potential for a conflict of interest between the individuals involved in the election. See *Examples 3, 4, and 5* of paragraph (f) of this section for illustrations of electronic systems that satisfy the authentication requirement of this paragraph (d)(3).

(4) *Opportunity to review.* The electronic system used in making participant elections provides the person making the participant election with a reasonable opportunity to review, confirm, modify, or rescind the terms of the election before the election becomes effective.

(5) *Confirmation of action.* The person making the participant election receives, within a reasonable time, a confirmation of the effect of the election under the terms of the plan or arrangement through either a written paper document or an electronic medium under a system that satisfies the requirements of either paragraph (b) or (c) of this section (as if the confirmation were an applicable notice).

(6) *Participant elections, including spousal consents, that are required to be witnessed by a plan representative or a notary public—(i) In general.* In the case of a participant election which is required to be witnessed by a plan representative or a notary public (such as a spousal consent under section 417), the signature of the individual making the participant election is witnessed in the physical presence of a plan representative or a notary public.

(ii) *Electronic notarization permitted.* If the requirements of paragraph (d)(6)(i) of this section are satisfied, an electronic notarization acknowledging a signature (in accordance with section 101(g) of E-SIGN and state law applicable to notary publics) will not be denied legal effect if the signature of the individual is witnessed in the physical presence of a notary public.

(iii) *Delegation to Commissioner.* In guidance published in the Internal Revenue Bulletin, the Commissioner may provide that the use of procedures under an electronic system is deemed to satisfy the physical presence requirement under paragraph (d)(6)(i) of this section, but only if those procedures with respect to the electronic system provide the same safeguards for participant elections as are provided through the physical presence requirement. See §601.601(d)(2)(ii)(b) of this chapter.

(e) *Definitions.* The definitions in this paragraph (e) apply for purposes of this section.

(1) *Applicable notice.* The term *applicable notice* includes any notice, report, statement, or other document required to be provided to a recipient under a retirement plan, employee benefit arrangement, or individual retirement plan as described in paragraph (a)(2) of this section.

(2) *Electronic.* The term *electronic* means technology having electrical, digital, magnetic, wireless, optical, electromagnetic, voice-recording systems, or similar capabilities.

(3) *Electronic medium.* The term *electronic medium* means an electronic method of communication (e.g., website, electronic mail, telephonic system, magnetic disk, and CD-ROM).

(4) *Electronic record.* The term *electronic record* means an applicable notice or a participant election that is created, generated, sent, communicated, received, or stored by electronic media.

(5) *Electronic system.* The term *electronic system* means a system designed for creating, generating, sending, receiving, storing, retrieving, displaying, or processing information that makes use of any electronic medium.

(6) *Participant election.* The term *participant election* includes any consent, election, request, agreement, or similar communication made by or from a participant, beneficiary, alternate payee, or

an individual entitled to benefits under a retirement plan, employee benefit arrangement, or individual retirement plan as described in paragraph (a)(2) of this section.

(7) *Recipient.* The term *recipient* means a plan participant, beneficiary, employee, alternate payee, or any other person to whom an applicable notice is to be provided.

(f) *Examples.* The following examples illustrate the rules of this section. *Examples 1, 2, 3, and 6* assume that the requirements of paragraph (a)(4) and (5) of this section are satisfied.

*Example 1.* (i) *Facts involving using the consumer consent requirements to deliver a section 402(f) notice via e-mail.* Plan A, a qualified plan, permits participants to request benefit distributions from the plan on Plan A's Internet website. Under Plan A's system for such transactions, a participant must enter his or her account number, personal identification number (PIN), and his or her e-mail address to which the notice is to be sent. The participant's PIN and account number must match the information in Plan A's records in order for the transaction to proceed. Participant H requests a distribution from Plan A on Plan A's website, and, at the time of the request for distribution, a disclosure statement appears on the computer screen that explains that Participant H can consent to receive the section 402(f) notice electronically. The disclosure statement provides information relating to the consent, including how to receive a paper copy of the notice, how to withdraw consent, the hardware and software requirements, and the procedures for accessing the section 402(f) notice, which is in a file format from a specific spreadsheet program. After reviewing the disclosure statement, which satisfies the requirements of paragraph (b)(3) of this section, Participant H consents to receive the section 402(f) notice via e-mail by selecting the consent button at the end of the disclosure statement. As a part of the consent procedure, an e-mail is sent to Participant H's e-mail address in order to demonstrate that Participant H can access the spreadsheet program. In the e-mail, Participant H is prompted to answer a question from the spreadsheet program, which is in an attachment to the e-mail. Once Participant H correctly answers the question, the section 402(f) notice is then delivered to Participant H via e-mail.

(ii) *Conclusion.* In this *Example 1*, Plan A's delivery of the section 402(f) notice to Participant H satisfies the requirements of paragraph (b) of this section.

*Example 2.* (i) *Facts—(A) Facts involving using the alternative method to deliver a section 411(a)(11) notice via e-mail.* Plan B, a qualified plan, permits participants to request benefit distributions from the plan on Plan B's Internet website. Under Plan B's system for such transactions, a participant must enter his or her account number and personal identification number (PIN), and his or her e-mail address to which the notice is to be sent. The participant's PIN and account number must match the information in Plan B's records in order for the transaction to proceed. After Participant K, a single employee, requests a distribu-

tion from Plan B on Plan B's Internet website, the plan administrator provides Participant K with a section 411(a)(11) notice in an attachment to an e-mail. Plan B sends the e-mail with a request for a computer generated notification that the message was received and opened. The e-mail instructs Participant K to read the attachment for important information regarding the request for a distribution. In addition, the e-mail also states that Participant K may request the section 411(a)(11) notice on a written paper document and that, if Participant K requests the notice on a written paper document, it will be provided at no charge. Plan B receives notification indicating that the e-mail was received and opened by Participant K.

(B) *Facts involving making a participant's consent to a distribution.* In order to consent to a distribution, Plan B requires a participant to enter the participant's account number and PIN in order to preclude any person other than the participant from making the election. After the authentication process, Participant K completes a distribution request form on the website. After completing the request form, the website provides a summary of the information entered on the form and gives Participant K an opportunity to review or modify the distribution request form before the transaction is completed. Within a reasonable period of time after Participant K consents to the distribution, the plan administrator, by e-mail, sends confirmation of the terms (including the form) of the distribution to Participant K and advises Participant K that, upon request, the confirmation may be provided to Participant K on a written paper document at no charge. Plan B retains an electronic copy of the consent to the distribution in a form that is capable of being retained and accurately reproduced for later reference by Participant K.

(ii) *Conclusion.* In this *Example 2*, Plan B's delivery of the section 411(a)(11) notice and the electronic system used to make Participant K's consent to a distribution satisfy the requirements of paragraphs (a), (c), and (d) of this section.

*Example 3.* (i) *Facts involving the transmission of a spousal consent via electronic notarization.* Plan C, a qualified money purchase pension plan, permits a married participant to request a plan loan through the Plan C's Internet website with the notarized consent of the spouse. Under Plan C's system for requesting a plan loan, a participant must enter his or her account number, personal identification number (PIN), and his or her e-mail address. The information entered by the participant must match the information in Plan C's records in order for the transaction to proceed. Participant M, a married participant, is effectively able to access the website available to apply for a plan loan. In order to apply for a loan, Plan C requires a participant to enter the participant's account number and PIN in order to preclude any person other than the participant from making the election. Participant M completes the loan application on Plan C's website. Within a reasonable period of time after submitting the plan loan application, the plan administrator, by e-mail, sends Participant M the loan application, including all attachments setting forth the terms of the loan agreement and all other required information. In the e-mail, Plan C also notifies Participant M that, upon request, the loan application may be provided to Participant M on a written paper document at no charge. Plan C then instructs Participant M that, in order for the loan application to proceed, Participant

M must submit to the plan administrator a notarized spousal consent form. Participant M and M's spouse go to a notary public and the notary witnesses Participant M's spouse signing the spousal consent for the loan agreement on an electronic signature capture pad with adequate security. After witnessing M's spouse signing the spousal consent, the notary public sends an e-mail with an electronic acknowledgement that is attached to or logically associated with the signature of M's spouse to the plan administrator. The electronic acknowledgement is in accordance with section 101(g) of E-SIGN and the relevant state law applicable to notary publics. After the plan receives the e-mail, Plan C sends an e-mail to Participant M, giving M a reasonable period to review and confirm the completed loan application and to determine whether the loan application should be modified or rescinded. In addition, the e-mail to Participant M also provides that M may request the completed loan application on a written paper document and that, if M requests the written paper document, it will be provided at no charge. Plan C retains an electronic copy of the loan agreement, including the spousal consent, in a form that is capable of being retained and accurately reproduced for later reference by all parties.

(ii) *Conclusion.* In this *Example 3*, the transmission of the plan loan agreement satisfies the requirements of paragraphs (a), (c), and (d) of this section. By requiring that the spouse sign the spousal consent on an electronic signature capture pad in the physical presence of a notary public, the electronic system satisfies the requirement that the system be reasonably designed to preclude any person other than the appropriate individual from making the election. Thus, the electronic notarization of spousal consent satisfies the requirements of paragraphs (a) and (d) of this section.

*Example 4.* (i) *Facts—(A) Facts involving using the alternative method of compliance to deliver a section 411(a)(11) notice via an automated telephone system.* A qualified profit-sharing plan (Plan D) permits participants to request distributions through an automated telephone system. Under Plan D's system for such transactions, a participant must enter his or her account number and personal identification number (PIN); this information must match the information in Plan D's records in order for the transaction to proceed. Plan D provides only the following distribution options: single-sum payment; and annual installments over 5, 10, or 20 years. Participant N, a single participant, requests a distribution from Plan D by following the applicable instructions on the automated telephone system. After Participant N has requested the distribution, the automated telephone system recites the section 411(a)(11) notice over the phone. The automated telephone system also advises Participant N that, upon request, the notice may be provided on a written paper document and that, if Participant N so requests, the notice will be provided on a written paper document at no charge.

(B) *Facts involving making a participant's consent to a distribution via an automated telephone system.* In order to consent to a distribution, Plan D requires a participant to enter the participant's account number and PIN in order to preclude any person other than the participant from making the election. Participant N requests a distribution by entering information on the automated telephone system. After completing the request, the automated telephone system provides a oral summary of the information entered

and gives Participant N an opportunity to review or modify the distribution request before the transaction is completed. Plan D's automated telephone system confirms the distribution request to Participant N and advises Participant N that, upon request, a confirmation may be provided on a written paper document at no charge. Plan D retains an electronic copy of the consent to the distribution in a form that is capable of being retained and accurately reproduced for later reference by Participant N.

(ii) *Conclusion.* In this *Example 4*, because Plan D has relatively few and simple distribution options, the provision of the section 411(a)(11) notice through the automated telephone system is no less understandable to the participant than a written paper notice for purposes of paragraph (a)(5)(i) of this section. In addition, the automated telephone procedures of Plan D satisfy the applicable requirements of paragraphs (a), (c), and (d) of this section.

*Example 5.* (i) *Facts.* Same facts as *Example 4* of this paragraph (f), except that, pursuant to Plan D's system for processing such transactions, a participant who so requests is transferred to a customer service representative whose conversation with the participant is recorded. The customer service representative provides the section 411(a)(11) notice from a prepared text and processes the participant's distribution in accordance with the predetermined instructions from the plan administrator.

(ii) *Conclusion.* As in *Example 4* of this paragraph (f), because Plan D has relatively few and simple distribution options, the provision of the section 411(a)(11) notice through the automated telephone system is no less understandable to the participant than a written paper notice for purposes of paragraph (a)(4) of this section. Further, in this *Example 5*, the customer service telephone procedures of Plan D satisfy the requirements of paragraphs (a), (c), and (d) of this section.

*Example 6.* (i) *Facts.* Plan E, a qualified plan, permits participants to request distributions by e-mail on the employer's e-mail system. Under this system, a participant must enter his or her account number, personal identification number (PIN), and e-mail address. This information must match that in Plan E's records in order for the transaction to proceed. If a participant requests a distribution by e-mail, the plan administrator provides the participant with a section 411(a)(11) notice by e-mail. The plan administrator also advises the participant by e-mail that he or she may request the section 411(a)(11) notice on a written paper document and that, if the participant requests the notice on a written paper document, it will be provided at no charge. Participant Q requests a distribution and receives the section 411(a)(11) notice from the plan administrator by reply e-mail. However, before Participant Q elects a distribution, Q terminates employment. Following termination of employment, Participant Q no longer has access to the employer's e-mail system.

(ii) *Conclusion.* In this *Example 6*, Plan E does not satisfy the participant election requirements under paragraph (d) of this section because Participant Q is not effectively able to access the electronic medium used to make the participant election. Plan E must provide Participant Q with the opportunity to make the participant election through a written paper document or another system that Participant Q is effectively able to access, such as the automated telephone

systems described in *Example 4* and *Example 5* of this paragraph (f).

(g) *Effective date.* The rules provided in this section apply to applicable notices provided, and to participant elections made, on or after January 1, 2007. However, a retirement plan, an employee benefit arrangement, or an individual retirement plan that provides an applicable notice or makes a participant election that complies with the requirements set forth in these regulations on or after October 1, 2000, and before January 1, 2007, will not be treated as failing to provide an applicable notice or to make a participant election merely because the notice or election was not in writing or written form.

Par. 5. Section 1.401(k)-3 is amended by adding a sentence to the end of the text of paragraph (d)(1) to read as follows:

*§1.401(k)-3 Safe harbor requirements.*

\*\*\*\*\*

(d) \*\*\*

(1) \*\*\* See §1.401(a)-21 of this chapter for rules permitting the use of electronic media to provide applicable notices to recipients with respect to retirement plans.

\*\*\*\*\*

Par. 6. Section 1.402(f)-1 is amended by:

- (1) Revising A-5.
- (2) Removing Q&A-6.

The revision reads as follows:

*§1.402(f)-1 Required explanation of eligible rollover distributions; questions and answers.*

\*\*\*\*\*

A-5. Yes. See §1.401(a)-21 of this chapter for rules permitting the use of electronic media to provide applicable notices to recipients with respect to retirement plans.

Par. 7. Section 1.411(a)-11 is amended by:

- (1) Revising the text of paragraphs (f)(1) and (2).
- (2) Removing paragraph (g).

The revisions read as follows.

*§1.411(a)-11 Restriction and valuation of distributions.*

\*\*\*\*\*

(f) \*\*\*

(1) \*\*\* The notice of a participant's rights described in paragraph (c)(2) of this section or the summary of that notice described in paragraph (c)(2)(iii)(B)(2) of this section must be provided on a written paper document. However, see §1.401(a)-21 of this chapter for rules permitting the use of electronic media to provide applicable notices to recipients with respect to retirement plans.

(2) \*\*\* The consent described in paragraphs (c)(2) and (3) of this section must be given on a written paper document. However, see §1.401(a)-21 of this chapter for rules permitting the use of electronic media to make participant elections with respect to retirement plans.

Par. 8. Section 1.417(a)(3)-1 is amended by adding a sentence to the end of the text of paragraph (a)(3) to read as follows:

*§1.417(a)(3)-1 Required explanation of qualified joint and survivor annuity and qualified preretirement survivor annuity.*

(a) \*\*\*

(3) \*\*\* But see §1.401(a)-21 of this chapter for rules permitting the use of electronic media to provide applicable notices to recipients with respect to retirement plans.

\*\*\*\*\*

Par. 9. Section 1.7476-2 is amended by revising paragraph (c)(2) to read as follows:

*§1.7476-2 Notice to interested parties.*

\*\*\*\*\*

(c) \*\*\*

(2) If the notice to interested parties is delivered using an electronic medium under an electronic system that satisfies the applicable notice requirements of §1.401(a)-21 of this chapter, the notice is deemed to be provided in a manner that satisfies the requirements of paragraph (c)(1) of this section.

\*\*\*\*\*

PART 35—EMPLOYMENT TAX AND COLLECTION OF INCOME TAX AT SOURCE REGULATIONS UNDER

## THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

Par. 10. The authority citation for part 35 continues to read, in part, as follows:  
Authority: 26 U.S.C. 7805 \*\*\*

Par. 11. Section 35.3405-1 is amended by:

- (1) Revising d-35, A.
- (2) Removing d-36, Q&A.

The revision reads as follows:

*§35.3405-1 Questions and answers relating to withholding on pensions, annuities, and certain other deferred income.*

\*\*\*\*\*

d-35. \*\*\*

A. A payor may provide the notice required under section 3405 (including the abbreviated notice described in d-27 of §35.3405-1T and the annual notice described in d-31 of §35.3405-1T) to a payee on a written paper document. However, see §1.401(a)-21 of this chapter for rules permitting the use of electronic media to provide applicable notices to recipients with respect to retirement plans and individual retirement plans.

## PART 54—PENSION EXCISE TAXES

Par. 12. The authority citation for part 54 continues to read, in part, as follows:  
Authority: 26 U.S.C. 7805 \*\*\*

Par. 13. Section 54.4980F-1, Q&A-13, is amended as follows:

- (1) Revising paragraph A-13 (c)(1)(ii) and (iii).
- (2) Revising the introductory text to paragraph A-13 (c)(2).
- (3) Removing paragraph A-13 (c)(3).

The revisions read as follows:

*§54.4980F-1 Notice requirements for certain pension plan amendments significantly reducing the rate of future benefit accrual.*

\*\*\*\*\*

A-13. \*\*\*

(c) \*\*\*

(1) \*\*\*

(ii) The section 204(h) notice is delivered using an electronic medium (other than an oral communication or a recording



of an oral communication) under an electronic system that satisfies the applicable notice requirements of §1.401(a)-21.

(iii) *Special effective date.* For plan years beginning prior to January 1, 2007, Q&A-13 of this section, as it appeared in the April 1, 2006 edition of 26 CFR part 1, applies.

(2) \* \* \* The following examples illustrate the requirement in paragraph (c)(1)(i) of this Q&A-13. In these examples, it is assumed that the notice satisfies the requirements in paragraphs (c)(1)(ii) of this section. The examples are as follows:

\* \* \* \* \*

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

Approved October 10, 2006.

Eric Solomon,  
*Acting Deputy Assistant Secretary  
of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on October 19, 2006, 8:45 a.m., and published in the issue of the Federal Register on October 20, 2006, 71 F.R. 61877)

### Section 408A.—Roth IRAs

The Service provides inflation adjustments to the applicable dollar amounts used to calculate the amount by which a taxpayer must reduce the maximum amount allowed as contributions to Roth IRAs for taxable years beginning the 2007. See Rev. Proc. 2006-53, page 996.

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

*26 CFR 1.472-1: Last-in, first-out inventories.*

**LIFO; price indexes; department stores.** The September 2006 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 2006.

## Rev. Rul. 2006-59

The following Department Store Inventory Price Indexes for September 2006 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, September 30, 2006.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups — soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE  
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS  
(January 1941 = 100, unless otherwise noted)

Groups	Sep 2005	Sep 2006	Percent Change from Sep 2005 to Sep 2006 <sup>1</sup>
1. Piece Goods . . . . .	497.3	455.4	-8.4
2. Domestic and Draperies . . . . .	514.7	493.1	-4.2
3. Women's and Children's Shoes . . . . .	700.4	691.1	-1.3
4. Men's Shoes . . . . .	890.9	888.7	-0.2
5. Infants' Wear . . . . .	569.6	570.3	0.1
6. Women's Underwear . . . . .	541.1	549.5	1.6
7. Women's Hosiery . . . . .	338.6	347.1	2.5
8. Women's and Girls' Accessories . . . . .	572.2	521.2	-8.9
9. Women's Outerwear and Girls' Wear . . . . .	364.0	377.0	3.6
10. Men's Clothing . . . . .	532.9	526.6	-1.2
11. Men's Furnishings . . . . .	561.0	572.0	2.0
12. Boys' Clothing and Furnishings . . . . .	393.1	403.0	2.5
13. Jewelry . . . . .	882.6	906.4	2.7
14. Notions . . . . .	807.4	818.5	1.4
15. Toilet Articles and Drugs . . . . .	996.4	1008.3	1.2
16. Furniture and Bedding . . . . .	596.0	598.4	0.4
17. Floor Coverings . . . . .	606.7	610.8	0.7
18. Housewares . . . . .	703.4	693.9	-1.4
19. Major Appliances . . . . .	204.4	204.6	0.1
20. Radio and Television . . . . .	38.6	35.1	-9.1
21. Recreation and Education <sup>2</sup> . . . . .	77.4	76.2	-1.6
22. Home Improvements <sup>2</sup> . . . . .	136.4	140.9	3.3
23. Automotive Accessories <sup>2</sup> . . . . .	116.3	121.6	4.6

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE  
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS  
(January 1941 = 100, unless otherwise noted)

Groups	Sep 2005	Sep 2006	Percent Change from Sep 2005 to Sep 2006 <sup>1</sup>
Groups 1–15: Soft Goods .....	559.6	563.8	0.8
Groups 16–20: Durable Goods .....	377.0	371.4	-1.5
Groups 21–23: Misc. Goods <sup>2</sup> .....	92.8	93.7	1.0
Store Total <sup>3</sup> .....	494.5	496.2	0.3

<sup>1</sup>Absence of a minus sign before the percentage change in this column signifies a price increase.

<sup>2</sup>Indexes on a January 1986 = 100 base.

<sup>3</sup>The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

**DRAFTING INFORMATION**

The principal author of this revenue ruling is John Roman Faron of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Faron at (202) 622-8142 (not a toll-free call).

**Section 512.—Unrelated Business Taxable Income**

The Service provides an inflation adjustment to the maximum amount of annual dues that can be paid to certain agricultural or horticultural organizations without any portion being treated as unrelated trade or business income by reason of any benefits or privileges available to members for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

**Section 513.—Unrelated Trade or Business**

The Service provides an inflation adjustment to the maximum cost of a “low cost article” for taxable years beginning in 2007. Funds raised through a charity’s distribution of “low cost articles” will not be treated as unrelated business income to the charity. See Rev. Proc. 2006-53, page 996.

**Section 685.—Treatment of Funeral Trusts**

The Service provides an inflation adjustment to the maximum amount of contributions that may be made to a qualified funeral trust for contracts entered in calendar year 2007. See Rev. Proc. 2006-53, page 996.

**Section 877.—Expatriation to Avoid Tax**

The Service provides an inflation adjustment to the amount used for calendar year 2007 to determine whether an individual’s loss of United States citizenship had the avoidance of United States tax as one of its principal purposes. See Rev. Proc. 2006-53, page 996.

**Section 911.—Citizens or Residents of the United States Living Abroad**

The Service provides an inflation adjustment to the amount of foreign earned income that may be excluded from gross income for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

**Section 2032A.—Valuation of Certain Farm, etc., Real Property**

The Service provides an inflation adjustment to the maximum amount by which the value of certain farm and other qualified real property included in a decedent’s gross estate may be decreased for purposes of valuing the estate of a decedent dying in calendar year 2007. See Rev. Proc. 2006-53, page 996.

**Section 2503.—Taxable Gifts**

The Service provides an inflation adjustment to the amount of gifts that may be made to a person in a calendar year without including the amount in taxable gifts for calendar year 2007. See Rev. Proc. 2006-53, page 996.

**Section 2523.—Gift to Spouse**

The Service provides an inflation adjustment to the amount of gifts that may be made in a calendar year to a spouse who is not a citizen of the United States without including the amount in taxable gifts for calendar year 2007. See Rev. Proc. 2006-53, page 996.

**Section 4161.—Imposition of Tax**

The Service provides an inflation adjustment to the amount of excise tax imposed for calendar year 2007 on the first sale by a manufacturer, producer, or importer of any shaft of a type used in the manufacture of certain arrows. See Rev. Proc. 2006-53, page 996.

**Section 4261.—Imposition of Tax**

The Service provides inflation adjustments to the amounts of the excise taxes on passenger air transportation beginning or ending in the United States and for each domestic segment of air transportation for calendar year 2007. See Rev. Proc. 2006-53, page 996.

**Section 6033.—Returns by Exempt Organizations**

The Service provides an inflation adjustment to the amount of dues certain exempt organizations with nondeductible lobbying expenditures can charge and still be excepted from reporting requirements for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

## **Section 6039F.—Notice of Large Gifts Received From Foreign Persons**

The Service provides an inflation adjustment to the amount of gifts received, in a taxable year from foreign persons, that triggers a reporting requirement for a United States person for taxable years beginning in 2007. See Rev. Proc. 2006-53, page 996.

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## **Section 6323.—Validity and Priority Against Certain Persons**

The Service provides inflation adjustments for calendar year 2007 to (1) the maximum amount of a casual sale of personal property below which a federal tax lien will not be valid against a purchaser of the property and (2) the maximum amount of a contract for the repair or improvement of certain residential property at or below which a federal tax lien will not be valid against a mechanic's lienor. See Rev. Proc. 2006-53, page 996.

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## **Section 6334.—Property Exempt From Levy**

The Service provides inflation adjustments to the value of certain property exempt from levy (fuel, provisions, furniture, household personal effects, arms for personal use, livestock, poultry, and books and tools of a trade, business, or profession) for calendar year 2007. See Rev. Proc. 2006-53, page 996.

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## **Section 6601.—Interest on Underpayment, Nonpayment, or Extensions of Time for Payment, of Tax**

The Service provides an inflation adjustment to the amount used to determine the amount of interest charged on a certain portion of the estate tax payable in installments for the estate of a decedent dying in calendar year 2007. See Rev. Proc. 2006-53, page 996.

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

The Service provides an inflation adjustment to the hourly limit on attorney fees incurred in calendar year 2007 that may be awarded in a judgment or settlement of an administrative or judicial proceeding concerning the determination, collection, or refund of tax, interest, or penalty. See Rev. Proc. 2006-53, page 996.

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## **Section 7702B.—Treatment of Qualified Long-Term Care Insurance**

The Service provides an inflation adjustment to the stated dollar amount for calendar year 2007 of the *per diem* limitation regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual. See Rev. Proc. 2006-53, page 996.

# Part III. Administrative, Procedural, and Miscellaneous

## Weighted Average Interest Rates Update

### Notice 2006-104

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code. In addition, it provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II).

#### CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension

Funding Equity Act of 2004 and by the Pension Protection Act of 2006, provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004-34, 2004-1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the

monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004-34 continues to apply in determining that rate. See Notice 2006-75, 2006-36 I.R.B. 366.

The composite corporate bond rate for October 2006 is 5.94 percent. Pursuant to Notice 2004-34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

Month	For Plan Years Beginning in:	Year	Corporate Bond Weighted Average	90% to 100% Permissible Range
November		2006	5.79	5.21 to 5.79

#### 30-YEAR TREASURY SECURITIES INTEREST RATE

Section 417(e)(3)(A)(ii)(II) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)-1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for October 2006 is 4.85 percent. The Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2036.

#### Drafting Information

The principal authors of this notice are Paul Stern and Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at 877-829-5500 (a toll-free number), between the hours of 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday. Mr. Stern may be reached at 202-283-9703. Mr. Montanaro may be reached at 202-283-9714. The telephone numbers in the preceding sentences are not toll-free.

*26 CFR 601.201: Rulings and determination letters.*

### Rev. Proc. 2006-52

#### SECTION 1. PURPOSE

The purpose of this revenue procedure is to inform plan proponents in cases under chapter 12 of Title 11 of the United States

Code (hereinafter referred to as the "Bankruptcy Code") of the procedures to be followed to request determinations of the income tax effects of proposed plans when such requests are authorized by the bankruptcy courts.

#### SECTION 2. BACKGROUND

.01 Chapter 12 of the Bankruptcy Code provides for the adjustment of debts of a family farmer or fisherman with regular annual income and contemplates the filing of a plan to do so. The income tax effects of transactions proposed in a chapter 12 plan could affect the feasibility of the plan in some cases.

.02 The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005), amended 11 U.S.C. § 1231(b) to allow bankruptcy courts to authorize the proponents of chapter 12 plans to request determinations of the federal income tax effects of proposed plans, limited to questions of law. In the event of an actual controversy, the court may declare the tax effects of a proposed plan after the earlier of the date on which the governmental unit

responds to the request, or 270 days after the request.

### SECTION 3. APPLICATION

.01 If a chapter 12 plan proponent is authorized by the bankruptcy court to request a determination of the income tax effects of a proposed plan, a written request must be filed with the Centralized Insolvency Operation, Post Office Box 21126, Philadelphia, PA 19114 (marked, "Request for Determination of Tax Effects of Chapter 12 Plan").

.02 A request is processable only if it contains the information specified in section 7.01, paragraphs (1) through (10), of Revenue Procedure 2006-1, as updated annually, including a copy of the proposed chapter 12 plan and a copy of the bankruptcy court order allowing the proponent to make the request. The request must be signed by the proponent with the following declaration, "Under penalties of perjury, I declare that I have examined this

request, including the accompanying documents, and, to the best of my knowledge and belief, this request contains all relevant facts relating to the request, and such facts are true, accurate, and complete." The Service will not treat the request as having been made until it receives the information described in this section. The Service will acknowledge in writing the date it has received the request with the information required by this section. Additional information may be requested during the consideration of the request.

.03. Within 270 days from receipt of a processable application, the Examination Function will notify the plan proponent of the determination. Unless the court declares otherwise pursuant to 11 U.S.C. § 1231(b), a field office examining the taxpayer's return will follow the determination if: (1) a copy of the determination is attached to the tax return to which it relates, (2), the determination is properly reflected in the return, (3) the representations upon which the determination was made

reflected an accurate statement of the controlling facts, (4) the transactions proposed in the plan were carried out substantially as proposed, and (5) there has been no change in the law that applies to the period during which the transactions were consummated.

### SECTION 4. EFFECTIVE DATE

This revenue procedure is applicable to Chapter 12 bankruptcy cases commenced after April 20, 2005.

### SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is G. William Beard of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue procedure, contact William Beard at (202) 622-3620 (not a toll-free call).

26 CFR 601.602: Tax forms and instructions.

(Also Part I, §§ 1, 23, 24, 25A, 25B, 32, 42, 59, 62, 63, 68, 132, 135, 137, 146, 148, 151, 170, 179, 213, 219, 220, 221, 223, 408A, 512, 513, 685, 877, 911, 2032A, 2503, 2523, 4161, 4261, 6033, 6039F, 6323, 6334, 6601, 7430, 7702B; 1.148-5.)

## Rev. Proc. 2006-53

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SECTION 5. EFFECTIVE DATE

SECTION 6. DRAFTING INFORMATION

SECTION 1. PURPOSE

This revenue procedure sets forth inflation adjusted items for 2007.

SECTION 2. CHANGES

.01 Under § 25B eligible individuals are allowed a credit against tax equal to the applicable percentage of qualified retirement savings contributions of the individual that do not exceed \$2,000. Section

833(a) of the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006) (PPA), added § 25B(b)(3), which provides that the adjusted gross income amounts in § 25B(b) used to determine the applicable percentage for calculating the

credit are adjusted for inflation. (See section 3.06 of this revenue procedure.)

.02 Section 219(a) allows individuals to deduct qualified retirement contributions for a taxable year. Section 833(b) of the PPA added § 219(g)(8), which provides that the applicable dollar amount under § 219(g)(3) used to determine the amount of reduction for the limitation on deduction for taxpayers who are active participants and for spouses who are not active participants in certain pension plans is adjusted for inflation. (See section 3.21 of this revenue procedure.)

.03 Section 408A(c) provides rules for the tax treatment of contributions made to Roth IRAs. Section 833(c) of the PPA added § 408A(c)(3)(C), which provides

that the applicable dollar amount under § 408A(c)(3) used to determine the dollar limit, based on modified adjusted gross income, for the contribution limit to Roth IRAs is adjusted for inflation. (See section 3.25 of this revenue procedure.)

.04 Q&A 14 of Rev. Proc. 2002-41, 2002-1 C.B. 1098, provides an inflation adjustment method for the hourly rates used to determine the amounts deemed substantiated for payments made by transportation mainline pipeline construction employers under accountable plans. (See section 3.10 of this revenue procedure.)

Q&A 14 is modified to read as follows:

Q-14. Will the amount deemed substantiated under this revenue procedure be adjusted for inflation?

A-14. Yes. For calendar years after 2006, the hourly rate will be adjusted annually for inflation under § 1(f)(3), except that the base year for such adjustment will be calendar year 2002 and any adjustment will be rounded to the nearest dollar. Any adjustment to the rates provided in this revenue procedure will be published annually.

### SECTION 3. 2007 ADJUSTED ITEMS

.01 *Tax Rate Tables.* For taxable years beginning in 2007, the tax rate tables under § 1 are as follows:

TABLE 1 — Section 1(a). — Married Individuals Filing Joint Returns and Surviving Spouses

<i>If Taxable Income Is:</i>	<i>The Tax Is:</i>
Not Over \$15,650	10% of the taxable income
Over \$15,650 but not over \$63,700	\$1,565 plus 15% of the excess over \$15,650
Over \$63,700 but not over \$128,500	\$8,772.50 plus 25% of the excess over \$63,700
Over \$128,500 but not over \$195,850	\$24,972.50 plus 28% of the excess over \$128,500
Over \$195,850 but not over \$349,700	\$43,830.50 plus 33% of the excess over \$195,850
Over \$349,700	\$94,601 plus 35% of the excess over \$349,700

TABLE 2 — Section 1(b). — Heads of Households

<i>If Taxable Income Is:</i>	<i>The Tax Is:</i>
Not Over \$11,200	10% of the taxable income
Over \$11,200 but not over \$42,650	\$1,120 plus 15% of the excess over \$11,200
Over \$42,650 but not over \$110,100	\$5,837.50 plus 25% of the excess over \$42,650
Over \$110,100 but not over \$178,350	\$22,700 plus 28% of the excess over \$110,100
Over \$178,350 but not over \$349,700	\$41,810 plus 33% of the excess over \$178,350
Over \$349,700	\$98,355.50 plus 35% of the excess over \$349,700

TABLE 3 — Section 1(c). — Unmarried Individuals (other than Surviving Spouses and Heads of Households).

<i>If Taxable Income Is:</i>	<i>The Tax Is:</i>
Not Over \$7,825	10% of the taxable income
Over \$7,825 but not over \$31,850	\$782.50 plus 15% of the excess over \$7,825
Over \$31,850 but not over \$77,100	\$4,386.25 plus 25% of the excess over \$31,850
Over \$77,100 but not over \$160,850	\$15,698.75 plus 28% of the excess over \$77,100
Over \$160,850 but not over \$349,700	\$39,148.75 plus 33% of the excess over \$160,850
Over \$349,700	\$101,469.25 plus 35% of the excess over \$349,700

TABLE 4 — Section 1(d). — Married Individuals Filing Separate Returns

<i>If Taxable Income Is:</i>	<i>The Tax Is:</i>
Not Over \$7,825	10% of the taxable income
Over \$7,825 but not over \$31,850	\$782.50 plus 15% of the excess over \$7,825
Over \$31,850 but not over \$64,250	\$4,386.25 plus 25% of the excess over \$31,850
Over \$64,250 but not over \$97,925	\$12,486.25 plus 28% of the excess over \$64,250
Over \$97,925 but not over \$174,850	\$21,915.25 plus 33% of the excess over \$97,925
Over \$174,850	\$47,300.50 plus 35% of the excess over \$174,850

TABLE 5 — Section 1(e). — Estates and Trusts

<i>If Taxable Income Is:</i>	<i>The Tax Is:</i>
Not Over \$2,150	15% of the taxable income
Over \$2,150 but not over \$5,000	\$322.50 plus 25% of the excess over \$2,150
Over \$5,000 but not over \$7,650	\$1,035 plus 28% of the excess over \$5,000
Over \$7,650 but not over \$10,450	\$1,777 plus 33% of the excess over \$7,650
Over \$10,450	\$2,701 plus 35% of the excess over \$10,450

.02 *Unearned Income of Minor Children Taxed as if Parent's Income (the "Kiddie Tax").* For taxable years beginning in 2007, the amount in § 1(g)(4)(A)(ii)(I), which is used to reduce the net unearned income reported on the child's return that is subject to the "kiddie tax," is \$850. This amount is the same as the \$850 standard deduction amount provided in section 3.11(2) of this revenue procedure. The same \$850 amount is used for purposes of § 1(g)(7) (that is, to determine whether a parent may elect to include a child's gross income in the parent's gross income and to calculate the "kiddie tax"). For example, one of the requirements for the parental election is that a child's gross income is more than the amount referenced in § 1(g)(4)(A)(ii)(I) but less than 10 times that amount; thus, a child's gross income for 2007 must be more than \$850 but less than \$8,500.

.03 *Adoption Credit.* For taxable years beginning in 2007, under § 23(a)(3) the

credit allowed for an adoption of a child with special needs is \$11,390. For taxable years beginning in 2007, under § 23(b)(1) the maximum credit allowed for other adoptions is the amount of qualified adoption expenses up to \$11,390. The available adoption credit begins to phase out under § 23(b)(2)(A) for taxpayers with modified adjusted gross income in excess of \$170,820 and is completely phased out for taxpayers with modified adjusted gross income of \$210,820 or more. (See section 3.15 of this revenue procedure for the adjusted items relating to adoption assistance programs.)

.04 *Child Tax Credit.* For taxable years beginning in 2007, the value used in § 24(d)(1)(B)(i) to determine the amount of credit under § 24 that may be refundable is \$11,750.

.05 *Hope and Lifetime Learning Credits.*

(1) For taxable years beginning in 2007, the Hope Scholarship Credit under

§ 25A(b)(1) is an amount equal to 100 percent of qualified tuition and related expenses not in excess of \$1,100 plus 50 percent of those expenses in excess of \$1,100, but not in excess of \$2,200. Accordingly, the maximum Hope Scholarship Credit allowable under § 25A(b)(1) for taxable years beginning in 2007 is \$1,650.

(2) For taxable years beginning in 2007, a taxpayer's modified adjusted gross income in excess of \$47,000 (\$94,000 for a joint return) is used to determine the reduction under § 25A(d)(2)(A)(ii) in the amount of the Hope Scholarship and Lifetime Learning Credits otherwise allowable under § 25A(a).

.06 *Elective Deferrals and IRA Contributions by Certain Individuals.* For taxable years beginning in 2007, the applicable percentage under § 25B(b) is determined based on the following amounts:



<i>Modified Adjusted Gross Income</i>						
<i>Joint Return</i>		<i>Head of Household</i>		<i>All Other Cases</i>		<i>Applicable Percentage</i>
<i>Over</i>	<i>Not Over</i>	<i>Over</i>	<i>Not Over</i>	<i>Over</i>	<i>Not Over</i>	
\$ 0	\$31,000	\$ 0	\$23,250	\$ 0	\$15,500	50%
\$31,000	\$34,000	\$23,250	\$25,500	\$15,500	\$17,000	20%
\$34,000	\$52,000	\$25,500	\$39,000	\$17,000	\$26,000	10%
\$52,000		\$39,000		\$26,000		0%

*.07 Earned Income Credit.*

(1) *In general.* For taxable years beginning in 2007, the following amounts are used to determine the earned income credit under § 32(b). The “earned income amount” is the amount of earned

income at or above which the maximum amount of the earned income credit is allowed. The “threshold phaseout amount” is the amount of adjusted gross income (or, if greater, earned income) above which the maximum amount of the credit begins

to phase out. The “completed phaseout amount” is the amount of adjusted gross income (or, if greater, earned income) at or above which no credit is allowed.

<i>Item</i>	<i>Number of Qualifying Children</i>		
	<i>One</i>	<i>Two or More</i>	<i>None</i>
Earned Income Amount	\$ 8,390	\$11,790	\$ 5,590
Maximum Amount of Credit	\$ 2,853	\$ 4,716	\$ 428
Threshold Phaseout Amount (Single, Surviving Spouse, or Head of Household)	\$15,390	\$15,390	\$ 7,000
Completed Phaseout Amount (Single, Surviving Spouse, or Head of Household)	\$33,241	\$37,783	\$12,590
Threshold Phaseout Amount (Married Filing Jointly)	\$17,390	\$17,390	\$ 9,000
Completed Phaseout Amount (Married Filing Jointly)	\$35,241	\$39,783	\$14,590

The instructions for the Form 1040 series provide tables showing the amount of the earned income credit for each type of taxpayer.

(2) *Excessive investment income.* For taxable years beginning in 2007, the earned income tax credit is not allowed under § 32(i) if the aggregate amount of certain investment income exceeds \$2,900.

*.08 Low-Income Housing Credit.* For calendar year 2007, the amounts used under § 42(h)(3)(C)(ii) to calculate the State housing credit ceiling for the low-income housing credit is the greater of (1) \$1.95

multiplied by the State population, or (2) \$2,275,000.

*.09 Alternative Minimum Tax Exemption for a Child Subject to the “Kiddie Tax.”* For taxable years beginning in 2007, for a child to whom the § 1(g) “kiddie tax” applies, the exemption amount under §§ 55 and 59(j) for purposes of the alternative minimum tax under § 55 may not exceed the sum of (1) the child’s earned income for the taxable year, plus (2) \$6,300.

*.10 Transportation Mainline Pipeline Construction Industry Optional Expense Substantiation Rules for Payments to Employees under Accountable Plans.* For

calendar year 2007, an eligible employer may pay certain welders and heavy equipment mechanics an amount of up to \$15 per hour for rig-related expenses that is deemed substantiated under an accountable plan if paid in accordance with Rev. Proc. 2002–41. If the employer provides fuel or otherwise reimburses fuel expenses, up to \$9 per hour is deemed substantiated if paid under Rev. Proc. 2002–41.

*.11 Standard Deduction.*

(1) *In general.* For taxable years beginning in 2007, the standard deduction amounts under § 63(c)(2) are as follows:

<i>Filing Status</i>	<i>Standard Deduction</i>
Married Individuals Filing Joint Returns and Surviving Spouses (§ 1(a))	\$10,700
Heads of Households (§ 1(b))	\$ 7,850
Unmarried Individuals (other than Surviving Spouses and Heads of Households) (§ 1(c))	\$ 5,350
Married Individuals Filing Separate Returns (§ 1(d))	\$ 5,350

(2) *Dependent.* For taxable years beginning in 2007, the standard deduction amount under § 63(c)(5) for an individual who may be claimed as a dependent by another taxpayer cannot exceed the greater of (1) \$850, or (2) the sum of \$300 and the individual's earned income.

(3) *Aged or blind.* For taxable years beginning in 2007, the additional standard deduction amount under § 63(f) for the aged or the blind is \$1,050. These amounts are increased to \$1,300 if the individual is also unmarried and not a surviving spouse.

.12 *Overall Limitation on Itemized Deductions.* For taxable years beginning in 2007, the "applicable amount" of adjusted gross income under § 68(b), above which the amount of otherwise allowable itemized deductions is reduced under § 68, is \$156,400 (or \$78,200 for a separate return filed by a married individual).

.13 *Qualified Transportation Fringe.* For taxable years beginning in 2007, the monthly limitation under § 132(f)(2)(A), regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass, is \$110. The monthly limitation under § 132(f)(2)(B), regarding the fringe benefit exclusion amount for qualified parking, is \$215.

.14 *Income from United States Savings Bonds for Taxpayers Who Pay Qualified Higher Education Expenses.* For taxable years beginning in 2007, the exclusion under § 135, regarding income from United States savings bonds for taxpayers who

pay qualified higher education expenses, begins to phase out for modified adjusted gross income above \$98,400 for joint returns and \$65,600 for other returns. The exclusion is completely phased out for modified adjusted gross income of \$128,400 or more for joint returns and \$80,600 or more for other returns.

.15 *Adoption Assistance Programs.* For taxable years beginning in 2007, under § 137(a)(2) the amount that can be excluded from an employee's gross income for the adoption of a child with special needs is \$11,390. For taxable years beginning in 2007, under § 137(b)(1) the maximum amount that can be excluded from an employee's gross income for the amounts paid or expenses incurred by an employer for qualified adoption expenses furnished pursuant to an adoption assistance program for other adoptions by the employee is \$11,390. The amount excludable from an employee's gross income begins to phase out under § 137(b)(2)(A) for taxpayers with modified adjusted gross income in excess of \$170,820 and is completely phased out for taxpayers with modified adjusted gross income of \$210,820 or more. (See section 3.03 of this revenue procedure for the adjusted items relating to the adoption credit.)

.16 *Private Activity Bonds Volume Cap.* For calendar year 2007, the amounts used under § 146(d)(1) to calculate the State ceiling for the volume cap for private activity bonds are the greater of (1) \$85

multiplied by the State population, or (2) \$256,235,000.

.17 *Safe Harbor Rules for Broker Commissions on Guaranteed Investment Contracts or Investments Purchased for a Yield Restricted Defeasance Escrow.* For calendar year 2007, under § 1.148-5(e)(2)(iii)(B)(1), a broker's commission or similar fee for the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is reasonable if (1) the amount of the fee that the issuer treats as a qualified administrative cost does not exceed the lesser of (A) \$33,000, and (B) 0.2 percent of the computational base (as defined in § 1.148-5(e)(2)(iii)(B)(2)) or, if more, \$3,000; and (2) the issuer does not treat more than \$93,000 in brokers' commissions or similar fees as qualified administrative costs for all guaranteed investment contracts and investments for yield restricted defeasance escrows purchased with gross proceeds of the issue.

.18 *Personal Exemption.*

(1) *Exemption amount.* For taxable years beginning in 2007, the personal exemption amount under § 151(d) is \$3,400. The exemption amount for taxpayers with adjusted gross income in excess of the maximum phaseout amount is \$1,133 for taxable years beginning in 2007.

(2) *Phaseout.* For taxable years beginning in 2007, the personal exemption amount begins to phase out at, and reaches the maximum phaseout amount after, the following adjusted gross income amounts:

<i>Filing Status</i>	<i>AGI – Beginning of Phaseout</i>	<i>AGI – Maximum Phaseout</i>
Married Individuals Filing Joint Returns and Surviving Spouses (§ 1(a))	\$234,600	\$357,100
Heads of Households (§ 1(b))	\$195,500	\$318,000
Unmarried Individuals (other than Surviving Spouses and Heads of Households) (§ 1(c))	\$156,400	\$278,900
Married Individuals Filing Separate Returns (§ 1(d))	\$117,300	\$178,550

.19 *Election to Expense Certain Depreciable Assets.* For taxable years beginning in 2007, under § 179(b)(1) the aggregate cost of any § 179 property a taxpayer may elect to treat as an expense can not exceed \$112,000. Under § 179(b)(2) the \$112,000

limitation is reduced (but not below zero) by the amount by which the cost of § 179 property placed in service during the 2007 taxable year exceeds \$450,000.

.20 *Eligible Long-Term Care Premiums.* For taxable years beginning in 2007,

the limitations under § 213(d)(10), regarding eligible long-term care premiums includible in the term “medical care,” are as follows:

<i>Attained Age Before the Close of the Taxable Year</i>	<i>Limitation on Premiums</i>
40 or less	\$ 290
More than 40 but not more than 50	\$ 550
More than 50 but not more than 60	\$1,110
More than 60 but not more than 70	\$2,950
More than 70	\$3,680

.21 *Retirement Savings.*

(1) For taxable years beginning in 2007, the applicable dollar amount under § 219(g)(3)(B)(i) for taxpayers filing a joint return is \$83,000. If the taxpayer’s spouse is not an active participant, the applicable dollar amount for the spouse under § 219(g)(3)(B)(i) is \$156,000 for taxable years beginning in 2007.

(2) For taxable years beginning in 2007, the applicable dollar amount under § 219(g)(3)(B)(ii) for all other taxpayers (except for married taxpayers filing separately) is \$52,000.

(3) The applicable dollar amount under § 219(g)(3)(B)(iii) for married taxpayers filing separately is \$0.

.22 *Medical Savings Accounts.*

(1) *Self-only coverage.* For taxable years beginning in 2007, the term “high deductible health plan” as defined in § 220(c)(2)(A) means, for self-only coverage, a health plan that has an annual deductible that is not less than \$1,900 and not more than \$2,850, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed \$3,750.

(2) *Family coverage.* For taxable years beginning in 2007, the term “high deductible health plan” means, for family coverage, a health plan that has an annual deductible that is not less than \$3,750 and not more than \$5,650, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed \$6,900.

.23 *Interest on Education Loans.* For taxable years beginning in 2007, the \$2,500 maximum deduction for interest paid on qualified education loans

under § 221 begins to phase out under § 221(b)(2)(B) for taxpayers with modified adjusted gross income in excess of \$55,000 (\$110,000 for joint returns), and is completely phased out for taxpayers with modified adjusted gross income of \$70,000 or more (\$140,000 or more for joint returns).

.24 *Health Savings Accounts.*

(1) *Monthly contribution limitation.* For calendar year 2007, the monthly limitation for any month on deductions under § 223(b)(2)(A) for an individual with self-only coverage under a high deductible plan as of the first day of the month is 1/12 of the lesser of (1) the annual deductible, or (2) \$2,850. For calendar year 2007, the monthly limitation for any month on deductions under § 223(b)(2)(B) for an individual with family coverage under a high deductible plan as of the first day of the month is 1/12 of the lesser of (1) the annual deductible, or (2) \$5,650.

(2) *High deductible health plan.* For calendar year 2007, a “high deductible health plan” is defined under § 223(c)(2)(A) as a health plan with an annual deductible that is not less than \$1,100 for self-only coverage or \$2,200 for family coverage, and the annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) do not exceed \$5,500 for self-only coverage or \$11,000 for family coverage.

.25 *Roth IRAs.*

(1) For taxable years beginning in 2007, the applicable dollar amount under § 408A(c)(3)(C)(ii)(I) for taxpayers filing a joint return is \$156,000.

(2) For taxable years beginning in 2007, the applicable dollar amount under

§ 408A(c)(3)(C)(ii)(II) for all other taxpayers (except for married taxpayers filing separately) is \$99,000.

(3) The applicable dollar amount under § 408A(c)(3)(C)(ii)(III) for married taxpayers filing separately is \$0.

.26 *Treatment of Dues Paid to Agricultural or Horticultural Organizations.* For taxable years beginning in 2007, the limitation under § 512(d)(1), regarding the exemption of annual dues required to be paid by a member to an agricultural or horticultural organization, is \$136.

.27 *Insubstantial Benefit Limitations for Contributions Associated with Charitable Fund-Raising Campaigns.*

(1) *Low cost article.* For taxable years beginning in 2007, the unrelated business income of certain exempt organizations under § 513(h)(2) does not include a “low cost article” of \$8.90 or less.

(2) *Other insubstantial benefits.* For taxable years beginning in 2007, the \$5, \$25, and \$50 guidelines in section 3 of Rev. Proc. 90–12, 1990–1 C.B. 471 (as amplified by Rev. Proc. 92–49, 1992–1 C.B. 987, and modified by Rev. Proc. 92–102, 1992–2 C.B. 579), for disregarding the value of insubstantial benefits received by a donor in return for a fully deductible charitable contribution under § 170, are \$8.90, \$44.50, and \$89, respectively.

.28 *Funeral Trusts.* For a contract entered into during calendar year 2007 for a “qualified funeral trust,” as defined in § 685, the trust may not accept aggregate contributions by or for the benefit of an individual in excess of \$8,800.

.29 *Expatriation to Avoid Tax.* For calendar year 2007, an individual with “aver-

age annual net income tax” of more than \$136,000 for the five taxable years ending before the date of the loss of United States citizenship under § 877(a)(2)(A) is subject to tax under § 877(b).

.30 *Foreign Earned Income Exclusion.* For taxable years beginning in 2007, the foreign earned income exclusion amount under § 911(b)(2)(D)(i) is \$85,700.

.31 *Valuation of Qualified Real Property in Decedent’s Gross Estate.* For an estate of a decedent dying in calendar year 2007, if the executor elects to use the special use valuation method under § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use § 2032A for purposes of the estate tax can not exceed \$940,000.

.32 *Annual Exclusion for Gifts.*

(1) For calendar year 2007, the first \$12,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under § 2503 made during that year.

(2) For calendar year 2007, the first \$125,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under §§ 2503 and 2523(i)(2) made during that year.

.33 *Tax on Arrow Shafts.* For calendar year 2007, the tax imposed under § 4161(b)(2)(A) on the first sale by the manufacturer, producer, or importer of any shaft of a type used in the manufacture of certain arrows is \$0.42 per shaft.

.34 *Passenger Air Transportation Excise Tax.* For calendar year 2007, the tax under § 4261(b) on the amount paid for each domestic segment of taxable air transportation is \$3.40. For calendar year 2007, the tax under § 4261(c) on any amount paid (whether within or without the United States) for any air transportation, if the transportation begins or ends in the United States, generally is \$15.10. However, for a domestic segment beginning or ending in Alaska or Hawaii as described in § 4261(c)(3), the tax applies only to departures and the rate is \$7.50.

.35 *Reporting Exception for Certain Exempt Organizations with Nondeductible Lobbying Expenditures.* For taxable years beginning in 2007, the annual per per-

son, family, or entity dues limitation to qualify for the reporting exception under § 6033(e)(3) (and section 5.05 of Rev. Proc. 98–19, 1998–1 C.B. 547), regarding certain exempt organizations with nondeductible lobbying expenditures, is \$95 or less.

.36 *Notice of Large Gifts Received from Foreign Persons.* For taxable years beginning in 2007, recipients of gifts from certain foreign persons may be required to report these gifts under § 6039F if the aggregate value of gifts received in a taxable year exceeds \$13,258.

.37 *Persons Against Whom a Federal Tax Lien Is Not Valid.* For calendar year 2007, a federal tax lien is not valid against (1) certain purchasers under § 6323(b)(4) who purchased personal property in a casual sale for less than \$1,290, or (2) a mechanic’s lienor under § 6323(b)(7) that repaired or improved certain residential property if the contract price with the owner is not more than \$6,450.

.38 *Property Exempt from Levy.* For calendar year 2007, the value of property exempt from levy under § 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) can not exceed \$7,720. The value of property exempt from levy under § 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer) can not exceed \$3,860.

.39 *Interest on a Certain Portion of the Estate Tax Payable in Installments.* For an estate of a decedent dying in calendar year 2007, the dollar amount used to determine the “2-percent portion” (for purposes of calculating interest under § 6601(j)) of the estate tax extended as provided in § 6166 is \$1,250,000.

.40 *Attorney Fee Awards.* For fees incurred in calendar year 2007, the attorney fee award limitation under § 7430(c)(1)(B)(iii) is \$170 per hour.

.41 *Periodic Payments Received under Qualified Long-Term Care Insurance Contracts or under Certain Life Insurance Contracts.* For calendar year 2007, the stated dollar amount of the *per diem* limitation under § 7702B(d)(4), regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life

insurance contract that are treated as paid by reason of the death of a chronically ill individual, is \$260.

#### SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–41 is modified for taxable years beginning after December 31, 2006.

#### SECTION 5. EFFECTIVE DATE

.01 *General Rule.* Except as provided in section 5.02, this revenue procedure applies to taxable years beginning in 2007.

.02 *Calendar Year Rule.* This revenue procedure applies to transactions or events occurring in calendar year 2007 for purposes of sections 3.08 (low-income housing credit), 3.10 (pipeline construction industry optional expense substantiation rules), 3.16 (private activity bond volume cap), 3.17 (safe harbor rules for broker commissions on guaranteed investment contracts or investments purchased for a yield restricted defeasance escrow), 3.24 (health savings accounts), 3.28 (funeral trusts), 3.29 (expatriation to avoid tax), 3.31 (valuation of qualified real property in decedent’s gross estate), 3.32 (annual exclusion for gifts), 3.33 (tax on arrow shafts), 3.34 (passenger air transportation excise tax), 3.37 (persons against whom a federal tax lien is not valid), 3.38 (property exempt from levy), 3.39 (interest on a certain portion of the estate tax payable in installments), 3.40 (attorney fee awards), and 3.41 (periodic payments received under qualified long-term care insurance contracts or under certain life insurance contracts).

#### SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Marnette M. Myers of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding sections 2.04 and 4 of this revenue procedure, contact Jeanne Royal Singley at (202) 622–0047 (not a toll-free call). For further information regarding the remainder of this revenue procedure, contact Ms. Myers at (202) 622–4920 (not a toll-free call).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking

### Limitations on Transfers of Built-in Losses

#### REG-110405-05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 362(e)(2) of the Internal Revenue Code of 1986 (Code). The proposed regulations reflect changes made to the law by the American Jobs Creation Act of 2004. These proposed regulations provide guidance regarding the determination of the bases of assets and stock transferred in certain nonrecognition transactions and will affect corporations and large shareholders of corporations, including individuals, partnerships, corporations, and tax-exempt entities.

DATES: Written or electronic comments and requests for a public hearing must be received by January 22, 2007.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-110405-05), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to CC:PA:LPD:PR (REG-110405-05), Courier's Desk, Internal Revenue Service, Crystal Mall 4 Building, 1901 S. Bell St., Arlington, VA. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or Federal e-Rulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-110405-05).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jay M. Singer, (202) 622-7530, or concerning submissions of comments, Richard A. Hurst, (202) 622-7180 (not toll-free numbers) or [Richard.A.Hurst@irs.counsel.treas.gov](mailto:Richard.A.Hurst@irs.counsel.treas.gov).

#### SUPPLEMENTARY INFORMATION:

##### Background

Prior to 1999, Congress grew concerned that taxpayers were engaging in corporate nonrecognition transactions in order to accelerate and duplicate losses. See S. Rep. No. 201, 106th Cong., 1st Sess. 46-48 (1999). Congress was primarily concerned with the acceleration and duplication of losses through the assumption of liabilities (including liabilities to which assets transferred in a corporate nonrecognition transaction were subject). As a result, in 1999, Congress enacted section 362(d) of the Code to prevent the bases of assets transferred to a corporation from being increased above such assets' aggregate fair market value as a result of a liability assumption. In addition, in 2000, Congress enacted section 358(h) to reduce the basis of stock received in certain corporate nonrecognition transactions, but not below fair market value, by the amount of any liabilities assumed in the transaction.

Following the enactment of sections 362(d) and 358(h), Congress remained concerned that taxpayers were engaging in various tax-motivated transactions to take more than one tax deduction for a single economic loss. Consequently, in the American Jobs Creation Act of 2004 (Public Law 108-357, 188 Stat. 1418), Congress enacted section 362(e), which limits the ability of taxpayers to duplicate net built-in loss in certain nonrecognition transactions.

Section 362(e)(1)(A) provides that if there would be an importation of a net built-in loss in a transaction described in section 362(a) or (b), the basis of certain property acquired in such a transaction shall be its fair market value immediately after the transaction. Section 362(e)(1)(B) provides that property is described in section 362(e)(1) if gain or loss with respect to such property is not subject to tax in the hands of the transferor immediately before the transfer, and gain or loss with respect to such property is subject to tax in the hands of the transferee immediately after the transfer. Further, section 362(e)(1)(C) provides that there is an importation of net built-in loss in a transaction if the trans-

feree's aggregate adjusted basis in such property would (but for the application of section 362(e)(1)) exceed the aggregate fair market value of such property immediately after the transaction.

Section 362(e)(2)(A) provides that if property is transferred by a transferor to a transferee in a transaction described in section 362(a) and not described in section 362(e)(1), and if the transferee's aggregate adjusted basis in the transferred property would (but for the application of section 362(e)(2)) exceed its aggregate fair market value immediately after the transfer, then the transferee's aggregate adjusted basis in the transferred property shall not exceed the fair market value of the property immediately after the transfer. Further, section 362(e)(2)(B) provides that this aggregate reduction in the basis of the transferred property shall be allocated among the property in proportion to their respective built-in losses immediately before the transaction. As an alternative to this reduction in the basis of the transferred assets, section 362(e)(2)(C) provides that if the transferor and the transferee both so elect, section 362(e)(2)(A) shall not apply, and the transferor's basis in the stock of the transferee received in exchange for the property that would otherwise be subject to basis reduction under section 362(e)(2)(A) shall not exceed its fair market value.

Since the enactment of section 362(e)(2), the IRS and Treasury Department have been exploring issues concerning the interpretation, scope, and application of the section and have proposed these regulations to address these issues. Additional guidance regarding the application of section 362(e)(2) to transfers between members of a consolidated group and the treatment of transactions that have the effect of importing losses into the U.S. tax system (to which section 362(e)(1) applies) will be addressed in separate guidance projects.

#### Explanation of Provisions

##### 1. General Provisions

In general, these proposed regulations apply to transfers of net built-in loss property within the U.S. tax system in which the Code otherwise would duplicate the

net built-in asset loss in the stock of the transferee. Such transfers include exchanges subject to section 351, capital contributions, and transfers of paid-in surplus. However, these proposed regulations do not apply to a transfer where the duplicated loss is imported into the U.S. tax system and the transfer is subject to section 362(e)(1), which addresses certain loss importation transactions. Property is net built-in loss property if the transferee corporation's aggregate basis in the property, but for the application of section 362(e)(2), would exceed the aggregate fair market value of such property immediately after the transfer.

If section 362(e)(2) applies to a transfer, the transferee corporation receives the property with an aggregate basis not exceeding the aggregate fair market value of the property immediately after the transfer. The transferee allocates the basis reduction among the transferred loss properties in proportion to the amount of loss in each such property immediately before the transfer.

Taxpayers have questioned the effect of any gain taken into account as a result of the transfer. The IRS and Treasury Department have determined that any gain recognized by the transferor that increases the transferee corporation's basis in the transferred property must be taken into account in order to determine the full amount of loss duplication. Accordingly, these proposed regulations provide that in determining whether the transferred property has a net built-in loss in the hands of the transferee, the bases of such property first must be increased under section 362(a) or (b) for any gain recognized by the transferor on the transfer of the property.

There also have been questions about the application of section 362(e)(2) in the case of multiple transferors. The legislative history to section 362(e)(2) contains some potentially conflicting language that refers to the aggregate adjusted basis of property contributed by a transferor or a control group of which the transferor is a member. See Conf. Rep. No. 108-755, 108th Cong., 2d Sess. 635 (2004). However, because the basis rules in section 362 and section 358 are applied on a transferor-by-transferor basis, applying section 362(e)(2) to an aggregated group of transferors would undermine Congress' intent

to prevent loss duplication. Further, section 362(e)(2) specifically refers to property "transferred by a transferor." Accordingly, these proposed regulations clarify that section 362(e)(2) applies separately to each transferor. Thus, each transferor's transfer is measured separately, and the determination of whether that transfer is subject to these provisions is made solely by reference to the property transferred by such transferor. Consequently, the treatment of one transferor is unaffected by the transfer of property by any other transferor for purposes of section 362(e)(2).

In addition, these proposed regulations clarify that, even if part of a transaction is subject to section 362(e)(1), section 362(e)(2) can apply to the portion of the transaction that is not described in section 362(e)(1).

## *2. Application of Section 362(e)(2) to Transfers Outside of the U.S. Tax System*

Under general principles of law, the Code applies to all transactions without regard to whether such application has any current U.S. tax consequences. In the case of transfers that are wholly outside the U.S. tax system, section 362(e)(2) applies but does not have relevance unless and until the assets transferred or the stock received in the exchange enter the U.S. tax system. Such assets or stock may subsequently enter the U.S. tax system either directly or indirectly. For example, the assets or stock could directly enter the U.S. tax system through a transfer of all or a portion of such assets or stock to a U.S. person, or as a result of the original transferor or original transferee becoming a U.S. person. Further, the assets or stock could indirectly enter the U.S. tax system, for example, through a transfer of all or a portion of such assets or stock to a CFC, or as a result of the original transferor or original transferee becoming a CFC. However, in many cases the U.S. tax treatment of a transfer that is wholly outside the U.S. tax system will never become relevant. The IRS and Treasury Department recognize that, if a transferor does not anticipate the transfer becoming U.S. tax relevant, it is not likely to undertake the valuation and record-keeping that section 362(e)(2) would generally require. If circumstances change at some later date, the administra-

tive burden of reconstructing appropriate records may be substantial.

The IRS and Treasury Department have determined that relief is appropriate when transactions are consummated with no plan or intention to enter the U.S. tax system. Thus, if assets are transferred in a transaction that is potentially subject to section 362(e)(2) more than two years before entering the U.S. tax system, then, solely for purposes of section 362(e)(2), these proposed regulations generally presume that the aggregate fair market value of the transferred assets equals their aggregate adjusted basis in the hands of the transferee immediately after the transfer. This presumption applies only if neither the original transfer nor the later entry of any portion of the assets into the U.S. tax system was undertaken with a view to reducing the U.S. tax liability of any person or duplicating loss by avoiding the application of section 362(e)(2).

If a transfer subject to section 362(e)(2) occurs within the two-year period immediately before becoming U.S. tax relevant, the IRS and Treasury Department do not believe that relief from the administrative burden is either necessary or appropriate. Thus, in such a case, the fair market value presumption does not apply, and section 362(e)(2) applies to the original transfer. The proposed regulations provide the relevant parties a means by which to make an election under section 362(e)(2)(C), if desired, at the time of entry into the U.S. tax system.

## *3. General Application of Section 362(e)(2) to Reorganizations*

Taxpayers have questioned whether a transaction described in both sections 362(a) and 362(b) may be subject to section 362(e)(2). The IRS and Treasury Department believe that, if there is a duplication of loss in a transaction described in section 362(a) (and not subject to section 362(e)(1)), Congressional intent requires that the transaction be recognized as described in section 362(a) notwithstanding that it is also described in section 362(b). The proposed regulations clarify that section 362(e)(2) can apply to such transactions.

#### 4. *Exception for Transactions in Which Net Built-in Loss is Eliminated Without Recognition*

In certain transactions, the transferor's duplicated basis in the transferee stock or securities is eliminated by operation of statute without recognition or benefit. For example, in a transaction meeting the requirements of both sections 351 and 368(a)(1)(D), the transferor ordinarily receives stock with an aggregate basis equal to that of the transferred property. As a result, where the transferred property has a net built-in loss, but for section 362(e)(2), the transferor would receive the transferee stock with an adjusted basis that duplicates the built-in loss in the transferred property. However, if the transferor distributes the transferee stock pursuant to a section 368(a)(1)(D) acquisitive reorganization or pursuant to section 355, no taxpayer will recognize the duplicated loss because the distributee will determine its basis in the transferee stock by reference to its basis in surrendered stock of the transferor.

The IRS and Treasury Department have concluded that, even if a transaction is described in section 362(e)(2), if there is no duplicated loss that can be recognized, section 362(e)(2) should not apply. Accordingly, these proposed regulations provide that section 362(e)(2) will not apply to transactions to the extent that loss duplication is prevented or eliminated where the transferor distributes the transferee stock and/or securities received in the transaction without recognizing gain or loss, and, upon completion of the transaction, no person holds any asset with a basis determined in whole or in part by reference to the transferor's basis in the transferee stock and/or securities.

#### 5. *Application of Section 362(e)(2) to Transfers in Exchange for Securities*

In certain transactions, net built-in loss also can be duplicated in securities received without the recognition of gain or loss. For example, a U.S. transferor duplicates a net built-in loss when it transfers property with a net built-in loss to a U.S. controlled corporation in exchange for stock and securities and all or part of the securities are retained following the distribution of the stock of the controlled corporation pursuant to section 355. Such

a transaction is described in section 362(a) but not section 362(e)(1) and, accordingly, may be subject to section 362(e)(2).

Although the statute is silent about the treatment of securities received in such a property transfer, the IRS and Treasury Department have concluded that Congressional intent would be circumvented if section 362(e)(2) were treated as not applying to both stock and securities received in transactions to which section 362(e)(2) applies. Accordingly, these proposed regulations apply section 362(e)(2) to transfers in exchange for both stock and securities to the extent necessary to eliminate loss duplication.

Because the section applies equally to transfers in exchange for both stock and securities, the IRS and Treasury Department have concluded that taxpayers must be allowed to make an election under section 362(e)(2)(C) for both stock and securities. Accordingly, these proposed regulations allow the transferor and transferee to elect to apply section 362(e)(2)(C) to the transferee stock and securities received in the exchange.

#### 6. *Election to Reduce Stock Basis*

Section 362(e)(2)(C) permits transferors and transferees that engage in transactions to which section 362(e)(2) applies to elect to reduce the transferor's basis in the stock received instead of reducing the transferee corporation's basis in the property transferred. As described in this preamble, section 362(e)(2)(C) provides that if the election is made, section 362(e)(2)(A) shall not apply, and the transferor's basis in the transferee stock received in the exchange shall not exceed its fair market value immediately after the exchange. The statutory language might be interpreted to require the transferor to reduce its basis in the stock received by an amount that is larger than the amount by which the transferee otherwise would have been required to reduce its aggregate basis in the assets under section 362(e)(2)(A). For example, assume a corporation, P, contributes a trade or business to a subsidiary, S, in a transaction to which section 351 applies. The assets of the business have an aggregate adjusted basis of \$100 and a value of \$90, and the business has \$20 of associated contingent liabilities. Even if section 358(h)(2)(A) applies to

prevent section 358 from reducing P's basis in the S stock by the amount of the contingent liabilities, section 362(e)(2)(C) might be interpreted to limit P's basis in the S stock to \$70 (notwithstanding that section 362(e)(2)(A) would only require a \$10 reduction in the basis of the assets in the hands of S). Thus, a section 362(e)(2)(C) election might result in a larger basis reduction in the stock than would be required in the assets absent an election.

The IRS and Treasury Department believe that, because section 362(e)(2) is intended to prevent the duplication of net built-in loss in the transferred assets, the amount of basis reduction resulting from an election under section 362(e)(2)(C) should not be any larger than what is necessary to eliminate the duplication of loss in the transferred assets. Therefore, these proposed regulations clarify that the amount of the reduction in the basis of the transferee stock (and securities) as a result of an election to apply section 362(e)(2)(C) is equal to the net built-in loss in the transferred assets in the hands of the transferee. In other words, under the proposed regulations, the amount of the reduction in the basis of the transferee stock (and securities) resulting from such an election equals the amount of the reduction in the basis of the assets required by section 362(e)(2)(A) absent the election.

These proposed regulations also implement Notice 2005-70, 2005-41 I.R.B. 694, see §601.601(d)(2), which instructs taxpayers how to elect to apply section 362(e)(2)(C). These proposed regulations revise and expand upon the procedures in Notice 2005-70 to provide more methods and time periods in which to make the section 362(e)(2)(C) election. Specifically, the regulations expand the classifications of persons who can attach the required election statement to a tax return (including an information return).

The "protective election" referenced in Notice 2005-70 also is included in the proposed regulations because the IRS and Treasury Department anticipate that, at the time of the transaction, taxpayers may not always be able to determine with reasonable certainty whether section 362(e)(2) applies to a transfer.

The IRS and Treasury Department request comments on whether the instructions provided in these proposed regula-

tions adequately address the needs of taxpayers. In particular, the IRS and Treasury Department invite comments regarding whether, alternatively, a separate form should be developed and made available to enable taxpayers to make the section 362(e)(2)(C) election prior to and apart from filing it with a U.S. return.

The basis tracing provisions in §1.358-2 apply to certain transfers to which section 351 and either section 354 or section 356 apply. However, the IRS and Treasury Department believe that the basis tracing provisions in §1.358-2 should not apply to a transfer to which section 362(e)(2) also applies if the transferor and transferee make an election to apply section 362(e)(2)(C). The IRS and Treasury Department believe that the statutory language in section 362(e)(2)(C) and the policy of preventing loss duplication precludes the application of the basis tracing provisions because basis tracing could allow the transferor to hold transferee stock or securities with a basis in excess of fair market value even after a reduction under section 362(e)(2)(C). Accordingly, these proposed regulations provide that the provisions of §1.358-2(a)(2) will not apply to a transaction to which section 362(e)(2) applies if the transferor and transferee elect to apply section 362(e)(2)(C). The IRS and Treasury Department request comments regarding whether this treatment is appropriate.

#### *7. Transfers by Partnerships and S Corporations*

The proposed regulations also provide that, where the transferor is a partnership and a section 362(e)(2)(C) election is made, any reduction to the partnership's basis in the transferee stock received is treated as an expenditure of the partnership, as described in section 705(a)(2)(B). The proposed regulations provide a similar rule applicable to transfers by S corporations that elect to apply section 362(e)(2)(C).

The IRS and Treasury Department are further exploring how the provisions of section 362(e)(2) apply to partnerships. The IRS and Treasury Department invite comments on this general issue and specifically invite comments regarding the transfer of a partnership interest in

exchange for stock in a section 351 transaction to which section 362(e)(2) applies. For example, individuals A and B contribute cash to form a partnership, PRS. PRS purchases property that subsequently decreases in value. A contributes his PRS interest to a corporation in a transaction that qualifies under section 351. PRS does not make an election under section 754. Comments are invited regarding the interaction of section 362(e)(2) and the partnership provisions under these and similar facts.

#### *8. Application of Section 336(d) to Property Previously Transferred in a Section 362(e)(2) Transaction*

Commentators have questioned how section 362(e)(2) interacts with other Code sections. Specifically, some have asked how section 362(e)(2) applies when section 336(d) might be implicated. Section 336(d) provides various limitations on a liquidating corporation's ability to recognize loss when it distributes property acquired in a section 351 transaction or as a contribution to capital. The IRS and Treasury Department believe that, generally, sections 336(d) and 362(e)(2) are fully compatible where the parties do not make an election to apply section 362(e)(2)(C). However, where an election has been made, the two sections may operate to deny part or all of an economic loss. The IRS and Treasury Department invite comments regarding this issue.

#### *9. Application to Section 304 Transactions*

In response to inquiries, the proposed regulations contain an example demonstrating how section 362(e)(2) applies to a section 351 transaction treated as occurring under section 304. The IRS and Treasury Department are considering whether the regulations should deem an election to apply section 362(e)(2)(C) to have been made in section 304 transactions. The IRS and Treasury Department invite comments regarding this issue.

#### **Proposed Effective Date**

These proposed regulations are proposed to apply to transactions occurring after the date these regulations are pub-

lished as final regulations in the **Federal Register**.

#### **Special Analyses**

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

#### **Comments and Requests for a Public Hearing**

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

#### **Drafting Information**

The principal authors of these regulations are Jay M. Singer and Filiz A. Serbes of the Office of Associate Chief Counsel (Corporate), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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#### **Proposed Amendments to the Regulations**

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



## PART 1—INCOME TAXES

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

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

Section 1.362-4 also issued under 26 U.S.C. 362. \* \* \*

Par. 2. Section 1.358-2 is amended by revising paragraphs (a)(2)(viii) and adding a new sentence at the end of paragraph (d) to read as follows:

*§1.358-2 Allocation of basis among nonrecognition property.*

(a) \* \* \*

(2) \* \* \*

(viii) This paragraph (a)(2) shall not apply to determine the basis of a share of stock or security received by a shareholder or security holder in an exchange described in both section 351 and either section 354 or section 356, if, in connection with the exchange, the shareholder or security holder exchanges property for stock or securities in an exchange to which neither section 354 nor section 356 applies, the shareholder or security holder exchanges property for stock or securities to which it elects to apply section 362(e)(2)(C), or liabilities of the shareholder or security holder are assumed.

\* \* \* \* \*

(d) \* \* \* Paragraph (a)(2)(viii) of this section applies to exchanges and distributions of stock occurring after the date these regulations are published as final regulations in the **Federal Register**.

Par. 3. In §1.362-3, the section heading is added and reserved to read as follows:

*§1.362-3 Limitations on loss importation.* [Reserved].

Par. 4. Section 1.362-4 is added to read as follows:

*§1.362-4 Limitations on built-in loss duplication.*

(a) *Purpose and scope.* The purpose of this section is to prevent the duplication of net built-in loss in transactions described in section 362(e)(2). Section 362(e)(2) applies to transfers of net built-in loss property described in section 362(a) but only to the extent not described in section 362(e)(1).

(b) *Application—(1) In general.* If property is transferred in any transaction described in section 362(a) but not section 362(e)(1), and, in the hands of the transferee, the transferred property would otherwise have a net built-in loss immediately after the transfer, then the transferee corporation receives such property with an aggregate adjusted basis not exceeding the aggregate fair market value of such property immediately after the transfer. If multiple built-in loss properties are transferred, the aggregate reduction in basis shall be allocated among the built-in loss properties so transferred in proportion to the relative amount of built-in loss in each property.

(2) *Multiple transferors.* If more than one transferor transfers property to a corporation in a transaction described in section 362(a), whether and the extent to which this section applies is determined separately for each transferor.

(3) *Transactions described in section 362(e)(1).* A transfer of property to a corporation is described in section 362(e)(1) only if and to the extent that the transferred property described in section 362(e)(1)(B) (section 362(e)(1)(B) property) would otherwise have a net built-in loss in the hands of the transferee. Thus, if a transferor transfers net built-in loss section 362(e)(1)(B) property together with property not described in section 362(e)(1)(B), the transfer of the net built-in loss section 362(e)(1)(B) property is described in section 362(e)(1). Accordingly, the net built-in loss section 362(e)(1)(B) property is not taken into account for purposes of determining whether section 362(e)(2) applies to the transfer of the other property. Alternatively, if a transferor transfers net built-in gain section 362(e)(1)(B) property together with property not described in section 362(e)(1)(B), no portion of the transfer is described in section 362(e)(1).

(4) *Net built-in loss—(i) In general.* Transferred property has a net built-in loss if its aggregate adjusted basis exceeds its aggregate fair market value.

(ii) *Basis adjustments for gain recognized on the transfer.* For purposes of determining whether the transferred property has a net built-in loss in the hands of the transferee, the bases of such property first must be increased under section 362(a) or (b) for any gain recognized by the transferor on the transfer of such property.

(5) *Application of section 362(e)(2) to reorganizations.* Section 362(e)(2) can apply to a transfer regardless of whether the basis of the property would, but for section 362(e)(2), be determined under section 362(b).

(6) *Exception for transactions in which net built-in loss is eliminated without recognition.* Section 362(e)(2) does not apply to a transfer of property to the extent that—

(i) The transferor distributes, without recognizing gain or loss, all of the transferee stock received in exchange for the transferred property; and

(ii) Upon completion of the transaction, no person holds transferee stock or any other asset with a basis determined in whole or in part by reference to the transferor's basis in the transferee stock.

(7) *Transfers where neither party is a U.S. person, a person otherwise required to file a U.S. return, or a CFC.* If property is transferred in a transaction described in section 362(a) but not section 362(e)(1), then, solely for purposes of section 362(e)(2), the aggregate fair market value of the transferred property shall be deemed to equal the aggregate adjusted basis of such property in the hands of the transferee immediately after the transfer if—

(i) Neither party to the transfer was a United States (U.S.) person (as defined in section 7701(a)(30)) on the date of the transfer;

(ii) Neither party to the transfer was required to file a return of tax under Subtitle A of the Internal Revenue Code (including an information return) for the year of the transfer;

(iii) Neither party to the transfer was a controlled foreign corporation (CFC), as defined in section 957, on the date of the transfer;

(iv) The transfer occurred more than two years prior to the date on which the transferor, transferee, or transferred assets are first described in paragraph (c)(5)(iii) of this section; and

(v) Neither the transfer nor the later entry into the U.S. tax system was entered into with a view to reducing the U.S. Federal income tax liability of any person or duplicating loss by avoiding the application of section 362(e)(2).

(c) *Section 362(e)(2)(C) election to apply limitation to transferor's stock ba-*

sis—(1) *In general.* If section 362(e)(2) applies to a transfer, the transferor and the transferee may make a joint election to reduce the transferor's basis in the transferee stock instead of reducing the transferee's basis in the property received under paragraph (b) of this section. Once made, the election is irrevocable. If the election is made, the transferor's basis in the transferee stock is reduced upon receipt by the transferor. The transferor and the transferee may make a protective election under this section, which will have no effect if section 362(e)(2) does not apply to the transfer, but which will otherwise be binding and irrevocable.

(2) *Stock and securities to which this section applies.* For purposes of this section, the term *stock* means stock and securities received without the recognition of gain or loss in a transaction to which section 362(e)(2) applies. See, for example, transactions described in sections 368(a)(1)(D) and 355.

(3) *Amount of basis reduction.* If an election is made pursuant to paragraph (c)(1) of this section, the amount of the basis reduction in the transferee stock received by the transferor in the transaction is equal to the total amount by which the aggregate basis of the transferred property would have been reduced under paragraph (b) of this section had such election not been made.

(4) *Allocation of basis reduction.* The transferor shall allocate the amount of the basis reduction under this paragraph (c) among all transferee stock received in the transaction in proportion to fair market value.

(5) *Procedures for making the election—(i) In general.* To make an election to apply section 362(e)(2)(C)—

(A) Prior to filing the election statement as described in paragraph (c)(5)(ii) or (c)(5)(iii) of this section, the transferor and transferee must execute a written, binding agreement electing to apply section 362(e)(2)(C); and

(B) An election statement must be filed pursuant to paragraph (c)(5)(ii) or (c)(5)(iii) of this section.

(ii) *Election statement where the transferor or transferee is a U.S. person, a person otherwise required to file a U.S. return for the year of the transfer, or a CFC on the date of the transfer—(A) Transferor is a U.S. person or a person otherwise re-*

*quired to file a U.S. return for the year of the transfer.* If the transferor is a U.S. person on the date of the transfer or a person otherwise required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return) for the year of the transfer, the election statement is filed by including the following statement on or with the transferor's timely filed original return (including extensions) for the taxable year in which the transfer occurred: “[insert name and tax identification number of transferor] certifies that [insert name and tax identification number of transferor] and [insert name and tax identification number, if any, of transferee] elect to apply section 362(e)(2)(C) with respect to a transfer of property described in section 362(e)(2)(A) on [insert date(s) of transfer(s)].”

(B) *Transferor is a CFC on the date of the transfer.* If, on the date of the transfer, the transferor is a CFC that is not required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return) for the year of the transfer, the election statement is filed by including the following statement on or with the timely filed original return (including extensions) of each one of the transferor's controlling U.S. shareholders, as defined in §1.964-1(c)(5), for the taxable year within which the transfer occurred: “[insert name and tax identification number of controlling U.S. shareholder filing return] certifies that [insert name and tax identification number, if any, of transferor (the CFC)] and [insert name and tax identification number, if any, of transferee] elect to apply section 362(e)(2)(C) with respect to a transfer of property described in section 362(e)(2)(A) on [insert date(s) of transfer(s)]. [insert name(s) and tax identification number(s) of any other controlling U.S. shareholder(s) of the CFC, or, if none, state that there are no other controlling U.S. shareholders of the CFC].”

(C) *Transferor is not a U.S. person on the date of the transfer, a person otherwise required to file a U.S. return for the year of the transfer, or a CFC on the date of the transfer, and transferee is a U.S. person on the date of the transfer or a person otherwise required to file a U.S. return for the year of the transfer.* If the transferor is not described in paragraph (c)(5)(ii)(A) or (c)(5)(ii)(B) of this section and the trans-

feree is a U.S. person on the date of the transfer or otherwise required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return) for the year of the transfer, the election statement is filed by including the following statement on or with the transferee's timely filed original return (including extensions) for the taxable year in which the transfer occurred: “[insert name and tax identification number of transferee] certifies that [insert name and tax identification number, if any, of transferor] and [insert name and tax identification number of transferee] elect to apply section 362(e)(2)(C) with respect to a transfer of property described in section 362(e)(2)(A) on [insert date(s) of transfer(s)].”

(D) *Transferor is not a U.S. person on the date of the transfer, a person otherwise required to file a U.S. return for the year of the transfer, or a CFC on the date of the transfer, and transferee is a CFC on the date of the transfer.* If the transferor is not described in paragraph (c)(5)(ii)(A) or (c)(5)(ii)(B) of this section, and, on the date of the transfer, the transferee is a CFC that is not required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return) for the year of the transfer, the election statement is filed by including the following statement on or with the timely filed original return (including extensions) of each one of the transferee's controlling U.S. shareholders as defined in §1.964-1(c)(5) for the taxable year within which the transfer occurred: “[insert name and tax identification number of controlling U.S. shareholder filing return] certifies that [insert name and tax identification number, if any, of transferor] and [insert name and tax identification number, if any, of transferee (the CFC)] elect to apply section 362(e)(2)(C) with respect to a transfer of property described in section 362(e)(2)(A) on [insert date(s) of transfer(s)]. [insert name(s) and tax identification number(s) of any other controlling U.S. shareholder(s) of the CFC, or, if none, state that there are no other controlling U.S. shareholders of the CFC].”

(iii) *Election where neither the transferor nor the transferee is a U.S. person on the date of the transfer, a person otherwise required to file a U.S. return for the year of the transfer, or a CFC on the date*

of the transfer. If the parties to a transfer to which section 362(e)(2) applies are not described in any of the classifications set forth in paragraph (c)(5)(ii) of this section, then the election statement under this paragraph (c) is made as described in this paragraph (c)(5)(iii).

(A) *Transferor later becomes a U.S. person, a person otherwise required to file a U.S. return, or a CFC.* If the transferor later becomes a U.S. person, a person otherwise required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return), or a CFC, an election statement under this paragraph (c) is filed as described in this paragraph (c)(5)(iii)(A).

(1) If the transferor becomes a U.S. person or a person otherwise required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return), the election statement is filed by including the statement described in paragraph (c)(5)(ii)(A) of this section on or with the transferor's timely filed original return (including extensions) for the taxable year in which the transferor first becomes a U.S. person or a person otherwise required to make a return.

(2) If the transferor becomes a CFC that is not required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return), the election statement is filed by including the statement described in paragraph (c)(5)(ii)(B) of this section on or with the timely filed original return (including extensions) of each one of the transferor's controlling U.S. shareholders, as defined in §1.964-1(c)(5), for the taxable year within which the transferor becomes a CFC.

(B) *Transferee later becomes a U.S. person, a person otherwise required to file a U.S. return, or a CFC.* If the transferor is not described in paragraph (c)(5)(iii)(A) of this section, and the transferee later becomes a U.S. person, a person otherwise required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return), or a CFC, an election statement under this paragraph (c) is filed as described in this paragraph (c)(5)(iii)(B).

(1) If the transferee becomes a U.S. person or a person otherwise required to make a return of tax under Subtitle A of the Internal Revenue Code (including an infor-

mation return), the election statement is filed by including the statement described in paragraph (c)(5)(ii)(C) of this section on or with the transferee's timely filed original return (including extensions) for the taxable year in which the transferee first becomes required to make a return.

(2) If the transferee becomes a CFC that is not required to make any return of tax under Subtitle A of the Internal Revenue Code (including an information return), the election statement is filed by including the statement described in paragraph (c)(5)(ii)(D) of this section on or with the timely filed original return (including extensions) of each one of the transferee's controlling U.S. shareholders as defined in §1.964-1(c)(5) for the taxable year within which the transferee becomes a CFC.

(C) *A U.S. person, a person otherwise required to file a U.S. return, or a CFC later acquires the transferred assets or transferee stock in a transferred basis transaction.* If neither the transferor nor the transferee is described in paragraph (c)(5)(iii)(A) or (c)(5)(iii)(B) of this section and a U.S. person, a person otherwise required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return), or a CFC not required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return) later acquires, in a transferred basis transaction, any portion of the assets that were transferred in a prior transaction to which section 362(e)(2) applied (section 362(e)(2) assets) or stock of the transferee corporation received in such prior transaction (section 362(e)(2) stock), then the election statement under this paragraph (c) is filed as described in this paragraph (c)(5)(iii)(C).

(1) If a U.S. person or a person otherwise required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return) later acquires, in a transferred basis transaction, any portion of the section 362(e)(2) assets or section 362(e)(2) stock, the election statement is filed by including the following statement on or with such acquiror's timely filed original return (including extensions) for the taxable year in which the acquiror first acquires any portion of the section 362(e)(2) assets or section 362(e)(2) stock: "[insert name and tax identification number of the acquiror] cer-

tifies that [insert name and tax identification number, if any, of transferor] and [insert name and tax identification number, if any, of transferee] elect to apply section 362(e)(2)(C) with respect to a transfer of property described in section 362(e)(2)(A) on [insert date(s) of transfer(s)]."

(2) If no person described in paragraph (c)(5)(iii)(C)(1) of this section has acquired any portion of the section 362(e)(2) assets or section 362(e)(2) stock, and a CFC not required to make a return of tax under Subtitle A of the Internal Revenue Code (including an information return) later acquires, in a transferred basis transaction, any portion of the section 362(e)(2) assets or section 362(e)(2) stock, the election statement is filed by including the following statement on or with each of the CFC's controlling U.S. shareholders' timely filed original returns (including extensions) for the taxable year within which the CFC first acquires any portion of the section 362(e)(2) assets or section 362(e)(2) stock: "[insert name and tax identification number of controlling U.S. shareholder filing return] certifies that [insert name and tax identification number, if any, of transferor] and [insert name and tax identification number, if any, of transferee] elect to apply section 362(e)(2)(C) with respect to a transfer of property described in section 362(e)(2)(A) on [insert date(s) of transfer(s)]. [insert name(s) and tax identification number(s) of any other controlling U.S. shareholder(s) of the CFC, or, if none, state that there are no other controlling U.S. shareholders of the CFC]."

(6) *Transfers by partnerships.* If the transferor is a partnership, for purposes of applying section 705 (determination of basis of partner's interest), any reduction under this section to the transferor's basis in the stock received in exchange for the transferred property is treated as an expenditure of the partnership described in section 705(a)(2)(B).

(7) *Transfers by S corporations.* If the transferor is an S corporation, for purposes of applying section 1367 (adjustments to basis of stock of shareholders, etc.), any reduction under this section to the transferor's basis in the stock received in exchange for the transferred property is treated as an expense of the S corporation described in section 1367(a)(2)(D).

(d) *Examples.* The following examples illustrate paragraphs (a) through (c) of this section. Unless otherwise indicated, all transferred property is subject to tax under Subtitle A of the Internal Revenue Code in the hands of the transferor, and, accordingly, section 362(e)(1) does not apply to the transaction. In addition, all assets are capital assets in the hands of the transferor and have been held for more than one year.

*Example 1. Property transfer qualifying under section 351.* (i) *Facts.* Individual A owns Asset 1 with a basis of \$90 and a fair market value of \$60, and Asset 2 with a basis of \$110 and a fair market value of \$120. In a transaction qualifying under section 351, A transfers Asset 1 and Asset 2 to newly formed corporation X in exchange for all of the X common stock. A and X do not elect to apply section 362(e)(2)(C) to reduce A's basis in the X stock received.

(ii) *Analysis.* Under section 362(a), X would otherwise receive Asset 1 and Asset 2 with an aggregate basis of \$200 (\$90+\$110), which exceeds their aggregate fair market value of \$180 (\$60+\$120). As a result, the assets have a net built-in loss of \$20, and this section applies to the transfer. Under paragraph (b)(1) of this section, X reduces its basis in Asset 1 by \$20 to \$70 and, under section 362(a), takes a basis in Asset 2 of \$110. Under section 358(a), A receives X stock with a basis of \$200.

(iii) *Election to apply section 362(e)(2)(C).* The facts are the same as in paragraph (i) of this *Example 1*, except that A and X elect to apply section 362(e)(2)(C) to reduce A's basis in the X stock received. Under paragraph (c)(3) of this section, A reduces its basis in the X stock received by the amount X would have been required to reduce its basis in the transferred assets had the election to apply section 362(e)(2)(C) not been made. Accordingly, A receives X stock with an aggregate basis of \$180, and, under section 362(a), X receives Asset 1 with a basis of \$90 and Asset 2 with a basis of \$110.

*Example 2. Property transfer qualifying under section 351 and described in section 368(a)(1)(B).* (i) *Facts.* Corporation P owns all of the outstanding stock of corporations S1 and S2. In a transaction qualifying under section 351 and described in section 368(a)(1)(B), P transfers all 10 shares of its S2 stock to S1 in exchange for an additional 10 shares of S1 voting stock. At the time of the transfer, each share of the S2 stock has a basis of \$10 and a fair market value of \$7. P and S1 do not elect to apply section 362(e)(2)(C) to reduce P's basis in its S1 stock.

(ii) *Analysis.* Under section 362, S1 would otherwise receive the 10 shares of S2 stock with a basis of \$10 per share, which exceeds their fair market value of \$7 per share. As a result, the S2 stock has a net built-in loss of \$30, and this section applies to the transfer. Under paragraph (b)(1) of this section, S1 reduces its basis in the S2 stock by \$30 to \$70. Under section 358(a), P receives the additional 10 shares of S1 stock with a basis of \$10 per share.

(iii) *Election under section 362(e)(2)(C).* (A) The facts are the same as in paragraph (i) of this *Example 2*, except that P and S1 elect to apply section 362(e)(2)(C) to reduce P's basis in its S1 stock received. Under paragraph (c)(3) of this section, P reduces its basis in the S1 stock received by the amount

S1 would have been required to reduce its basis in the transferred S2 stock had the election to apply section 362(e)(2)(C) not been made. Accordingly, under paragraph (c)(4) of this section, P receives the additional 10 shares of S1 stock each with a basis of \$7. Under section 362, S1 receives the 10 shares of S2 stock each with a basis of \$10.

(B) The facts are the same as in paragraph (i) of this *Example 2*, except that five shares of the S2 stock have a basis of \$10 each, five shares have a basis of \$5 each, and P and S1 elect to apply section 362(e)(2)(C) to reduce P's basis in its S1 stock. The \$75 ((5 X \$10) + (5 x \$5)) aggregate basis in the S2 stock exceeds the \$70 aggregate fair market value of the S2 stock, and this section applies to the transfer. Under paragraph (c)(3) of this section, P reduces its basis in the S1 stock received by the amount S1 would have been required to reduce its basis in the transferred S2 stock had the election to apply section 362(e)(2)(C) not been made. Accordingly, under paragraph (c)(4) of this section and §1.358-2(a)(2)(viii), P receives the additional 10 shares of S1 stock each with a basis of \$7. Under section 362, S1 receives five shares of the S2 stock with a basis of \$10 each and five shares of the S2 stock with a basis of \$5 each.

*Example 3. Property transfer qualifying under section 351 and described in section 368(a)(1)(A).* (i) *Facts.* Individual A owns all of the outstanding stock of corporation X and corporation Y, which owns Asset 1 with an adjusted basis of \$250 and a fair market value of \$210. A also owns Asset 2 with an adjusted basis of \$120 and a fair market value of \$130. In a transaction qualifying as a reorganization described in section 368(a)(1)(A), Y merges with and into X. Pursuant to the same plan, A transfers Asset 2 to X in exchange for additional X stock. Y's transfer of Asset 1 to X in the merger coupled with A's transfer of Asset 2 to X in exchange for X stock qualifies as a section 351 contribution.

(ii) *Analysis.* Under paragraph (b)(2) of this section, the potential application of section 362(e)(2) is determined separately for each transferor. Y is treated as having transferred Asset 1 to X in exchange for X stock, and X would otherwise take Asset 1 with a basis of \$250, which exceeds its fair market value of \$210. As a result, Asset 1 has a built-in loss of \$40. Under paragraph (b)(6) of this section, section 362(e)(2) does not apply to Y's transfer of property to X because Y distributes all of the X stock received in the exchange without recognizing gain or loss pursuant to section 361(c), and, upon completion of the transaction, no person holds X stock or any other asset with a basis determined in whole or in part by reference to Y's basis in the X stock received in the exchange. As a result, under section 362, X receives Asset 1 with a basis of \$250. A's transfer of Asset 2 to X is not subject to section 362(e)(2) because X receives Asset 2 with a basis of \$120, which is less than its fair market value of \$130.

*Example 4. Property transfers qualifying under section 351 and described in section 368(a)(1)(D), followed by a section 355 distribution.* (i) *Facts.* Individual A and individual B each own 50 percent of corporation X. X owns Asset 1 with an adjusted basis of \$120 and a fair market value of \$70, Asset 2 with an adjusted basis of \$160 and a fair market value of \$110, and Asset 3 with an adjusted basis of \$220 and a fair market value of \$240. In a transaction qualifying under section 351(a) and described in section

368(a)(1)(D), X transfers Asset 1, Asset 2, and Asset 3 to Y, a newly formed corporation, in exchange for all of the Y stock, and then distributes all of the Y stock to A in exchange for all of A's X stock in a distribution qualifying under section 355. At the time of the transaction, A has no plan or intention to dispose of his Y stock, and B has no plan or intention to dispose of his X stock.

(ii) *Analysis.* The aggregate adjusted basis of the properties transferred to Y (\$120+\$160+\$220=\$500) exceeds their aggregate fair market value (\$70+\$110+\$240=\$420). As a result, the assets have a total net built-in loss of \$80. Under paragraph (b)(6) of this section, section 362(e)(2) does not apply to this transfer of property because X distributes all of the Y stock received in the exchange without recognizing gain or loss under section 361(c), and, upon completion of the transaction, no person holds Y stock or any other asset with a basis determined in whole or in part by reference to X's basis in the Y stock received in the exchange. A's basis in the Y stock is determined under section 358 by reference to his basis in the X stock he surrenders.

(iii) *Section 355(e).* (A) The facts are the same as in paragraph (i) of this *Example 4*, except that, one year after the section 355 distribution, Y is acquired pursuant to a plan, resulting in the application of section 355(e) to the transaction. X and Y do not elect to apply section 362(e)(2)(C).

(B) *Analysis.* Due to the application of section 355(e), section 361(c) will not apply and X will not be granted nonrecognition treatment on the distribution of the Y stock. As a result, paragraph (b)(6) of this section does not apply, and section 362(e)(2) applies to X's transfer of assets to Y. Under paragraph (b)(1) of this section, Y reduces its basis in Asset 1 and Asset 2 by the amount of the net built-in loss in the transferred assets, or \$80 (\$500-\$420). The \$80 basis reduction is allocated between Asset 1 and Asset 2 in proportion to their respective built-in losses. Prior to reduction, Asset 1 had a built-in loss of \$50 (\$120-\$70), and Asset 2 had a built-in loss of \$50 (\$160-\$110). As a result, the basis of Asset 1 is reduced by \$40 (50/100 x \$80), and the basis of Asset 2 is reduced by \$40 (50/100 x \$80), and Y receives Asset 1 with a basis of \$80 (\$120-\$40) and Asset 2 with a basis of \$120 (\$160-\$40).

(iv) *Retained stock and securities without a section 362(e)(2)(C) election.* (A) The facts are the same as in paragraph (i) of this *Example 4*, except that X transfers Asset 1, Asset 2, and Asset 3 to Y in exchange for an equal amount of Y stock and Y securities. For a valid business purpose, X retains Y stock and Y securities each worth 1 percent of the total consideration. X and Y do not elect to apply section 362(e)(2)(C).

(B) *Analysis.* The aggregate basis of the properties transferred (\$120+\$160+\$220=\$500) exceeds their aggregate fair market value (\$70+\$110+\$240=\$420) by \$80 (\$500-\$420), and this section applies to the transfer. Under paragraph (b)(6) of this section, section 362(e)(2) applies to X's transfer of assets to Y in exchange for the Y stock and the Y securities to the extent X does not distribute the Y stock and Y securities without the recognition of gain or loss. Accordingly, section 362(e)(2)(A) applies to the extent property was exchanged for the retained Y stock and Y securities (2 percent of the total). Under paragraph (b)(1) of

this section, Y reduces its basis in Asset 1 and in Asset 2 by 2 percent of the amount of the net built-in loss in the transferred assets (\$80), or \$1.60. The \$1.60 basis reduction is allocated between Asset 1 and Asset 2 in proportion to their respective built-in losses before reduction under paragraph (b)(1) of this section. Prior to reduction, Asset 1 had a built-in loss of \$50 (\$120—\$70), and Asset 2 had a built-in loss of \$50 (\$160—\$110). As a result, the basis of Asset 1 is reduced by \$.80 (50/100 x \$1.60), the basis of Asset 2 is reduced by \$.80 (50/100 x \$1.60), and Y receives Asset 1 with a basis of \$119.20 (\$120—\$.80) and Asset 2 with a basis of \$159.20 (\$160—\$.80).

(v) *Retained stock and securities with a section 362(e)(2)(C) election.*

(A) The facts are the same as in paragraph (iv)(A) of this *Example 4*, except that X and Y elect to apply section 362(e)(2)(C) to reduce X's basis in its retained Y stock and retained Y securities.

(B) *Analysis.* Under paragraph (b)(6) of this section, section 362(e)(2) applies to X's transfer of assets to Y in exchange for the Y stock and the Y securities to the extent X does not distribute the Y stock and Y securities without the recognition of gain or loss. Under paragraph (c) of this section, the election to apply section 362(e)(2)(C) applies to both the retained Y stock and the retained Y securities. Accordingly, under paragraph (c)(3) of this section, X reduces its basis in the retained Y stock and the retained Y securities by the amount Y would have been required to reduce its basis in the transferred assets had the election to apply section 362(e)(2)(C) not been made. As described in paragraph (iv)(B) of this *Example 4*, under paragraphs (b)(1) and (b)(6) of this section, Y would have been required to reduce its basis in the transferred assets by \$1.60. Accordingly, X is required to reduce its basis in the retained Y stock and Y securities by \$1.60, and, under paragraph (c)(4) of this section, this \$1.60 basis reduction is allocated between the retained Y stock and Y securities in proportion to fair market value. Because X retained Y stock and Y securities with equal values, X holds the retained Y stock with an adjusted basis of \$1.70 (((\$500/2) x .01)—\$.80) and the retained Y securities with an adjusted basis of \$1.70 (((\$500/2) x .01)—\$.80).

*Example 5. Transfer of contingent liabilities subject to section 358(h)(2)(A) with section 362(e)(2)(C) election.* (i) *Facts.* Corporation P owns Asset 1 with a basis of \$800 and a fair market value of \$700. Asset 1 constitutes a trade or business for purposes of section 358(h)(2)(A). Contingent liabilities of \$200 are associated with the Asset 1 business. P transfers Asset 1 to newly formed corporation S in exchange for all of the S stock and assumption of the contingent liabilities in a transaction qualifying under section 351. P and S elect to apply section 362(e)(2)(C).

(ii) *Analysis.* Under section 362(a), S would otherwise receive Asset 1 with a basis of \$800, which exceeds its fair market value of \$700. As a result, Asset 1 has a net built-in loss of \$100, and this section applies to the transfer. Under paragraph (c)(3) of this section, P reduces its basis in the S stock received by the amount S would have been required to reduce its basis in Asset 1 had the election to apply section 362(e)(2)(C) not been made (\$100). Accordingly, A receives S stock with an aggregate basis of \$700, and, under section 362(a), S receives Asset 1 with a basis of \$800.

*Example 6. Property transfer qualifying under section 351 with boot.* (i) *Facts.* Individual A owns Asset 1 with a basis of \$80 and a fair market value of \$100, and Asset 2 with a basis of \$30 and a fair market value of \$25. In a transaction qualifying under section 351, A transfers Asset 1 and Asset 2 to newly formed corporation N in exchange for 10 shares of N stock and \$25. A and N do not elect to apply section 362(e)(2)(C) to reduce A's basis in the N stock received.

(ii) *Analysis.* Under paragraph (b)(4)(iii) of this section, for purposes of determining whether the transferred property has a net built-in loss in the hands of the transferee, the transferee's basis in the transferred property must be adjusted for any gain recognized by the transferor on the transfer. Section 351(b) requires transferors in transactions otherwise qualifying under section 351(a) for nonrecognition treatment to recognize gain (but not loss) to the extent the transferor receives other property or money in addition to the stock permitted to be received. For purposes of computing the amount of gain recognized under section 351(b), the consideration is allocated *pro rata* among the transferred properties according to their fair market values. As a result, to compute the amount of gain recognized on the transfer, A is treated as having received eight shares of N stock and \$20 in exchange for Asset 1, and two shares of N stock and \$5 in exchange for Asset 2. Under section 351(b), A must recognize \$20 of gain for the cash received in exchange for Asset 1. Thus, under section 362(a), N would otherwise have a basis of \$100 in Asset 1 and \$30 in Asset 2. N's total basis in Asset 1 and Asset 2 of \$130 (\$100 + \$30) would exceed the total fair market value of Asset 1 and Asset 2 of \$125 (\$100 + \$25). As a result, this section applies to the transfer. Under paragraph (b)(1) of this section, N reduces its basis in Asset 2 by \$5 to \$25 and, under section 362(a), takes a basis in Asset 1 of \$100. Under section 358(a), A receives N stock with a basis of \$105.

*Example 7. Property transfer subject to both sections 362(e)(1) and 362(e)(2).* (i) *Facts.* Foreign corporation FP transfers Asset 1 and Asset 2 to a domestic corporation DS in a transaction that qualifies under section 351. Asset 1 is not property described in section 362(e)(1)(B) and has a basis of \$80 and a fair market value of \$50. Asset 2 is property described in section 362(e)(1)(B) and has a basis of \$120 and a value of \$110. Section 367(b) does not apply to the transfer of Asset 1 or Asset 2.

(ii) *Analysis.* Under paragraphs (b)(1) and (b)(3) of this section, a transfer is described in section 362(e)(1), and thus not subject to this section, only if and to the extent there is a transfer of property described in section 362(e)(1)(B) that otherwise would have a net built-in loss in the hands of the transferee. Because Asset 2 is property described in section 362(e)(1)(B) and DS would otherwise receive Asset 2 with a basis of \$120 and a value of \$110, FP's transfer of property to DS is described in section 362(e)(1) only to the extent of the transfer of Asset 2. Asset 1 is not property described in section 362(e)(1)(B), and under section 362(a), DS would receive Asset 1 with a basis (\$80) in excess of its fair market value (\$50). Accordingly, this section applies solely to the transfer of Asset 1. Under paragraph (b)(1) of this section, DS reduces its basis in Asset 1

by \$30 to \$50. Under section 358(a), FP receives the DS stock with a basis of \$200.

*Example 8. Section 304 sale of built-in loss stock.* (i) *Facts.* Individual A owns all the stock of corporation X and corporation Y. A sells all his X stock to Y for \$60. Under section 304, A is treated as though he transferred the X stock to Y in exchange for Y stock in a transaction to which section 351 applies. Then, Y is treated as redeeming the Y stock it was treated as having issued to A in the section 351 transaction. At the time of the transaction, A holds X stock with a basis of \$90 and a fair market value of \$60. A and Y do not elect to apply section 362(e)(2)(C) to reduce A's basis in the Y stock deemed received.

(ii) *Analysis.* Under section 362(a), Y would otherwise receive X stock with an aggregate basis of \$90, which exceeds its aggregate fair market value of \$60. As a result, the X stock has a net built-in loss of \$30, and, under paragraph (b)(1) of this section, Y reduces its basis in the X stock received by \$30 to \$60. Under section 358(a), A receives the deemed issued Y stock with a basis of \$90.

(e) *Effective date.* This section applies to transactions occurring after the date these regulations are published as final regulations in the **Federal Register**.

Par. 5. Section 1.705-1(a)(9) is added to read as follows:

*§1.705-1 Determination of basis of partner's interest.*

(a) \* \* \*

(9) For basis adjustments necessary to coordinate sections 705 and 362(e)(2), see §1.362-4(c)(6).

\* \* \* \* \*

Par. 6. In §1.1367-1, a new sentence is added at the end of paragraph (c)(2) to read as follows:

*§1.1367-1 Adjustments to basis of shareholder's stock in an S corporation.*

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \* For basis adjustments necessary to coordinate sections 1367 and 362(e)(2), see §1.362-4(c)(7).

\* \* \* \* \*

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

(Filed by the Office of the Federal Register on October 20, 2006, 8:45 a.m., and published in the issue of the Federal Register for October 23, 2006, 71 F.R. 62067)

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

## TIPRA Amendments to Section 199

### REG-127819-06

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9293) concerning the application of section 199 of the Internal Revenue Code, which provides a deduction for income attributable to domestic production activities. The text of those regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 17, 2007. Outlines of topics to be discussed at the public hearing scheduled for February 5, 2007, must be received by January 16, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-127819-06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:PR (REG-127819-06), Internal Revenue Service, Crystal Mall 4 Building, 1901 S. Bell St., Arlington, VA, or sent electronically, via the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS-REG-127819-06). The public hearing will be held in the auditorium of the New Carrollton Federal Building, 5000 Ellin Rd., Lanham, Maryland 20706.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations,

Paul Handleman or Lauren Ross Taylor, (202) 622-3040; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Kelly D. Banks, (202) 622-7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR Part 1) relating to section 199. The temporary regulations provide guidance concerning the amendments made by the Tax Increase Prevention and Reconciliation Act of 2005 to section 199 of the Internal Revenue Code. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

##### Special Analyses

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

##### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. In addition, the IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to under-

stand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 5, 2007 at 10:00 a.m., in the auditorium of the New Carrollton Federal Building, 5000 Ellin Rd., Lanham, Maryland 20706. Due to building security procedures, visitors must enter at the main entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by January 16, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

##### Drafting Information

The principal authors of these regulations are Paul Handleman and Lauren Ross Taylor, Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

##### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

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

Par. 2. Section 1.199-2 is amended to read as follows:

### *§1.199–2 Wage limitation.*

[The text of proposed §1.199–2 is the same as the text of §1.199–2T published elsewhere in this issue of the Bulletin.]

Par. 3. Section 1.199–3 is amended to read as follows:

### *§1.199–3 Domestic production gross receipts.*

[The text of proposed §1.199–3 is the same as the text of §1.199–3T published elsewhere in this issue of the Bulletin.]

Par. 4. Section 1.199–5 is amended to read as follows:

### *§1.199–5 Application of section 199 to pass-thru entities for taxable years beginning after May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.*

[The text of proposed §1.199–5 is the same as the text of §1.199–5T published elsewhere in this issue of the Bulletin.]

Par. 5. Section 1.199–7 is amended to read as follows:

### *§1.199–7 Expanded affiliated groups.*

[The text of proposed §1.199–7 is the same as the text of §1.199–7T published elsewhere in this issue of the Bulletin.]

Par. 6. Section 1.199–8 is amended to read as follows:

### *§1.199–8 Other rules.*

[The text of proposed §1.199–8 is the same as the text of §1.199–8T published elsewhere in this issue of the Bulletin.]

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

(Filed by the Office of the Federal Register on October 18, 2006, 8:45 a.m., and published in the issue of the Federal Register for October 19, 2006, 71 F.R. 61692)

## **Foundations Status of Certain Organizations**

### **Announcement 2006–92**

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors

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

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

ABA Diocesan Seminarians Support Group, Inc., Rosedale, NY  
Advance Cellular Technology, Scottsdale, AZ  
African Cultural Center, Incorporated, Silver Spring, MD  
Agape Community Outreach, Inc., Flint, MI  
AGAPE Home Development Corporation, Broken Arrow, OK  
Aids Vaccine Research Institute, Glemont, NY  
Alice Hawthorne Education and Development Fund, Inc., Sarasota, FL  
Alliance for Citizens Rights, Suitland, MD  
Alliance for Mental Health Consumers Rights, San Antonio, TX  
Amateur International Sports Educational Federation, Inc., Albuquerque, NM  
Ambassadors for Children's Health, Inc., Johnson City, TN  
America Sevens Foundation, Inc., Miami Beach, FL  
American Institute of Regeneration, Los Angeles, CA  
American Students Leadership Institute, Inc., Rockville, MD  
Andiens, Inc., Houston, TX  
Antioch Community Development Corporation, Memphis, TN  
Ark-Tex Housing Corporation, Texarkana, TX  
Arks Foundation, Inc., Watchung, NJ  
Armanis House, Houston, TX  
Armenian International Sports Foundation, Woodside, NY  
Association of Consumers and Tax Payers Foundation, Washington, DC  
Association of Mexico – US Binational Organizations, Ramsey, NJ

Audio Recording Museum of Science, Inc., South Hadley, MA  
Back Together Again, Inc., Greensboro, NC  
Barnes Retirement Living Center, Barnes, WI  
Bay Side Oyster Nursery, Inc., Lockport, LA  
Bemodet International, Inc., Bowling Green, OH  
Bessie Lang Ministries, St. Louis, MO  
BGA Industries Community Development Corporation, Jacksonville, FL  
Biomedical Research Institute, Scarsdale, NY  
Bolinias Lagoon Watershed Team, Bolinas, CA  
Bossier Housing Corporation, Inc., Shreveport, LA  
Brothers Helping Others, Inc., Orange Park, FL  
Business Cares International, Lawrenceville, GA  
Business in Development, Inc., Indianapolis, IN  
CA & J Economic Development, Inc., Montgomery, AL  
California Watershed Conservancy, Sacramento, CA  
Carlson Family Foundation, Inc., Brunswick, OH  
Carsan Publishing Co., Inc., Atlanta, GA  
Caselli Ensemble, Corte Madera, CA  
Cassius Clay Foundation, Inc., Richmond, KY  
Center for International Theatre Development, Inc., Baltimore, MD  
Center of Excellence in Geriatrics Foundation, Inc., Charlotte, NC  
Cents–A–Page, Inc., Aurora, CO  
CFS Health Resource Alliance, Minneapolis, MN  
Chadakoin Gateway Environmental Development Group, Inc., Jamestown, NY  
Childrens Day Care, Riverdale, IL  
Choosing Hope Ministries, Inc., Falls Church, VA  
Christian Counseling International, San Juan, PR  
Claremont Homes Tenant Council, Baltimore, MD  
Clear Vision, Inc., Cordova, TN  
Club Recovery, Inc., West Palm Beach, FL  
Community & Business Resource Development Corp., Homewood, IL  
Community Contributions for Kids, McAllen, TX

Community Health Access Project, Inc., Hawthorne, CA  
Coree Indian Tribe, Inc., Atlantic, NC  
Covenant Ministries Community Development, Inc., Richmond, VA  
Creative Christian Solutions, Cary, NC  
Crescendo the International Center for Program Innovation, Bellevue, WA  
Deliverance Temple Child Development Center, Inc., Memphis, TN  
Destined for Greatness Foundation, Inc., St. Paul, MN  
Disabled Water Skiers Association, Inc., Melbourne, FL  
Disaster Relief Ministries, Gladewater, TX  
Diverse Renaissance Project, Los Angeles, CA  
Double Praise Ministries, Inc., Cheltenham, PA  
Dual Diagnosis Institute, Inc., La Crosse, WI  
Dubois-Garvey Foundation, Merchantville, NJ  
E Makamae O Na Keiki O Hawaii, Hilo, HI  
Earthrise International, Portland, OR  
East Gate Entrepreneurs, Inc., Medford, NY  
Education Partnerships, Inc., Fairfield, CT  
Elden Hotel Care Corporation, San Juan, PR  
Employment Assistance Training Services, Inc., Cherry Hill, NJ  
Energy Conservation Finance Institute, San Francisco, CA  
Engine 27, Inc., New York, NY  
Ensemble Adriatico, Inc., Boston, MA  
Esparza Foundation, Inc., Inglewood, CA  
Eternal Light Community Center, Maywood, IL  
Evangelist Community Organization Center, Hot Springs, AR  
Family Life Global Resource Center, South Holland, IL  
Father's Heart Ministry, Denison, TX  
First Community Academy, Inc., Houston, TX  
For Him Outreach Ministries, Inc., Milwaukee, WI  
Foundation for Educational Renewal, Inc., Charlotte, VT  
Foundation for International Space Commerce and Law, Inc., New Smyrna Beach, FL  
Foundation for Research, Education, and Excellence (FREE), Inc., Washington, DC  
Foundation Service Center, Inc., Leominster, MA  
Foundation Up, Inc., Pennington, NJ  
Friends of the Universiteit Van Amsterdam, Inc., New York, NY  
Fund for Late Vocations, St. Louis, MO  
GA Community Development, Inc., Miami, FL  
GAIA Foundation, Calabasas, CA  
Gary Wright Ministries, Saginaw, TX  
Georgia Learning Center, Riverdale, GA  
Get Outta Debt Now, Inc., Granada Hills, CA  
Gods Beloved Dove Ministries, Inc., West Los Angeles, CA  
God's Economy, Baltimore, MD  
Goldfield Fairlord, Inc., Denver, CO  
Grady Scholars, Inc., Brooklyn, NY  
Green Strategies, Seattle, WA  
Haitian Pentecostal Community Development Corp., South Orange, NJ  
Halt, Rockland, ME  
Hammarkjold Legacy, Inc., Fond du Lac, WI  
Harvest Time Evangelistic Assn., Batavia, IL  
Hawaii County Medical Society Scholarship Fund, Honolulu, HI  
Hells on Fire Productions, Los Angeles, CA  
Hillman Memorial Scholarship Fund, Fremont, CA  
Home Network Center, Columbus, OH  
Hopelab Foundation, Inc., Palo Alto, CA  
Hosana Charities, Inc., New Brunswick, NJ  
Human Rights Protection Project, Forestville, CA  
Huntington Beach Employment Council, Huntington Beach, CA  
I Corinthians 13 Outreach Ministry, Inc., Atlanta, GA  
Institute for Family Development (FID), Inc., Marblehead, MA  
Interfaith Missionary Movement, Philadelphia, PA  
International Foundation for Applied Research in the Natural Sciences, Newport Beach, CA  
Jade Kinder Care & Ministry, Washington, DC  
Jeradnellys Corp., Carolina, PR  
Jersey City Firefighters Memorial, Inc., Jersey City, NJ  
Joe Hewitt Ministries, Rockwall, TX  
Juneteenth Productions, Inc., Chicago, IL  
Jungle Animal Wildlife Sanctuary, Julian, CA  
Just Say Y.E.S. (Youth Empowerment Supporters) Youth Services, Memphis, TN  
Kent Ministries, Inc., Forsyth, IL  
Kiddie Academy, Inc., Houston, TX  
Kids R' Smart, Las Vegas, NV  
King of Glory Ministries Jesus is the Answer, Bartow, FL  
Kiwanis Club of Sterling Foundation, Sterling, IL  
Kiwanis Club of Third District Foundation, Inc., New Orleans, LA  
La Alborada De Los Angeles, Inc., Yauco, PR  
Lancaster Community Housing, Inc., Lancaster, SC  
Le W. E. Learning Center, Chicago, IL  
Leading By Example, Inc., Sanford, FL  
Learning Excellence Achieving Purpose, Inc., Detroit, MI  
Leon Educational Fund a Nonprofit Corporation, New Orleans, LA  
Lifetime Solutions, Inc., Indianapolis, IN  
Light of Hope Evangelistic Ministries, Kansas City, MO  
Lighthouse Sabbath Ministries, Inc., Doddridge, AR  
Lodi FFA Foundation, Lodi, CA  
Lottie House of House, Inc., Bridgeport, CT  
Manalapan Englishtown Education Association Philanthropic Fund, Inc., Spotswood, NJ  
Maranatha World Ministries, Inc., Beaumont, TX  
Marin People Care, Petaluma, CA  
Mariner Foundation, Inc., Ketchikan, AK  
Massillon Area Charity and Scholarship Fund, Massillon, OH  
Mc Mullen Ministries, Inc., Peoria, AZ  
Meade School District 46-1 Charitable Trust, Sturgis, SD  
Means of Access, Inc., Bronx, NY  
Mercadien Foundation, Inc., Hamilton, NJ  
Miami Valley Golf Foundation, Dayton, OH  
Miccio Foundation, Iowa City, IA  
Midway Heritage Foundation, Midway, UT  
Military Heritage Foundation, Eureka, CA  
Moms Mission, Pontiac, MI  
Murad Foundation, Houston, TX  
Musicians, Iron Mountain, MI  
Na Hoaloha O Kaaina, Ltd., Lahaina, HI  
Napa Valley Express Softball Club, Napa, CA  
National Community Relations Foundation, Richton Park, IL



Native American Life Alternative, Inc.,  
 Copperas Cove, TX  
 New Birth Community Services,  
 Ft. Lauderdale, FL  
 New Braintree Historical Society,  
 New Braintree, MA  
 New Life X S A Group, Inc., Newark, NJ  
 New Pathway Institute, Inc.,  
 Boca Raton, FL  
 Next Step Foundation, Belleville, MI  
 Nichiren Shoshu Buddhist Learning  
 Center, Russellville, AR  
 Non Profit Auto Tech, Inc., Houston, TX  
 North American Foundation, Littleton, CO  
 North East Regional American Indian  
 Movement, Inc., Shirley, NY  
 Oak Creek Crime Stoppers,  
 Oak Creek, WI  
 Old Farm Museum, Inc., Manti, UT  
 Oliver Van Foundation for the Needy,  
 Chicago, IL  
 Open Planning Project, Inc.,  
 New York, NY  
 Opera House, Pittsburgh, PA  
 Our Fathers House, Redford, MI  
 Panoramic Viewpoints, Oxnard, CA  
 Parents United for Child Care, Inc.,  
 Augusta, GA  
 Peak Foundation, Inverness, IL  
 Pineywoods Youth Football Association,  
 Nacogdoches, TX  
 PlusTime USA, Chichester, NH  
 Police Athletic League of North  
 Huntingdon Umpire School, Inc.,  
 North Huntingdon, PA  
 Potters House of Victory, Lilburn, GA  
 Power of One — International Aids  
 Relief, Phoenix, AZ  
 Prayer Praise & Peace International  
 Incorporation, Rockford, IL  
 Prayer Time Ministries, Atlanta, GA  
 Princess Lee Foundation for Child Abuse  
 and Neglect, Las Vegas, NV  
 Project Wave, Inc., Houston, TX  
 Project Youth Care, Inc., Gainesville, FL  
 R M N R, Inc., Ontario, CA  
 Raoul Wallenberg Humanitarian Institute,  
 Chicago, IL  
 Resource Roundup Research Fund,  
 Hulett, WY  
 Richland Social Services Center, Inc.,  
 Mansfield, OH  
 Rising Farmworker Dream Fund,  
 Live Oak, CA  
 Robert Duncan Ministries,  
 Wilkesboro, NC  
 Rocking R Ranch, Trona, CA  
 Russian American Rule of Law  
 Consortium, Inc., Burlington, VT  
 Safe Kids International, Inc.,  
 Richmond, VA  
 Sahmas Hope, Inc., Atlanta, GA  
 Sail Sport Med, Inc., Wilmington, NC  
 San Francisco Filipino Cultural Center,  
 San Francisco, CA  
 Sawyer Economic Development Fund,  
 Inc., Memphis, TN  
 SCF Charitable Giving Fund, Canton, OH  
 Second Chance Int'l Housing,  
 Incorporated, Gary, IN  
 Seeds of Hope Foundation, Inc.,  
 East Bridgewater, MA  
 SHA-LA-DAI Economic Development  
 Corporation, Los Angeles, CA  
 Share Our Vision Ministries,  
 Chattanooga, TN  
 Sharing Caring Mission of Love, Inc.,  
 Los Angeles, CA  
 Silverlake Dog Park Association,  
 Los Angeles, CA  
 Sisters Keeper Resource Center, Inc.,  
 Temple Hills, MD  
 Small Wonders Daycare and Learning  
 Centers, Inc., Detroit, MI  
 Society of Young-Porterfield Descendants,  
 Columbia, SC  
 Soho Arts Council, Inc., New York, NY  
 South Davidson Community Chest,  
 Denton, NC  
 Space Age Evangelism International, Inc.,  
 Hesperia, CA  
 Stillwell's Community, Inc., Lithonia, GA  
 Stinger Foundation, Murfreesboro, TN  
 Synergistic Healing, Inc., Sheboygan, WI  
 Synergistic Youth Enterprises, Inc.,  
 Fairburn, GA  
 Tarheel Regional Community  
 Development Corporation,  
 Henderson, NC  
 This Time Around, Inc., Dallas, TX  
 Tidd Home, Woburn, MA  
 To Know Jesus Ministries, Inc.,  
 Cloves, NM  
 Total Woman, Inc., Montalba, TX  
 Touch Support Services, Inc.,  
 Winston-Salem, NC  
 Training Office & Professional Services,  
 Dayton, OH  
 Transition House an Arkansas/Non Profit,  
 Little Rock, AR  
 Tri-State Liver Transplant Support Group,  
 Cincinnati, OH  
 Triangle Developmental Boxing  
 Association, Inc., Durham, NC  
 TSS Cosmetology Tutorial Services,  
 St. Louis, MO  
 United States Colored Troops Institute of  
 Suffolk County, Amityville, NY  
 United We Stand, Inc., Morrow, GA  
 Uplifting You, Inc., Los Angeles, CA  
 Usher's New Look, Inc., Larenceville, GA  
 Utopia Community Home Care &  
 Transportation, Chicago, IL  
 V & C Childrens Ranch, Houston, TX  
 Verve Entertainment, Lake Elsinore, CA  
 Vidalia Economic Housing Association,  
 Inc., Vidalia, GA  
 Vietnamese Women Mutual Assistance  
 Association of San Francisco,  
 San Francisco, CA  
 Vision From Education to Success,  
 Detroit, MI  
 Vision Health Institute, Alexandria, VA  
 Vision Theatrical Foundation, Inc.,  
 Las Vegas, NV  
 Walter R. Behrens Foundation,  
 Neotsu, OR  
 We All Win, Inc., Springfield, OR  
 Westchester Center, Inc., Thornwood, NY  
 Whitehead Foundation, Inc., Silsbee, TX  
 Wisconsin Motor Carriers Association  
 Foundation, Inc., Madison, WI  
 WOCO, Inc., Wilmington, DE  
 World Mystery Research Center, Niles, IL  
 World to Come Foundation, Inc.,  
 Buford, GA  
 Youth of America, Suffolk, VA

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

## Procedures for 501(c)(3) Tax-Exempt Organizations to Change Public Charity Classification

### Announcement 2006-93

The Pension Protection Act of 2006 permits specified individuals to make contributions from their Individual Retirement Accounts (“IRA”) to certain public charities without including the amounts in the contributor’s income. In addition, the Act restricts private foundations from making distributions to certain public charities. In both cases, the new provisions relate to the recipient organization’s classification as a public charity under section 509(a).

Public charities include churches, schools, hospitals, and charities that receive public support as described in section 509(a)(1) and (2), as well as organizations that are described in section 509(a)(3) that support one or more specified organizations described in sections 509(a)(1) or (2). Organizations described in section 509(a)(3) also are known as supporting organizations.

Under the Pension Protection Act of 2006, distributions from IRAs to supporting organizations, as described in section 509(a)(3), are not excludable from the IRA holder’s income. In addition, distributions from private foundations to certain supporting organizations described in section 509(a)(3) are not qualifying distributions

and may be taxable expenditures for the private foundation. For this reason, organizations currently classified as supporting organizations, as described in section 509(a)(3), may wish to seek reclassification under section 509(a)(1) or (2).

#### Process to Request Change in Public Charity Classification Related to Pension Protection Act

A section 501(c)(3) tax-exempt organization seeking to change its public charity classification for reasons related to changes made by the Pension Protection Act has to submit a written request for reclassification from section 509(a)(3) to the Internal Revenue Service pursuant to Revenue Procedure 2006-4, 2006-1 I.R.B. 132 (available at [www.irs.gov/pub/irs-tege/rp2006-4.pdf](http://www.irs.gov/pub/irs-tege/rp2006-4.pdf)). This request has to include the following:

1. A statement requesting reclassification from section 509(a)(3) to another public charity status under 509(a)(1) or (2); and,
2. Either,
  - a. Page one and the signature page of most recently filed Form 990 or Form 990-EZ, and pages 2 and 3 (Parts IV and IV-A) of Schedule A related to the organization’s most recently filed Form 990 or 990-EZ; or

- b. Form 8734, *Support Schedule for Advance Ruling Period*

The organization has to write at the top of the request, “509(a)(3) Pension Protection Act”, and mail or fax the complete request for reclassification to:

Mail:  
IRS-TEGE  
Attn: Adjustments Unit, Room 4024  
P.O. Box 2508  
Cincinnati, OH 45201

Fax:  
IRS-TEGE  
Attn: Adjustments Unit, Room 4024  
Fax number: (513) 263-3522

If an organization previously submitted a regular request for reclassification related to changes made by the Pension Protection Act, the organization should mail or fax a statement notifying us that a request for reclassification was submitted.

Organizations will receive a determination letter indicating whether the change in public charity classification has been made. There is no user fee for this determination letter.

#### For Further Information

Contact Customer Account Services, 1-877-829-5500.

## Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Suspensions, Censures, Disbarments, and Resignations

### Announcement 2006-94

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another

person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin

their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

# Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service,

may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

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

Name	Address	Designation	Date of Suspension
Tomasulo, Maria V.	Wantagh, NY	CPA	Indefinite from August 7, 2006
Maloy, Jr., Robert J.	Galion, OH	CPA	Indefinite from August 15, 2006
Pate, Janet M.	Broadview, NM	CPA	Indefinite from August 15, 2006
Scott, Howard	Miami, FL	Attorney	Indefinite from August 15, 2006
Adamic, Jonathan E.	San Lorenzo, CA	CPA	Indefinite from August 18, 2006
Becker, Ira S.	Wilmette, IL	CPA	August 22, 2006 to August 21, 2008
Snigur, Virginia Iaquina	Warwick, NY	Attorney	Indefinite from August 31, 2006
Galpern, Joel G.	North Miami, FL	CPA	Indefinite from September 1, 2006
DiSiena, Frank E.	Katonah, NY	CPA	Indefinite from September 4, 2006
Carusona, Thomas M.	Huntington, NY	Attorney	Indefinite from September 15, 2006
Shaikh, Firoz A.	Melville, NY	CPA	Indefinite from September 15, 2006
Wickline, Ella L.	Ronceverte, WV	Enrolled Agent	Indefinite from September 15, 2006

Name	Address	Designation	Date of Suspension
Smith, Daniel B.	Garden City, NY	CPA	Indefinite from September 18, 2006
Carlin, Charles R.	South Bend, IN	CPA	Indefinite from October 1, 2006
Devine, Daniel M.	Boca Raton, FL	CPA	Indefinite from October 1, 2006
Dupont, Hewitt, J.	Daytona Beach, FL	CPA	Indefinite from October 1, 2006
Farrell, Raymond J.	Matawan, NJ	Attorney	Indefinite from October 1, 2006
Kelligrew, John R.	White Plains, NY	Attorney	Indefinite from October 1, 2006
Klein, Robert B.	Bardonia, NY	Enrolled Agent	Indefinite from October 1, 2006
Long, Gregory S.	Hutchinson, KS	Attorney	Indefinite from October 1, 2006
Moore, Ronald L.	Cayce, SC	CPA	Indefinite from October 1, 2006
Schaffer, Robert J.	Calverton, NY	CPA	Indefinite from October 1, 2006
Berlin, Stanley	Erie, PA	Attorney	Indefinite from October 15, 2006
Briscoe, Jack	Drexel Hill, PA	Attorney	Indefinite from October 15, 2006
Buzzeo, Michael V.	New Canaan, CT	CPA	Indefinite from October 15, 2006
Sacco, John M.	Pound Ridge, NY	CPA	Indefinite from October 15, 2006
Sheiman, Alan P.	Sherman Oaks, CA	Enrolled Agent	Indefinite from October 15, 2006

Name	Address	Designation	Date of Suspension
Tourin, Mark	Miami, FL	CPA	Indefinite from October 15, 2006
Burns, William J.	Randolph, MA	Attorney	Indefinite from October 16, 2006
Webb, Norman R.	Daphne, AL	CPA	Indefinite from October 16, 2006
Brown, Guia EP	Hobe Sound, FL	Enrolled Agent	October 20, 2006 to April 19, 2008
Gram, John A.	Gainesville, GA	Attorney	Indefinite from November 1, 2006
Herzog, Samuel A.	Jericho, NY	CPA	Indefinite from November 1, 2006
Kellicker, John F.	Cleveland, OH	CPA	Indefinite from November 1, 2006
Krieger, Robert M.	Hampton, NH	CPA	Indefinite from November 1, 2006
Minsky, Neil J.	Randolph, NJ	CPA	Indefinite from November 1, 2006
O'Brien, Timothy	Newton Center, MA	Attorney	Indefinite from November 1, 2006
Sukenik, Martin	Kew Gardens, NY	Attorney	Indefinite from November 1, 2006
Savoy, Cassandra	East Orange, NJ	Attorney	Indefinite from November 7, 2006
Bonner, Charles B.	Athens, GA	CPA	Indefinite from November 15, 2006
Levine, Barton P.	New York, NY	Attorney	Indefinite from November 15, 2006
Taves, Joseph G.	Provincetown, MA	CPA	Indefinite from November 15, 2006
Young, Ronald	Fairfield, CT	CPA	Indefinite from November 16, 2006

Name	Address	Designation	Date of Suspension
Brush, Charles, H.	Southbury, CT	CPA	Indefinite from December 1, 2006
Jacob, Robert T.	Tucson, AZ	CPA	Indefinite from December 15, 2006

## Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date

the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

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

Name	Address	Designation	Date of Suspension
Williams, Donna M.	York, PA	CPA	Indefinite from July 25, 2006
Foushee, Wayne H.	Winston-Salem, NC	Attorney	Indefinite from August 3, 2006
Kronegold, Sheldon H.	Englewood, NJ	Attorney	Indefinite from August 3, 2006
Norman, Clarence	Brooklyn, NY	Attorney	Indefinite from August 3, 2006
Chin, Arnold	San Francisco, CA	Attorney	Indefinite from August 31, 2006
McCann, Thomas	Des Moines, IA	Attorney	Indefinite from August 31, 2006
Whaley, Daniel P.	Hood, CA	Attorney	Indefinite from August 31, 2006
Chukumba, Stephen C.	Montclair, NJ	Attorney	Indefinite from September 12, 2006
Katz, Edward C.	New York, NY	Attorney	Indefinite from September 12, 2006

Name	Address	Designation	Date of Suspension
Kadunce, Darrell L.	Butler, PA	Attorney	Indefinite from September 18, 2006
Allen, Robert W.	Torrance, CA	CPA	Indefinite from September 21, 2006
Brown, Davin W.	Raleigh, NC	CPA	Indefinite from September 21, 2006
Cunningham, R. Scott	Dalton, GA	Attorney	Indefinite from September 21, 2006
Eilers, Tom D.	Raleigh, NC	CPA	Indefinite from September 21, 2006
Gerdes, Roger A.	Carpinteria, CA	Attorney	Indefinite from September 21, 2006
Kurth, Richard Frederick	Danville, IL	Attorney	Indefinite from September 21, 2006
Mitchell, McArthur D.	Charlotte, NC	CPA	Indefinite from September 21, 2006
Ragusa, Patricia A.	Spring, TX	CPA	Indefinite from September 21, 2006
Wulfsberg, David E.	Murrieta, CA	Attorney	Indefinite from September 21, 2006
Cox, Brian J.	Plymouth, MI	CPA	Indefinite from September 25, 2006
Mandelman, Michael D.	Mequon, WI	Attorney	Indefinite from September 25, 2006
Miller, Steven L.	Canal Winchester, OH	Attorney	Indefinite from September 25, 2006
Felli, Jay A.	Mequon, WI	Attorney	Indefinite from October 2, 2006
Schoch V, Arch K.	High Point, NC	Attorney	Indefinite from October 2, 2006

Name	Address	Designation	Date of Suspension
Andre, Patrick F.	Manchester, MO	Attorney	Indefinite from October 12, 2006
Brill, Kevin Michael	Downers Grove, IL	Attorney	Indefinite from October 12, 2006
Day, Richard G.	Largo, FL	Attorney	Indefinite from October 12, 2006
Dull, Kay E.	Miami Shores, FL	Attorney	Indefinite from October 12, 2006
Frank, Arthur J.	Chicago, IL	Attorney	Indefinite from October 12, 2006
Gackle, Thomas E.	Plymouth, MI	Attorney	Indefinite from October 12, 2006
Hamilton, Howard D.	Fort Dodge, IA	Attorney	Indefinite from October 12, 2006
Hodge, Robert M.	Lafayette, LA	Attorney	Indefinite from October 12, 2006
Lesyshen, Donna P.	Waterloo, IA	Attorney	Indefinite from October 12, 2006
Peiss, John H.	Downers Grove, IL	Attorney	Indefinite from October 12, 2006
Petty, James E.	Austin, TX	CPA	Indefinite from October 12, 2006
Ruffin-Hudson, Linda C.	Saint Louis, MO	Attorney	Indefinite from October 12, 2006
Schaefer, James E.	St. Louis Park, MN	Attorney	Indefinite from October 12, 2006
Schmitt, Martha G.	Minneapolis, MN	Attorney	Indefinite from October 12, 2006
Shannon, Terrance J.	Mission Viejo, CA	Attorney	Indefinite from October 12, 2006
Smith, Matthew S.	Denver, CO	Attorney	Indefinite from October 12, 2006



Name	Address	Designation	Date of Suspension
Swanson, Richard	West Chicago, IL	CPA	Indefinite from October 12, 2006
Thomas, Kenneth A.	Farmers Branch, TX	Attorney	Indefinite from October 12, 2006
Tomasa, Ryan H.	Honolulu, HI	Attorney	Indefinite from October 12, 2006
Williams, Jr., Harry D.	San Antonio, TX	Attorney	Indefinite from October 12, 2006
Wilson, Jr., Robert N.	Ayer, MA	Attorney	Indefinite from October 12, 2006
Yum, Chris Chulho	Woodbridge, VA	Attorney	Indefinite from October 12, 2006
Dunham, Richard G.	Irvine, CA	Enrolled Agent	Indefinite from October 15, 2006
Housman, David	Albuquerque, NM	Attorney	Indefinite from October 15, 2006
Malitz, Charles P.	Beachwood, OH	CPA	Indefinite from October 15, 2006
Emig, Robert W.	Houston, TX	CPA	Indefinite from October 24, 2006
Freese, Scott D.	Norfolk, NE	Attorney	Indefinite from October 24, 2006
Rambo, Byron L.	Sanford, FL	EA	Indefinite from October 24, 2006
Ask, Ronald W.	Riverside, CA	Attorney	Indefinite from October 30, 2006
Berry, Richard S.	Tempe, AZ	Attorney	Indefinite from October 30, 2006
Burkhardt, William R.	Canyon Lake, TX	CPA	Indefinite from October 30, 2006
Callaway, Jr., Paul F.	Greensboro, NC	CPA	Indefinite from October 30, 2006

Name	Address	Designation	Date of Suspension
Doyle, David W.	Arvada, CO	Attorney	Indefinite from October 30, 2006
Elmore, III, Virgil	Birmingham, AL	Attorney	Indefinite from October 30, 2006
Grandt, Lawrence E.	Gurnee, IL	CPA	Indefinite from October 30, 2006
Hanson, Steven G.	Lodi, CA	Attorney	Indefinite from October 30, 2006
Omodele, Boluwaji	Houston, TX	CPA	Indefinite from October 30, 2006
Rahden, Horst R.	Fort Wayne, IN	CPA	Indefinite from October 30, 2006
Censoprano, Salvatore	Foster City, CA	CPA	Indefinite from October 31, 2006
Powell, James S.	Lakewood, CO	Attorney	Indefinite from October 31, 2006
Allen, Leonard G.	Mesa, AZ	CPA	Indefinite from November 1, 2006
Parker, Donald A.	Benson, NC	Attorney	Indefinite from November 6, 2006
Rogers, James M.	Tulsa, OK	Attorney	Indefinite from November 6, 2006
Coopet, Michael W.	Saint Paul, MN	Attorney	Indefinite from November 8, 2006
Day, Jr., John Taylor	Hingham, MA	Attorney	Indefinite from November 8, 2006
Grella, Paul J.	Canton, MA	Attorney	Indefinite from November 8, 2006
Meggers, Theodore M.	Des Moines, IA	Attorney	Indefinite from November 8, 2006

Name	Address	Designation	Date of Suspension
Tolbert, James L.	Los Angeles, CA	Attorney	Indefinite from November 8, 2006

## Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an ad-

ministrative law judge, the following individuals have been placed under suspension

from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Lazaro, Charles	Visalia, CA	Attorney	July 20, 2006 to January 19, 2010
Wasilowski, Ronald	Natrona Heights, PA	CPA	July 21, 2006 to July 20, 2011
Wellbery, William J.	Deerfield Beach, FL	CPA	October 12, 2006 to October 11, 2008
Clapper, Gary L.	La Mesa, CA	Enrolled Agent	November 2, 2006 to November 1, 2008

## Consent Disbarments From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from prac-

tice before the Internal Revenue Service, may offer his or her consent to disbarment from such practice. The Director, Office of Professional Responsibility, in his discretion, may disbar an attorney, certified pub-

lic accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

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

Name	Address	Designation	Date of Disbarment
Grossman, Robert S.	Ardmore, PA	Attorney	Indefinite from October 4, 2006

# Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Hubbard, Murphy	Springfield, MO	CPA	September 20, 2006
Kardos, Sandra E.	Van Nuys, CA	CPA	October 2, 2006
Jewett, Jerry A.	Fremont, OH	Enrolled Agent	November 2, 2006

## Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand. The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Applegate, William F.	Madison, NJ	CPA	September 12, 2006
Vigliotti, Anthony J.	East Haven, CT	Enrolled Agent	September 12, 2006
Bolgiani, Janette A.	Brooklyn, NY	Enrolled Agent	September 14, 2006
Cheney, James E.	Phelps, NY	CPA	September 18, 2006
Dollinger, Douglas	Middletown, NY	Attorney	October 2, 2006
Reeves, Zak E.	Denver, CO	Enrolled Agent	October 2, 2006
Castiglione, John	Pittsfield, MA	Attorney	October 4, 2006
Shannon, James P.	Rochester, NH	Attorney	October 4, 2006
Kuller, Mark A.	Bethesda, MD	Attorney	October 6, 2006

## Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation. The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Resignation
Schwartz, Judy	Las Vegas, NV	October 13, 2006

# 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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<sup>1</sup> A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2006–1 through 2006–26 is in Internal Revenue Bulletin 2006–26, dated June 26, 2006.



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### Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
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TDO	Treasury Department Order

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