Internal Revenue
bulletin

Bulletin No. 2007-9
February 26, 2007

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. 2007–11, page 606.

LIFO; price indexes; department stores. The December 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, December 31, 2006.

REG–159444–04, page 618.

Proposed regulations under section 6325 of the Code outline specific procedures for obtaining a release of a federal tax lien or a discharge of a federal tax lien from property to which it has attached. The regulations incorporate changes to the Code that were made by the IRS Restructuring and Reform Act of 1998, which afford a means for a person whose property is encumbered by a federal tax lien, but who does not owe the tax giving rise to the lien, to have his property discharged from the lien.

Notice 2007–21, page 611.

Donor advised funds and supporting organizations. This notice requests public comments in connection with a study being conducted by the Department of the Treasury and the Service on the organization and operation of donor advised funds and supporting organizations. The study is required by section 1226 of the Pension Protection Act of 2006.

Announcement 2007–18, page 625.

This announcement sets forth a compliance resolution program (Program) that permits employers to pay the additional section 409A taxes arising due to the exercise of certain stock options and stock appreciation rights (stock rights). The Program (1) applies only to discounted stock rights exercised during 2006, (2) applies only to certain employees and former employees who are not corporate insiders, and were not corporate insiders at the date of grant of the stock right, (3) requires the employer's full payment of the section 409A taxes, (4) provides relief for the employees from the requirement to pay these taxes, and (5) requires treatment of the employer's payment of the employee's section 409A taxes as an additional payment of compensation. Employers wishing to participate in the Program must notify the IRS no later than February 28, 2007, and must notify affected employees within 15 days of notifying the IRS.

EMPLOYEE PLANS

T.D. 9310, page 601.

Final regulations under section 412(l)(7) of the Code provide mortality tables to be used in determining current liability for purposes of applying certain pension funding requirements.

Notice 2007–18, page 608.

This notice provides guidance under section 4965 of the Code to tax-exempt entities described in section 4965(c) regarding whether they are parties to a prohibited tax shelter transaction. This notice also provides guidance to tax-exempt entities described in sections 4965(c)(1), (2), and (3) subject to tax under section 4965(a) regarding the allocation to various periods of net income or proceeds attributable to a prohibited tax shelter transaction. In addition, the notice invites comments from the public regarding all aspects of these provisions.

(Continued on the next page)

Finding Lists begin on page ii.
Index for January through February begins on page iv.

Department of the Treasury
Internal Revenue Service

Notice 2007–20, page 610.
Weighted average interest rate update; corporate bond indices; 30-year Treasury securities. The weighted average interest rate for February 2007 and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution are set forth.

EXEMPT ORGANIZATIONS

Notice 2007–18, page 608.
This notice provides guidance under section 4965 of the Code to tax-exempt entities described in section 4965(c) regarding whether they are parties to a prohibited tax shelter transaction. This notice also provides guidance to tax-exempt entities described in sections 4965(c)(1), (2), and (3) subject to tax under section 4965(a) regarding the allocation to various periods of net income or proceeds attributable to a prohibited tax shelter transaction. In addition, the notice invites comments from the public regarding all aspects of these provisions.

ADMINISTRATIVE

Rev. Proc. 2007–21, page 613.
This procedure provides guidance to persons against whom a penalty under section 6707 or 6707A of the Code is assessed, and who may request rescission of those penalties from the Commissioner if the violation is with respect to a reportable transaction other than a listed transaction. This procedure describes the procedures for requesting rescission, including the deadline by which a person must request rescission; the information the person must provide in the rescission request; the factors that weigh in favor and against granting rescission; where the person must submit the rescission request; and the rules governing requests for additional information from the person requesting rescission.

Announcement 2007–21, page 630.
This document contains corrections to final regulations (T.D. 9276, 2006–37 I.R.B. 423) that provide for determining the amount of income tax withholding on supplemental wages. The regulations apply to all employers and others making supplemental wage payments to employees.

Announcement 2007–22, page 631.
This document contains corrections to final regulations (T.D. 9263, 2006–25 I.R.B. 1063) relating to the deductions for income attributable to domestic production activities under section 199 of the Code.

The IRS Mission

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

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are 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 412.—Minimum Funding Standards

26 CFR 1.412(l)(7)–1: Mortality tables used to determine current liability.

T.D. 9310

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Updated Mortality Tables for Determining Current Liability

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing mortality tables to be used in determining current liability for purposes of applying certain pension funding requirements. These regulations affect sponsors, administrators, participants, and beneficiaries of certain retirement plans.

DATES: *Effective Date:* These regulations are effective February 2, 2007.

Applicability Date: These regulations apply for plan years beginning on or after January 1, 2007.

FOR FURTHER INFORMATION CONTACT: Bruce Perlin or Linda Marshall at (202) 622–6090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 412 of the Internal Revenue Code provides minimum funding requirements with respect to certain defined benefit pension plans.[1] Title I of the Pension Protection Act of 2006 (PPA), Pub. L. No. 109–280, 120 Stat. 780, makes extensive changes to the rules of section 412, generally applicable to plan years beginning on or after January 1, 2008. Except as otherwise stated, all references to section 412 in this document refer to section 412 without regard to the amendments made by Title I of PPA.

Section 412(l) provides additional funding requirements for certain defined benefit pension plans, based in part on a plan's unfunded current liability, as defined in section 412(l)(8). Pursuant to section 412(c)(6), if the otherwise applicable minimum funding requirement exceeds the plan's full funding limitation (defined in section 412(c)(7) as the excess of a specified measure of plan liability over the plan assets), then the minimum funding requirement for the year is reduced by that excess. Under section 412(c)(7)(E), the full funding limitation cannot be less than the excess of 90% of the plan's current liability (including the expected increase in current liability due to benefits accruing during the plan year) over the value of the plan's assets. For this purpose, the term *current liability* generally has the same meaning given that term under section 412(l)(7).

Section 412(l)(7)(C)(ii) provides that, for purposes of determining current liability in plan years beginning on or after January 1, 1995, the mortality table used is the table prescribed by the Secretary. Under section 412(l)(7)(C)(ii)(I), the initial mortality table used in determining current liability under section 412(l)(7) must be based on the prevailing commissioners' standard table (described in section 807(d)(5)(A)) used to determine reserves for group annuity contracts issued on January 1, 1993. For purposes of section 807(d)(5), Rev. Rul. 92–19, 1992–1 C.B. 227, specifies the prevailing commissioners' standard table used to determine reserves for group annuity contracts issued on January 1, 1993, as the 1983 Group Annuity Mortality Table (1983 GAM). Accordingly, Rev. Rul. 95–28, 1995–1 C.B. 74, sets forth two gender-specific mortality tables, based on 1983 GAM, for purposes of determining current liability for participants and beneficiaries (other than disabled participants).

Section 412(l)(7)(C)(iii)(I) specifies that the Secretary is to establish different mortality tables to be used to determine current liability for individuals who are entitled to benefits under the plan on account of disability. One such set of tables is to apply to individuals whose disabilities occur in plan years beginning before January 1, 1995, and a second set of tables for individuals whose disabilities occur in plan years beginning on or after such date. Under section 412(l)(7)(C)(iii)(II), the separate tables for disabilities that occur in plan years beginning after December 31, 1994, apply only with respect to individuals who are disabled within the meaning of title II of the Social Security Act and the regulations thereunder. Rev. Rul. 96–7, 1996–1 C.B. 59, sets forth the mortality tables established under section 412(l)(7)(C)(iii).

Under section 412(l)(7)(C)(ii)(III), the Secretary is required to periodically (at least every 5 years) review any tables in effect under that subsection and, to the extent necessary, by regulation update the tables to reflect the actual experience of pension plans and projected trends in such experience. Section 412(l)(7)(C)(ii)(II) provides that the updated tables are to take into account the results of available independent studies of mortality of individuals covered by pension plans. Pursuant to section 412(l)(7)(C)(ii)(II), any new mortality tables prescribed by regulation can be effective no earlier than the first plan year beginning after December 31, 1999. Under section 412(l)(10), increases in current liability arising from the adoption of such a new mortality table are required to be amortized over a 10-year period.

Notice 2003–62, 2003–2 C.B. 576, was issued as part of the periodic review by the IRS and the Treasury Department of the mortality tables used in determining current liability under section 412(l)(7). At the time Notice 2003–62 was issued, the IRS and the Treasury Department were

[1] Section 302 of the Employee Retirement Income Security Act of 1974, as amended (ERISA) sets forth funding rules that are parallel to those in section 412 of the Code. Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713) and section 302 of ERISA, the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed in these regulations for purposes of ERISA, as well as the Code. Thus, these final Treasury regulations issued under section 412 of the Code apply as well for purposes of section 302 of ERISA.

aware of two reviews of mortality experience for retirement plan participants undertaken by the Retirement Plans Experience Committee of the Society of Actuaries (the UP–94 Study and the RP–2000 Mortality Tables Report),[2] and commentators were invited to submit any other independent studies of pension plan mortality experience. Notice 2003–62 also requested the submission of studies regarding projected trends in mortality experience. With respect to projecting mortality improvements, the IRS and the Treasury Department requested comments regarding the advantages and disadvantages of reflecting these trends on an ongoing basis through the use of generational, modified generational, or sequentially static mortality tables.

The IRS and the Treasury Department have reviewed the mortality tables that are used for purposes of determining current liability for participants and beneficiaries (other than disabled participants). The existing mortality table for determining current liability (1983 GAM) was compared to independent studies of mortality of individuals covered by pension plans, after reflecting projected trends for mortality improvement through 2007. The comparison indicated that the 1983 GAM is no longer appropriate for determining current liability.

Based on this review of the 1983 GAM compared to more recent mortality experience, the IRS and the Treasury Department have determined that updated mortality tables based on the RP–2000 Mortality Tables Report should be used to determine current liability for participants and beneficiaries (other than disabled participants).[3]

On December 2, 2005, the IRS issued proposed regulations under section 412(l)(7) (REG–124988–05, 2005–2 C.B. 1186 [70 FR 72260]) setting forth mortality tables, proposed to be effective for plan years beginning on or after January 1, 2007, to be used for nondisabled pension plan participants. The proposed regulations would have required plans of 500 or more participants to use separate mortality tables (derived from the RP–2000 mortality tables) for nonannuitant and annuitant periods. These separate tables were developed by projecting mortality improvement from a base year of 2007 over the period of the approximate expected duration of liabilities (7 years for the annuitant tables and 15 years for the nonannuitant tables). Small plans, defined as those with fewer than 500 participants (including both active and inactive participants), would have been permitted to use a combined table that applies the same mortality rates to both annuitants and nonannuitants. The proposed regulations provided for updated tables to be issued annually reflecting a new base year and using the projection factors described in the proposed regulations, to reflect expected improvements in mortality. Two comments on the proposed regulation were received, and no public hearing was requested or held.

On August 17, 2006, PPA was enacted. PPA contains a comprehensive revision of the minimum funding requirements for single employer plans, based on the calculation of a funding target that replaces the current liability calculation under section 412(l). These minimum funding provisions of PPA are generally effective for plan years beginning after December 31, 2007. Under section 430(h)(3)(A) as enacted in PPA, the Secretary is directed to prescribe by regulation the mortality tables used in determining present value or making any computation under the funding rules. The specifications for developing the mortality tables under section 430(h)(3)(A) are the same as the specifications set forth in section 412(l)(7)(C)(ii)(III).

Explanation of Provisions

These regulations set forth the mortality tables to be used under section 412(l)(7)(C)(ii) to determine current liability for participants and beneficiaries (other than disabled participants) for plan years beginning on or after January 1, 2007. These mortality tables are the same mortality tables that were published for 2007 in the proposed regulations, and are based on the tables contained in the RP–2000 Mortality Tables Report. The IRS and the Treasury Department have reviewed the RP–2000 mortality tables and the accompanying report published by the Society of Actuaries, and have determined that the RP–2000 mortality tables form the best available basis for predicting mortality of pension plan participants and beneficiaries (other than disabled participants) based on pension plan experience and expected trends. As under the mortality tables applicable for earlier plan years, the mortality tables set forth in these regulations are gender-distinct because of significant differences between expected male mortality and expected female mortality.

Of the two comments received on the proposed regulations, one commentator stated that requiring separate annuitant and nonannuitant mortality tables adds complexity without increasing accuracy. According to this commentator, the complexity could be avoided without loss of accuracy by using the RP–2000 blended table. This commentator suggested that, if separate annuitant and nonannuitant mortality tables are required, they should not be required to be used before 2008. The other commentator agreed with the use of separate annuitant and nonannuitant tables.

In a change from the proposed regulations, the IRS and the Treasury Department have chosen to permit all plans to use a blended table for 2007 rather than require the use of separate annuitant and nonannuitant tables. This decision was made because of the sweeping changes made to the minimum funding requirements for single employer plans by PPA that will generally become effective in 2008. The IRS and the Treasury Department believe that using separate annuitant and nonannuitant tables results in a more accurate measure of a plan's current liability. However, in view of the sweeping PPA changes and the resulting need to overhaul actuarial valuation systems, it was determined that all plans (and not just small plans) should be permitted to use the combined mortal-

[2] The UP–94 Study, prepared by the UP–94 Task Force of the Society of Actuaries, was published in the Transactions of the Society of Actuaries, Vol. XLVII (1995), p. 819. The RP–2000 Mortality Table Report was released in July, 2000. Society of Actuaries, RP–2000 Mortality Tables Report, at *http://www.soa.org/ccm/content/research-publications/experience-studies-tools/the-rp–2000-mortality-tables/*.

[3] Because of the enactment of PPA, the IRS and Treasury Department are not planning to complete a review of the section 412(l)(7)(C)(iii) mortality tables for disabled participants pursuant to section 412(l)(7)(C)(ii)(III). The IRS and Treasury Department will review recent mortality experience and expected trends for disabled participants to determine what mortality tables should be used for disabled participants under section 430(h)(3)(D) as added by PPA.

ity tables for the 2007 plan year.[4] It is expected that proposed regulations under section 430(h)(3)(A) providing mortality tables for purposes of determining present value under section 430 will require large plans to use separate annuitant and nonannuitant tables to achieve a more accurate measure of the present value of plan benefits.

If the separate tables for annuitants and nonannuitants are used, the nonannuitant mortality table is applied to determine the probability of survival for a nonannuitant for the period before the nonannuitant is projected to commence receiving benefits. The annuitant mortality table is applied to determine the present value of benefits for each annuitant, and for each nonannuitant for the period after which the nonannuitant is projected to commence receiving benefits. For purposes of this section, an annuitant means a plan participant who has commenced receiving benefits and a nonannuitant means a plan participant who has not yet commenced receiving benefits (*e.g.*, an active employee or a terminated vested participant). Thus, for example, with respect to a 45-year-old active participant who is projected to commence receiving an annuity at age 55, current liability would be determined using the nonannuitant mortality table for the period before the participant attains age 55 (*i.e.*, so that the probability of an active male participant living from age 45 to the age of 55 for the table that applies in plan years beginning in 2007 is 98.59%) and the annuitant mortality table for the period ages 55 and above. Similarly, if a 45-year-old terminated vested participant is projected to commence an annuity at age 65, current liability would be determined using the nonannuitant mortality table for the period before the participant attains age 65 and the annuitant mortality table for ages 65 and above. A participant whose benefit has partially commenced is treated as an annuitant with respect to the portion of the benefit which has commenced and a nonannuitant with respect to the balance of the benefit.

As under the proposed regulations, the annuitant and nonannuitant tables were developed by applying projected mortality improvements to the annuitant and nonannuitant tables from the RP–2000 Mortality Tables Report. Mortality improvement was projected forward from the base year of 2007 by 7 years for annuitants and 15 years for nonannuitants, to approximate an average expected duration of liabilities. The projection factors used are from Mortality Projection Scale AA, which was also recommended for use in the UP–94 Study and RP–2000 Mortality Tables Report.

The blended table provided under these regulations was constructed in the same manner as under the proposed regulations, by applying the nonannuitant/annuitant weighting factors published in the RP–2000 Mortality Tables Report. However, because the RP–2000 Mortality Tables Report does not provide weighting factors before age 50 or after age 70, the IRS and the Treasury Department have extended the table of weighting factors for ages 41 through 50 (ages 45–50 for females) and for ages 70 through 79 in order to develop the blended table.

For most plans, these regulations will be in effect only for the 2007 plan year because the minimum funding requirements enacted in PPA will replace the currently applicable minimum funding requirements for plan years beginning on or after January 1, 2008. For plans that remain subject to the pre-PPA requirements of section 412 after the 2007 plan year (see sections 104 through 106 of PPA), these regulations require that the mortality tables that will be provided pursuant to section 430(h)(3)(A) are to be used as the mortality tables that apply for determining current liability under section 412 for those later plan years.

Applicability Date

These regulations apply to plan years beginning on or after January 1, 2007.

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does 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, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Bruce Perlin and Linda S. F. Marshall, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in the development of these regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.412(l)(7)–1 is added to read as follows:

§1.412(l)(7)–1 Mortality tables used to determine current liability.

(a) *In general.* The mortality tables set forth in paragraph (d) of this section are to be used in determining current liability under section 412(l)(7) for participants and beneficiaries (other than disabled participants) for plan years beginning in 2007. For plan years beginning on or after January 1, 2008, the mortality tables described in section 430(h)(3)(A) are to be used in determining current liability under section 412(l)(7) for participants and beneficiaries (other than disabled participants).

(b) *Separate tables for annuitants and nonannuitants.* The separate tables for annuitants and nonannuitants are used unless the plan applies the optional combined table pursuant to paragraph (c) of this section. If these separate tables are used, the

[4] For most single employer plans, these regulations will be in effect only for the plan year beginning in 2007 because changes to section 412 made by PPA will eliminate the need for single employer plans to calculate current liability for plan years beginning on or after January 1, 2008. However, sections 104 through 106 of PPA provide later effective dates for the PPA changes to section 412 with respect to certain plans, and therefore those plans will continue to be required to determine current liability for some plan years beginning on or after January 1, 2008.

nonannuitant mortality table is applied to determine the probability of survival for a nonannuitant for the period before the nonannuitant is projected to commence receiving benefits. The annuitant mortality table is applied to determine the present value of benefits for each annuitant, and for each nonannuitant for the period after which the nonannuitant is projected to commence receiving benefits. For purposes of this section, an annuitant means a plan participant who has commenced receiving benefits and a nonannuitant means a plan participant who has not yet commenced receiving benefits (*e.g.*, an active employee or a terminated vested participant). Thus, for example, with respect to a 45-year-old active participant who is projected to commence receiving an annuity at age 55, current liability would be determined using the nonannuitant mortality table for the period before the participant attains age 55 (*i.e.*, so that the probability of an active male participant living from age 45 to the age of 55 for the table that applies in plan years beginning in 2007 is 98.59%) and the annuitant mortality table for the period ages 55 and above. Similarly, if a 45-year-old terminated vested participant is projected to commence an annuity at age 65, current liability would be determined using the nonannuitant mortality table for the period before the participant attains age 65 and the annuitant mortality table for ages 65 and above. For purposes of this section, a participant whose benefit has partially commenced is treated as an annuitant with respect to the portion of the benefit which has commenced and a nonannuitant with respect to the balance of the benefit.

(c) *Optional combined tables*. As an alternative to the separate tables specified for annuitants and nonannuitants as described in paragraph (b) of this section, the optional combined table, which applies the same mortality rates to both annuitants and nonannuitants, can be used.

(d) *Mortality tables for 2007*. As set forth in paragraph (a) of this section, the following tables are to be used for determining current liability for plan years beginning during 2007 in accordance with the rules of this section.

Age	MALE Non-Annuitant Table	MALE Annuitant Table	MALE Optional Combined Table	FEMALE Non-Annuitant Table	FEMALE Annuitant Table	FEMALE Optional Combined Table
1	0.000408	0.000408	0.000408	0.000366	0.000366	0.000366
2	0.000276	0.000276	0.000276	0.000239	0.000239	0.000239
3	0.000229	0.000229	0.000229	0.000178	0.000178	0.000178
4	0.000178	0.000178	0.000178	0.000133	0.000133	0.000133
5	0.000163	0.000163	0.000163	0.000121	0.000121	0.000121
6	0.000156	0.000156	0.000156	0.000113	0.000113	0.000113
7	0.000150	0.000150	0.000150	0.000106	0.000106	0.000106
8	0.000138	0.000138	0.000138	0.000094	0.000094	0.000094
9	0.000134	0.000134	0.000134	0.000090	0.000090	0.000090
10	0.000136	0.000136	0.000136	0.000090	0.000090	0.000090
11	0.000140	0.000140	0.000140	0.000092	0.000092	0.000092
12	0.000146	0.000146	0.000146	0.000095	0.000095	0.000095
13	0.000154	0.000154	0.000154	0.000099	0.000099	0.000099
14	0.000167	0.000167	0.000167	0.000109	0.000109	0.000109
15	0.000176	0.000176	0.000176	0.000119	0.000119	0.000119
16	0.000186	0.000186	0.000186	0.000127	0.000127	0.000127
17	0.000197	0.000197	0.000197	0.000135	0.000135	0.000135
18	0.000207	0.000207	0.000207	0.000138	0.000138	0.000138
19	0.000217	0.000217	0.000217	0.000136	0.000136	0.000136
20	0.000226	0.000226	0.000226	0.000134	0.000134	0.000134
21	0.000239	0.000239	0.000239	0.000132	0.000132	0.000132
22	0.000251	0.000251	0.000251	0.000133	0.000133	0.000133
23	0.000267	0.000267	0.000267	0.000138	0.000138	0.000138
24	0.000282	0.000282	0.000282	0.000144	0.000144	0.000144
25	0.000301	0.000301	0.000301	0.000152	0.000152	0.000152
26	0.000331	0.000331	0.000331	0.000164	0.000164	0.000164
27	0.000342	0.000342	0.000342	0.000171	0.000171	0.000171
28	0.000352	0.000352	0.000352	0.000180	0.000180	0.000180
29	0.000369	0.000369	0.000369	0.000190	0.000190	0.000190
30	0.000398	0.000398	0.000398	0.000212	0.000212	0.000212
31	0.000447	0.000447	0.000447	0.000257	0.000257	0.000257
32	0.000503	0.000503	0.000503	0.000293	0.000293	0.000293
33	0.000565	0.000565	0.000565	0.000323	0.000323	0.000323
34	0.000629	0.000629	0.000629	0.000349	0.000349	0.000349
35	0.000692	0.000692	0.000692	0.000372	0.000372	0.000372
36	0.000753	0.000753	0.000753	0.000394	0.000394	0.000394

Age	MALE Non-Annuitant Table	MALE Annuitant Table	MALE Optional Combined Table	FEMALE Non-Annuitant Table	FEMALE Annuitant Table	FEMALE Optional Combined Table
37	0.000810	0.000810	0.000810	0.000415	0.000415	0.000415
38	0.000844	0.000844	0.000844	0.000439	0.000439	0.000439
39	0.000875	0.000875	0.000875	0.000465	0.000465	0.000465
40	0.000904	0.000904	0.000904	0.000506	0.000506	0.000506
41	0.000936	0.000963	0.000936	0.000555	0.000555	0.000555
42	0.000974	0.001081	0.000975	0.000611	0.000611	0.000611
43	0.001018	0.001258	0.001021	0.000672	0.000672	0.000672
44	0.001071	0.001493	0.001079	0.000738	0.000738	0.000738
45	0.001131	0.001788	0.001146	0.000788	0.000791	0.000788
46	0.001185	0.002142	0.001211	0.000839	0.000896	0.000840
47	0.001244	0.002554	0.001286	0.000889	0.001054	0.000893
48	0.001304	0.003026	0.001366	0.000962	0.001265	0.000972
49	0.001368	0.003557	0.001457	0.001039	0.001528	0.001059
50	0.001434	0.004146	0.001557	0.001149	0.001844	0.001184
51	0.001500	0.004226	0.001636	0.001272	0.001962	0.001312
52	0.001570	0.004254	0.001754	0.001442	0.002173	0.001496
53	0.001681	0.004312	0.001932	0.001637	0.002445	0.001714
54	0.001803	0.004369	0.002134	0.001861	0.002771	0.001969
55	0.001986	0.004514	0.002508	0.002117	0.003155	0.002314
56	0.002217	0.004749	0.003020	0.002414	0.003608	0.002755
57	0.002488	0.005069	0.003464	0.002696	0.004088	0.003170
58	0.002803	0.005501	0.003990	0.002947	0.004588	0.003583
59	0.003095	0.005972	0.004529	0.003223	0.005156	0.004066
60	0.003421	0.006539	0.005177	0.003521	0.005780	0.004640
61	0.003860	0.007284	0.006030	0.003838	0.006450	0.005354
62	0.004244	0.008024	0.006929	0.004170	0.007168	0.006148
63	0.004746	0.008989	0.008099	0.004513	0.007932	0.007084
64	0.005154	0.009947	0.009159	0.004862	0.008758	0.007996
65	0.005553	0.011015	0.010377	0.005213	0.009662	0.009018
66	0.006073	0.012379	0.011951	0.005559	0.010640	0.010192
67	0.006447	0.013705	0.013349	0.005896	0.011690	0.011323
68	0.006650	0.014940	0.014641	0.006220	0.012838	0.012522
69	0.006974	0.016504	0.016231	0.006528	0.014126	0.013843
70	0.007115	0.017971	0.017689	0.006818	0.015607	0.015309
71	0.008002	0.019884	0.019606	0.007450	0.017078	0.016784
72	0.009777	0.022078	0.021822	0.008714	0.018995	0.018716
73	0.012439	0.024592	0.024371	0.010610	0.020819	0.020577
74	0.015988	0.027435	0.027256	0.013139	0.023074	0.022872
75	0.020425	0.031057	0.030919	0.016299	0.025117	0.024967
76	0.025749	0.034615	0.034523	0.020092	0.027673	0.027570
77	0.031961	0.039054	0.038999	0.024516	0.030911	0.030846
78	0.039059	0.044018	0.043992	0.029573	0.034074	0.034043
79	0.047046	0.049617	0.049610	0.035261	0.037618	0.037610
80	0.055919	0.055919	0.055919	0.041582	0.041582	0.041582
81	0.063476	0.063476	0.063476	0.046024	0.046024	0.046024
82	0.071926	0.071926	0.071926	0.051021	0.051021	0.051021
83	0.080176	0.080176	0.080176	0.056651	0.056651	0.056651
84	0.090433	0.090433	0.090433	0.063006	0.063006	0.063006
85	0.100383	0.100383	0.100383	0.071188	0.071188	0.071188
86	0.111295	0.111295	0.111295	0.080522	0.080522	0.080522
87	0.125051	0.125051	0.125051	0.091080	0.091080	0.091080
88	0.140385	0.140385	0.140385	0.101448	0.101448	0.101448
89	0.155142	0.155142	0.155142	0.114246	0.114246	0.114246
90	0.173400	0.173400	0.173400	0.126258	0.126258	0.126258
91	0.188868	0.188868	0.188868	0.138648	0.138648	0.138648
92	0.207683	0.207683	0.207683	0.151126	0.151126	0.151126
93	0.224037	0.224037	0.224037	0.165722	0.165722	0.165722

Age	MALE Non-Annuitant Table	MALE Annuitant Table	MALE Optional Combined Table	FEMALE Non-Annuitant Table	FEMALE Annuitant Table	FEMALE Optional Combined Table
94	0.240367	0.240367	0.240367	0.177747	0.177747	0.177747
95	0.260098	0.260098	0.260098	0.189133	0.189133	0.189133
96	0.276058	0.276058	0.276058	0.199703	0.199703	0.199703
97	0.291564	0.291564	0.291564	0.212246	0.212246	0.212246
98	0.310910	0.310910	0.310910	0.220832	0.220832	0.220832
99	0.325614	0.325614	0.325614	0.228169	0.228169	0.228169
100	0.339763	0.339763	0.339763	0.234164	0.234164	0.234164
101	0.358628	0.358628	0.358628	0.244834	0.244834	0.244834
102	0.371685	0.371685	0.371685	0.254498	0.254498	0.254498
103	0.383040	0.383040	0.383040	0.266044	0.266044	0.266044
104	0.392003	0.392003	0.392003	0.279055	0.279055	0.279055
105	0.397886	0.397886	0.397886	0.293116	0.293116	0.293116
106	0.400000	0.400000	0.400000	0.307811	0.307811	0.307811
107	0.400000	0.400000	0.400000	0.322725	0.322725	0.322725
108	0.400000	0.400000	0.400000	0.337441	0.337441	0.337441
109	0.400000	0.400000	0.400000	0.351544	0.351544	0.351544
110	0.400000	0.400000	0.400000	0.364617	0.364617	0.364617
111	0.400000	0.400000	0.400000	0.376246	0.376246	0.376246
112	0.400000	0.400000	0.400000	0.386015	0.386015	0.386015
113	0.400000	0.400000	0.400000	0.393507	0.393507	0.393507
114	0.400000	0.400000	0.400000	0.398308	0.398308	0.398308
115	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
116	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
117	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
118	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
119	0.400000	0.400000	0.400000	0.400000	0.400000	0.400000
120	1.000000	1.000000	1.000000	1.000000	1.000000	1.000000

(e) *Effective date*. This section applies for plan years beginning on or after January 1, 2007.

Linda M. Kroening,
Acting Deputy Commissioner for Services and Enforcement.

Approved January 26, 2007.

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

(Filed by the Office of the Federal Register on February 1, 2007, 8:45 a.m., and published in the issue of the Federal Register for February 2, 2007, 72 F.R. 4955)

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

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

LIFO; price indexes; department stores. The December 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, December 31, 2006.

Rev. Rul. 2007–11

The following Department Store Inventory Price Indexes for December 2006 were issued by the Bureau of Labor Statistics (BLS). 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, December 31, 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	Dec. 2005	Dec. 2006	Percent Change From Dec. 2005 to Dec. 2006[1]
1.	Piece Goods	467.2	448.2	-4.1
2.	Domestics and Draperies	506.3	476.6	-5.9
3.	Women's and Children's Shoes	659.5	667.5	1.2
4.	Men's Shoes	862.7	889.6	3.1
5.	Infants' Wear	568.5	561.2	-1.3
6.	Women's Underwear	547.0	547.6	0.1
7.	Women's Hosiery	337.9	345.8	2.3
8.	Women's and Girls' Accessories	558.5	542.4	-2.9
9.	Women's Outerwear and Girls' Wear	350.8	356.8	1.7
10.	Men's Clothing	527.4	519.6	-1.5
11.	Men's Furnishings	560.6	571.4	1.9
12.	Boys' Clothing and Furnishings	394.0	387.5	-1.6
13.	Jewelry	842.7	872.7	3.6
14.	Notions	801.0	822.8	2.7
15.	Toilet Articles and Drugs	1000.7	1014.0	1.3
16.	Furniture and Bedding	602.9	597.4	-0.9
17.	Floor Coverings	614.5	622.1	1.2
18.	Housewares	697.7	685.7	-1.7
19.	Major Appliances	205.0	209.5	2.2
20.	Radio and Television	37.7	34.0	-9.8
21.	Recreation and Education[2]	77.4	76.1	-1.7
22.	Home Improvements[2]	136.7	141.2	3.3
23.	Automotive Accessories[2]	117.0	122.1	4.4
	Groups 1–15: Soft Goods	548.0	551.3	0.6
	Groups 16–20: Durable Goods	375.7	370.0	-1.5
	Groups 21–23: Misc. Goods[2]	93.0	93.8	0.9
	Store Total[3]	487.2	488.2	0.2

[1]Absence of a minus sign before the percentage change in this column signifies a price increase.

[2]Indexes on a January 1986 = 100 base.

[3]The Store Total index covers all departments, with the following exceptions: candy, food, liquor, tobacco, as well as 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).

Part III. Administrative, Procedural, and Miscellaneous

Definition of Party and Allocation of Net Income or Proceeds for Purposes of Section 4965

Notice 2007–18

I Purpose

This notice provides guidance under section 4965 of the Internal Revenue Code ("Code") to tax-exempt entities described in section 4965(c) that may be parties to prohibited tax shelter transactions. This notice also provides guidance to tax-exempt entities described in sections 4965(c)(1), (2), and (3) (referred to herein as Non-Plan Entities) subject to tax under section 4965(a) regarding the allocation to various periods of net income or proceeds attributable to a prohibited tax shelter transaction. In particular, this notice responds to written comments requesting guidance regarding the definition of the term "party to a prohibited tax shelter transaction" for purposes of section 4965 and related disclosure provisions and regarding the appropriate treatment of net income or proceeds received prior to the effective date of the section 4965(a) tax.

II Background

The Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA"), Pub. L. No. 109–222, 120 Stat. 345, enacted on May 17, 2006, designates certain transactions as prohibited tax shelter transactions and includes new entity-level and manager-level excise taxes and disclosure rules applicable to prohibited tax shelter transactions to which a tax-exempt entity is a party. TIPRA creates new section 4965 and amends sections 6033(a)(2), 6011(g), and 6652(c)(3) of the Code.

A. Imposition of Excise Tax on Certain Tax-Exempt Entities

Section 4965(a) requires Non-Plan Entities to pay an excise tax "for the taxable year in which the entity becomes [a party to a prohibited tax shelter transaction] and any subsequent taxable year in the amount determined under [section 4965(b)]." Non-Plan Entities include those entities described in section 4965(c)(1) through (3) — *i.e.*, entities described in section 501(c), 501(d), section 170(c) (other than the United States), and Indian tribal governments (within the meaning of section 7701(a)(40)). Section 4965(e)(1) defines the term "prohibited tax shelter transaction" to mean (1) "any listed transaction," and (2) "any prohibited reportable transaction." A "listed transaction" is defined by cross-reference to section 6707A(c)(2). A "prohibited reportable transaction" means any confidential transaction under Treas. Reg. § 1.6011–4(b)(3) or any transaction with contractual protection under Treas. Reg. § 1.6011–4(b)(4) which is a reportable transaction as defined by section 6707A(c)(1). Pursuant to Revenue Procedure 2007–20, 2007–7 I.R.B. 517 (Feb. 2, 2007), transactions in which the refundable or contingent fee is related to tax credits under sections 42 and 45D of the Code will not be treated as reportable transactions for purposes of Treas. Reg. § 1.6011–4(b)(4) and, thus, will not be subject to section 4965.

B. General Computation Rule

Section 4965(b)(1) provides that, for a transaction other than a "subsequently listed transaction" as defined in section 4965(e)(2), the amount of the excise tax imposed on the Non-Plan Entity is computed based on the greater of (1) the entity's net income "for the taxable year" attributable to the transaction or (2) 75 percent of the proceeds "received by the entity for the taxable year" which are attributable to the transaction.

C. Computation Rule for Subsequently Listed Transactions

Section 4965(e)(2) defines the term "subsequently listed transaction" as any transaction to which a tax-exempt entity is a party and which is determined by the Secretary to be a listed transaction at any time after the entity has become a party to the transaction, provided, however, that the transaction was not a prohibited reportable transaction at the time the entity became a party to the transaction.

Section 4965(b)(1) provides that, for a subsequently listed transaction, the amount of the excise tax is based on the greater of (1) the entity's net income for the taxable year which is attributable to the prohibited tax shelter transaction and is "properly allocable" to the period beginning on the later of the date the transaction is identified as a listed transaction or the first day of the taxable year, or (2) 75 percent of the proceeds received by the entity for the taxable year which are attributable to the prohibited tax shelter transaction and which are "properly allocable" to the period beginning on the later of the date the transaction is identified as a listed transaction or the first day of the taxable year.

D. Effective Date

Section 516(d) of TIPRA provides that section 4965 generally applies to taxable years ending after the date of enactment with respect to transactions entered into before, on, or after that date. However, "no tax under section 4965(a) . . . shall apply with respect to income or proceeds that are properly allocable to any period ending on or before the date which is 90 days after the date of enactment." The 90th day after the date of enactment was August 15, 2006.

Section 4965(f) authorizes the Secretary to promulgate regulations providing guidance "regarding the determination of the allocation of net income or proceeds of a tax-exempt entity attributable to a transaction to various periods, including before and after the listing of the transaction or the date which is 90 days after the date of the enactment of this section."

On July 11, 2006, the Internal Revenue Service ("Service") released Notice 2006–65, 2006–31 I.R.B. 102, which alerted taxpayers to the new provisions and solicited comments regarding these provisions. The Service received numerous written comments in response to Notice 2006–65. Many of the comments requested guidance regarding the circumstances under which a tax-exempt entity will be considered a "party" to a prohibited tax shelter transaction, as well as how the Service intends to exercise its allocation authority under section 4965(f), particularly with respect to transactions entered into prior to the enactment of section 4965.

The Service and the Treasury Department intend to issue further guidance under section 4965 and the related statutory provisions. Pending the issuance of further guidance, taxpayers may rely upon the guidance in this notice.

III Definition of Party

A. In General

For purposes of sections 4965, 6033(a)(2) and 6011(g), a tax-exempt entity is a party to a transaction if it (1) facilitates the transaction by reason of its tax-exempt, tax indifferent or tax-favored status; or (2) is identified in published guidance, by type, class or role, as a party to a prohibited tax shelter transaction.

Published guidance may identify which tax-exempt entities, by type, class or role, will not be treated as a party to a prohibited tax shelter transaction for purposes of sections 4965, 6033(a)(2) and 6011(g).

B. Examples

Example 1. A tax-exempt entity enters into a transaction ("Transaction A") with an S corporation. Transaction A is the same as or substantially similar to the transaction identified by the Secretary as a listed transaction in Notice 2004–30, 2004–1 C.B. 828. The tax-exempt entity's role in Transaction A is similar to the role of the exempt party, as described in Notice 2004–30. The tax-exempt entity purportedly receives the S corporation stock and, due to the tax-exempt entity's tax-exempt status, aids the S corporation and its shareholders in avoiding taxable income. The tax-exempt entity facilitates Transaction A by reason of its tax-exempt, tax indifferent or tax-favored status. Accordingly, the tax-exempt entity is a party to Transaction A for purposes of sections 4965, 6033(a)(2) and 6011(g).

Example 2. A tax-exempt entity is a partner in a partnership. The partnership has a number of other taxable and tax-exempt partners. The partnership enters into a number of transactions, including a transaction ("Transaction B") which is the same as or substantially similar to the transaction identified by the Secretary as a listed transaction in Notice 2002–35, 2002–1 C.B. 992 (as clarified and modified by Notice 2006–16, 2006–9 I.R.B. 538). The partnership participates in Transaction B in a role similar to the role of T, as described in Notice 2002–35, *i.e.*, the role of the taxpayer receiving the purported tax benefits from the transaction. The tax and economic consequences from Transaction B to the other partners are not dependent on the tax-exempt entity's tax-exempt, tax indifferent or tax-favored status. Accordingly, the tax-exempt entity does not facilitate Transaction B by reason of its tax-exempt, tax indifferent or tax-favored status. The tax-exempt entity also has not been identified, by type, class or role, as a party to a prohibited tax shelter transaction in published guidance. Therefore, the tax-exempt entity is not a party to Transaction B for purposes of sections 4965, 6033(a)(2) and 6011(g).

The IRS and Treasury Department recognize that "party" as used in section 4965 applies more broadly than the term is defined for purposes of this interim notice. Accordingly, the IRS and Treasury Department will propose regulations that will define "party" under section 4965 to include a tax-exempt entity that enters into a prohibited tax shelter transaction that reduces such entity's liability for applicable Federal taxes (*i.e.*, employment taxes, excise taxes, and in appropriate cases unrelated business income tax).

IV Net Income and Proceeds

A. In general

For purposes of section 4965(a), the amount and the timing of the net income and proceeds attributable to the prohibited tax shelter transaction will be computed in a manner consistent with the substance of the transaction. In determining the substance of listed transactions, the Service will look to, among other items, the listing guidance and any subsequent published guidance relating to the transaction.

B. Allocation of net income / proceeds to a taxable year

In general, for purposes of section 4965(a), the net income and proceeds attributable to a prohibited tax shelter transaction must be allocated to a particular taxable year in a manner consistent with the Non-Plan Entity's established method of accounting for Federal income tax purposes. If the Non-Plan Entity has not established a method of accounting for Federal income tax purposes, the Non-Plan Entity must use the cash receipts and disbursements method of accounting ("cash method") provided for in section 446 of the Code to determine the amount and timing of net income and proceeds attributable to a prohibited tax shelter transaction solely for purposes of section 4965(a). If a Non-Plan Entity has established a method of accounting other than the cash method, the Non-Plan Entity may nevertheless use the cash method of accounting to determine the amount of the net income and proceeds attributable to a prohibited tax shelter transaction entered into prior to the date of enactment of section 4965 and allocable to pre- and post-enactment periods.

If a Non-Plan Entity has not established a taxable year for Federal income tax purposes, the entity's taxable year for the purpose of determining the amount and timing of net income and proceeds attributable to a prohibited tax shelter transaction will be deemed to be the annual period the entity has used in keeping its books and records.

Any net income or proceeds attributable to a prohibited tax shelter transaction allocated to a taxable year ending on or before August 15, 2006 under this section IV, will not be subject to the excise tax imposed by section 4965(a).

C. Examples

Example 3. In 1999, X, a calendar year Non-Plan Entity using the cash method of accounting, entered into a lease-in/lease-out transaction ("LILO") substantially similar to the transaction described in Notice 2000–15, 2000–1 C.B. 826 (describing Rev. Rul. 99–14, 1999–1 C.B. 835, superseded by Rev. Rul. 2002–69, 2002–2 C.B. 760). In 1999, X purported to lease property to Y pursuant to a "head lease," and Y purported to lease the property back to X pursuant to a "sublease" of a shorter term. In form, X received $268M as an advance payment of head lease rent. Of this amount, $200M had been, in form, financed by a nonrecourse loan obtained by Y. X deposited the $200M with a "debt payment undertaker." This served to defease both a portion of X's rent obligation under its sublease and Y's repayment obligation under the nonrecourse loan. Of the remainder of the $268M advance head lease rent payment, X deposited $54M with an "equity payment undertaker." This served to defease the remainder of X's rent obligation under the sublease. This amount inures to the benefit of Y and enables Y to recover its investment in the transaction and a return on that investment. In substance, the $54M is a loan from Y to X. X retained the remaining $14M of the advance head lease rent payment. In substance, this represents an accommodation fee for X's participation in the transaction.

According to the substance of the transaction, the head lease, sublease and nonrecourse debt will be ignored for Federal income tax purposes. Therefore, any net income or proceeds resulting from these elements of the transaction will not be considered net income or proceeds attributable to the LILO transaction for purposes of section 4965(a).

Under X's established cash basis method of accounting, any net income and proceeds received in 1999 and attributable to the LILO transaction are allocated to X's December 31, 1999, tax year for purposes of section 4965. Because the 1999 tax year is before the effective date of TIPRA, X will not be subject to any excise tax under section 4965 for the amounts received in 1999.

D. Special rule relating to taxable years that include August 16, 2006

In the case of the taxable year that includes August 16, 2006 ("the transition year"), the Service will treat the period beginning on the first day of the transition year and ending on August 15, 2006, and the period beginning on August 16, 2006, and ending on the last day of the transition year as short taxable years. This treatment is solely for purposes of allocating net income or proceeds under section 4965, and the Non-Plan Entity does not file tax returns with respect to these short taxable years or otherwise take the short taxable year into account for Federal tax purposes. Accordingly, the net income or proceeds that are properly allocated to the transition year in accordance with this section IV will be treated as follows:

- as allocable to the period ending on or before August 15, 2006, (and accordingly not subject to tax under section 4965(a)) to the extent such net income or proceeds would have been properly taken into account in accordance with this section IV by the Non-Plan Entity in the deemed short year ending on August 15, 2006; and
- as allocable to the period beginning after August 15, 2006, (and accordingly subject to tax under section 4965(a)) to the extent such net income or proceeds would have been properly taken into account in accordance with this section IV by the Non-Plan Entity in the short year beginning August 16, 2006.

Example 4. B, a Non-Plan Entity using the cash method of accounting, has an annual accounting period that ends on December 31, 2006. B became a party to a prohibited tax shelter transaction on March 15, 2006. On that date, B received a payment of $600,000 as an accommodation fee for its involvement in the transaction. B received no other proceeds or income attributable to this transaction in 2006. Under B's method of accounting, the payment received by B on March 15, 2006, is taken into account in the deemed short year ending on August 15, 2006. Accordingly, solely for purposes of section 4965, the payment is treated as allocable solely to a period ending on or before August 15, 2006, and is not subject to the excise tax imposed by section 4965(a).

Example 5. The facts are the same as in Example 4, above, except that B received an additional payment of $400,000 on September 30, 2006. Under B's method of accounting, the payment received by B on September 30, 2006, is taken into account in the deemed short year beginning on August 16, 2006. Accordingly, solely for purposes of section 4965, the payment is treated as allocable to a period beginning after August 15, 2006, and is subject to the excise tax imposed by section 4965(a).

V Request For Comments

The Service anticipates issuing further guidance under section 4965 and related statutory provisions and invites comments from the public regarding all aspects of these provisions and, in particular, regarding the definition of the term "party to a prohibited tax shelter transaction" for purposes of section 4965 and related disclosure provisions, the appropriate method for allocating net income or proceeds (including, specifically, with respect to governments) to various periods, including pre- and post-listing periods for subsequently listed transactions, and the definition of the term "proceeds" for section 4965 purposes. Written comments should be submitted by March 23, 2007. Send submissions to: CC:PA:LPD:PR (Notice 2007–18), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (Notice 2007–18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically to *notice.comments@irscounsel.treas.gov* (Notice 2007–18).

VI Drafting Information

The principal author of this notice is Galina Kolomietz of the Office of Division Counsel/Associate Chief Counsel (Tax-Exempt and Government Entities). For further information regarding this notice, contact Ms. Kolomietz at (202) 622–6070 (not a toll-free call).

Weighted Average Interest Rates Update

Notice 2007–20

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 January 2007 is 5.89 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.

For Plan Years Beginning in: Month	Year	Corporate Bond Weighted Average	90% to 100% Permissible Range
February	2007	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 January 2007 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.

Study on Donor Advised Funds and Supporting Organizations

Notice 2007–21

PURPOSE

This notice invites public comments in connection with a study being conducted by the Department of the Treasury (the Treasury) and the Internal Revenue Service (the Service) on the organization and operation of donor advised funds (as defined in § 4966(d)(2) of the Internal Revenue Code (Code)) and of supporting organizations described in § 509(a)(3). This study is required by § 1226 of the Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (2006) (the PPA).

BACKGROUND

Charitable organizations described in § 501(c)(3) are classified under § 509 as either public charities or private foundations, depending on their exempt purposes, the sources of their financial support, or their manner of operation. Private foundations, which typically derive their support from, and are often controlled by, a small number of donors, are subject to a number of anti-abuse rules and excise taxes not applicable to public charities. In addition, contributions to private foundations are subject to lower charitable deduction limits than are contributions to public charities.

Supporting Organizations

Under § 509(a)(3), a supporting organization is a § 501(c)(3) charitable organization that is classified as a public charity, not as a private foundation, as a result of the supporting organization's close relationship to one or more organizations described in §§ 509(a)(1) or 509(a)(2) (referred to in regulations under section 509(a)(3) as "publicly supported organizations"). To qualify as a supporting organization under § 509(a)(3), an organization must satisfy three requirements:

(A) the organization must be organized and at all times thereafter operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified publicly supported organizations;

(B) the organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations; and

(C) the organization must not be controlled directly or indirectly by one or more disqualified persons (as defined in § 4946) other than foundation managers and other than one or more publicly supported organizations.

Section 1.509(a)–4 of the Income Tax Regulations provides that the second requirement is met if the supporting organization has one of three relationships with one or more publicly supported organizations. A "Type I" supporting organization is "operated, supervised, or controlled by" a publicly supported organization. This relationship is comparable to that of a parent and subsidiary in that one or more publicly supported organizations can direct the policies, programs or activities of the supporting organization. A "Type II" supporting organization is "supervised or controlled in connection with" one or more publicly supported organizations. In this relationship, the supporting organization and the publicly supported organization(s) are under common supervision or control. A "Type III" supporting organization is "operated in connection with" a publicly supported organization. An organization will qualify as a Type III supporting organization only if it meets certain tests designed to ensure that the organization will be responsive to, and significantly involved in the operations of, the publicly supported organization(s). Under the PPA, this previously informal nomenclature used to describe the relationship between a supporting organization and its publicly supported organizations is incorporated into new §§ 4942(g)(4), 4943(f)(5) and (6), and 4966(d)(4).

Donor Advised Funds

Prior to the PPA, the term donor advised fund was not defined in the Code. However, the term generally was understood to refer to separate funds or accounts established and maintained by public charities to receive contributions from a single donor or a group of donors. The charities had ultimate authority over how the assets in each account were invested and distributed, but the donors, or individuals selected by the donors, were permitted to provide nonbinding recommendations regarding account distributions and/or investments. Donor advised funds often were compared to component funds of certain community trusts. See §§ 1.170A–9(e)(10) and (11).

The PPA adds new § 4966(d)(2), which defines a donor advised fund as a fund or account that is owned and controlled by a sponsoring organization, separately identified by reference to contributions of a donor or donors, and with respect to which the donor or a person appointed or designated by the donor (donor advisor) has or reasonably expects to have advisory privileges with respect to the distribution or investment of the assets in the fund. The term donor advised fund does not include a fund or account (1) that makes distributions only to a single identified organization or governmental entity, or (2) with respect to which a donor advises a sponsoring organization regarding grants for travel, study or similar purposes, provided that certain requirements are met.

A sponsoring organization is defined under new § 4966(d)(1) as a § 170(c) organization that is not a governmental organization (referenced in §§ 170(c)(1) and (2)(A)) or a private foundation and maintains one or more donor advised funds.

Supporting Organizations and Donor Advised Funds as Alternatives to Private Foundations

Traditionally, supporting organizations and donor advised funds have offered donors certain advantages relative to private foundations, such as the possibility of a higher charitable contribution deduction and the avoidance of certain limitations that apply to private foundations, including the § 4941 self-dealing rules, the § 4942 annual payout requirements, and the § 4943 business holdings limits. Although certain advantages remain, new rules enacted as part of the PPA add certain requirements for deductibility of charitable contributions to donor advised funds and impose new restrictions on the operations of donor advised funds and supporting organizations.

New Rules Affecting Supporting Organizations and Donor Advised Funds under the PPA

The PPA contains several provisions intended to improve the accountability of donor advised funds and supporting organizations (see §§ 1226, 1231–1235 and 1241–1245 of the PPA). Those PPA provisions add §§ 4966 and 4967 to the Code, and amend §§ 170, 508, 509, 2055, 2522, 4942, 4943, 4945, 4958, and 6033 of the Code. For a description of some of the new rules, see Notice 2006–109, 2006–51 I.R.B. 1121 (December 18, 2006).

The new rules affecting supporting organizations include: excise taxes on certain payments to a substantial contributor or a related person and on the entire amount of any loan to a disqualified person (§ 4958(c)(3)); the extension of § 4958 to transactions between a supported organization and a person who is a disqualified person of a supporting organization (§ 4958(f)); a grant of regulatory authority to adopt a new payout requirement for certain Type III supporting organizations (PPA § 1241(d)); limits on the permitted business holdings of certain supporting organizations (§ 4943(f)); organizational and operational requirements (§ 509(f)); and reporting requirements (§§ 6033(a)(3)(B) and 6033(l)). In addition, new rules apply to certain private foundations that make grants to certain supporting organizations (§§ 4942(g)(4) and 4945(d)(4)(A)).

The new rules affecting donor advised funds include: definitions of the terms "sponsoring organization" and "donor advised fund" (§ 4966(d)); excise taxes on certain taxable distributions from a donor advised fund (§ 4966(c)); excises taxes on donors, advisors, or related persons who receive certain benefits as a result of a distribution from a donor advised fund (or who advise as to such a distribution) (§ 4967); excise taxes on payments from a donor advised fund to any donor, advisor, or a related person (§§ 4958(c)(2) and 4958(f)(1)(E)); the extension of § 4958 to transactions between the sponsoring organization and certain investment advisors or related persons (§§ 4958(f)(1)(F) and 4958(f)(8)); limits on permitted business holdings (§ 4943(e)); substantiation requirements (§§ 170(f)(18), 2055(e)(5) and 2522(c)(5)); and reporting and disclosure requirements for sponsoring organizations (§§ 508(f) and 6033(k)).

Deductible Charitable Contributions

Generally, an income tax deduction is allowed under § 170 for a charitable contribution made in the year the deduction is claimed, subject to certain limitations and substantiation requirements. *See*, *e.g.*, *U.S. v. American Bar Endowment*, 477 U.S. 105 (1986); §§ 1.170A–1(a) and 1.170A–13. Charitable contributions also may be deductible for gift or estate tax purposes. §§ 2522 and 2055. Under the PPA, a taxpayer may deduct a contribution to a donor advised fund only if the sponsoring organization receiving the contribution is one of certain specified types, and the taxpayer making the contribution obtains an acknowledgement from the sponsoring organization that the organization has exclusive legal control over the property contributed. §§ 170(f)(18), 2522(c)(5), and 2055(e)(5).

ISSUES IDENTIFIED FOR FURTHER STUDY UNDER THE PPA

In discussing § 1226 of the PPA, the Technical Explanation prepared by the Joint Committee on Taxation states, in part, "Elsewhere in the bill, provision is made for new rules with respect to donor advised funds and supporting organizations. Many issues arise under current law with respect to such organizations, some of which are addressed in the bill and some of which would benefit from additional study."[1]

Section 1226 of the PPA provides that the Secretary shall undertake a study on the organization and operation of donor advised funds and supporting organizations,

[1] Joint Committee on Taxation, *Technical Explanation of H.R. 4, The "Pension Protection Act of 2006," as Passed by the House on July 28, 2006 and as Considered by the Senate on August 3, 2006*, (JCX–38–06), August 3, 2006, at 333.

and that the study shall specifically consider:

(1) whether the deductions allowed for income, gift, or estate taxes for charitable contributions to sponsoring organizations of donor advised funds or to supporting organizations are appropriate in consideration of (i) the use of contributed assets (including the type, extent, and timing of such use) or (ii) the use of the assets of such organizations for the benefit of the person making the charitable contribution (or a person related to such person),

(2) whether donor advised funds should be required to distribute for charitable purposes a specified amount (whether based on the income or assets of the fund) in order to ensure that the sponsoring organization with respect to the fund is operating consistent with the purposes or functions constituting the basis for its exemption under § 501 or its status as an organization described in § 509(a),

(3) whether the retention by donors to donor advised funds or supporting organizations of rights or privileges with respect to amounts transferred to such organizations (including advisory rights or privileges with respect to the making of grants or the investment of assets) is consistent with the treatment of such transfers as completed gifts that qualify for a deduction for income, gift, or estate taxes, and

(4) whether any of the issues described above also are issues with respect to other forms of charities or charitable donations.

REQUEST FOR PUBLIC COMMENTS

To assist in performing the required study, the Treasury and the Service request comments on the specific issues identified above and other issues relevant to the study. In particular, the Treasury and the Service request comments with respect to the following:

1. What are the advantages and disadvantages of donor advised funds and supporting organizations to the charitable sector, donors, sponsoring organizations, and supported organizations, compared to private foundations and other charitable giving arrangements?

2. How should the amount and availability of a charitable contribution deduction for a transfer of assets to a donor advised fund or a supporting organization, and the tax-exempt status or foundation classification of the donee, be determined if:

a. the transferred assets are paid to, or used for the benefit of, the donor or persons related to the donor (including, for example, salaries and other compensation arrangements, loans, or any other personal benefits or rights)?

b. the donor has investment control over the transferred assets?

c. there is an expectation that the donor's "advice" will be followed, or will be the sole or primary consideration, in determining distributions from, or investment of the assets in, the supporting organization or the donor advised fund?

d. the donor or the donee has option rights (*e.g.*, puts, calls, or rights of first refusal) with respect to the transferred assets?

e. the transferred assets are appreciated real, personal, or intangible property that is not readily convertible to cash?

3. What are the effects or the expected effects of the PPA provisions (including the § 4958 excess benefit transaction tax amendments applicable to donor advised funds and supporting organizations) on the practices and behavior of donors, donor advised funds, sponsoring organizations, supporting organizations and supported organizations?

4. What would be appropriate payout requirements, and why, for:

a. donor advised funds?

b. funds that are excepted from donor advised fund treatment by statute or by the authority of the Secretary, but for which the donor retains meaningful rights with respect to the investment or use of the transferred amounts?

c. supporting organizations?

d. any other types of charities?

5. What are the advantages and disadvantages of perpetual existence of donor advised funds or supporting organizations?

6. What other types of charitable giving arrangements give rise to any of the above issues?

Section 1226 of the PPA provides that, not later than August 16, 2007, the Secretary shall submit to the Congress a report on the study. Comments should refer to Notice 2007–21 and be submitted by April 9, 2007, to:

Internal Revenue Service
P. O. Box 7604
Ben Franklin Station
Washington, D.C. 20044
Attn: CC:PA:LPD:PR
Room 5203

Alternatively, comments may be submitted electronically via e-mail to *Notice.Comments@irscounsel.treas.gov*. The comments you submit will be available for public inspection and copying.

DRAFTING INFORMATION

The principal authors of this notice are Robert Fontenrose of the Exempt Organizations, Tax Exempt and Government Entities Division, and Susan J. Kassell of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding exempt organization issues, contact Mr. Fontenrose at (202) 283–9484 (not a toll-free call). For further information regarding charitable contribution issues, contact Ms. Kassell at (202) 622–5020 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also: Part 1, §§ 6011, 6111, 6662A, 6707, 6707A.)

Rev. Proc. 2007–21

SECTION 1. PURPOSE

This revenue procedure provides guidance to persons against whom a penalty under section 6707 or 6707A of the Internal Revenue Code is assessed, and who may request rescission of all or any portion of that penalty from the Commissioner of the Internal Revenue Service if the penalty is with respect to a reportable transaction other than a listed transaction. This revenue procedure describes the procedures for requesting rescission, including the deadline by which a person must request rescission; the information the person must provide in the rescission request; the factors that weigh in favor of and against granting rescission; where the person must submit the rescission request; and the rules governing requests for additional information from the person requesting rescission.

SECTION 2. BACKGROUND

.01 Section 6011 and the regulations thereunder require a taxpayer that has participated in a reportable transaction to disclose certain information with respect to the reportable transaction with its tax return. Section 1.6011–4(b) of the Income Tax Regulations enumerates and describes the categories of reportable transactions. One category of reportable transactions is a transaction that is the same as, or substantially similar to, one of the types of transactions that the Internal Revenue Service has determined to be a tax avoidance transaction and has identified by notice, regulation, or other form of published guidance as a "listed transaction." Treas. Reg. § 1.6011–4(b)(2).

.02 The American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418 (the Act), was enacted on October 22, 2004. Section 811 of the Act added section 6707A to the Code to provide a monetary penalty for the failure to include on any return or statement any information required to be disclosed under section 6011 with respect to a reportable transaction. Section 6707A(b)(1) provides that the penalty for failure to include information with respect to a reportable transaction, other than a listed transaction, is $10,000 in the case of a taxpayer that is a natural person, and $50,000 in any other case. Section 6707A(b)(2) provides that for a listed transaction, the penalty is increased to $100,000 in the case of a taxpayer that is a natural person, and $200,000 in any other case.

.03 Section 816 of the Act amended section 6707 to provide for the imposition of a penalty on a material advisor who is required to file a return under section 6111(a) with respect to any reportable transaction, and who fails to file a timely return or who files a false or incomplete return with respect to the reportable transaction. Section 6707(b)(1) provides that the penalty for failing to file a timely return or filing a false or incomplete return with respect to any reportable transaction other than a listed transaction is $50,000. Section 6707(b)(2) provides that the penalty with respect to any listed transaction equals the greater of (1) $200,000, or (2) 50 percent of the gross income derived by the material advisor with respect to aid, assistance, or advice that is provided with respect to the listed transaction before the date the return is filed under section 6111. If the penalty is with respect to a listed transaction and the failure or action subject to the penalty was intentional, the penalty is the greater of (1) $200,000, or (2) 75 percent of the gross income derived by the material advisor with respect to aid, assistance, or advice that is provided with respect to the listed transaction before the date the return is filed under section 6111.

.04 Section 6707A(d)(1) grants the Commissioner authority to rescind all or a portion of any penalty imposed under section 6707A if (1) the violation relates to a reportable transaction that is not a listed transaction and (2) rescission of the penalty would promote compliance with the requirements of the Code and effective tax administration. Section 6707A(d)(2) provides that the Commissioner's determination whether to rescind the penalty may not be reviewed in any judicial proceeding. The legislative history to section 6707A provides that "the IRS Commissioner or his delegate can rescind (or abate) the penalty." H.R. Conf. Rep. No. 755, 108th Cong., 2d Sess. at 373 (2004). Section 6707(c) provides that the rescission provisions of section 6707A(d) shall also apply to any penalty imposed on a material advisor under section 6707.

.05 Section 6707A(e) requires a person that is required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934, or is required to be consolidated with another person for purposes of those reports, to disclose in those reports for the periods specified by the Secretary, the requirement to pay the penalties set forth in section 6707A(e)(2) (*i.e.*, certain penalties under section 6662(h) and penalties under section 6662A(c), section 6707A(b)(2), or section 6707A(e)). If the person fails to disclose the requirement to pay the penalties, then section 6707A(e) requires that the failure be treated as a failure to disclose a listed transaction for which an additional section 6707A penalty applies. Because a penalty imposed under section 6707A(e) is treated as a penalty imposed with respect to a listed transaction, the penalty is not subject to rescission. *See* Rev. Proc. 2005–51, 2005–2 C.B. 296.

.06 Section 812 of the Act, which added section 6662A to the Code, provides that a 20-percent accuracy-related penalty may be imposed on any "reportable transaction understatement," as defined in section 6662A(b). Section 6662A(c) increases the penalty rate to 30 percent for the portion of any reportable transaction understatement with respect to which the relevant facts affecting the tax treatment of the reportable transaction were not adequately disclosed in accordance with regulations prescribed under section 6011. If the Commissioner (or the Commissioner's delegate) rescinds the penalty under section 6707A, then the taxpayer is treated as meeting the reportable transaction disclosure requirements of the regulations under section 6011, and the 30-percent penalty rate under section 6662A(c) does not apply. *See* I.R.C. § 6664(d)(2).

.07 Section 812 of the Act also added section 6664(d) to the Code, which provides a reasonable cause exception to the section 6662A reportable transaction understatement penalty. Generally, this exception cannot apply to any reportable transaction understatement unless, among other things, the relevant facts affecting the tax treatment of the reportable transaction are adequately disclosed in accordance with the regulations prescribed under section 6011. If the Commissioner (or the Commissioner's delegate) rescinds the penalty under section 6707A for failure to include reportable transaction information with a return or statement, then the taxpayer is treated as meeting the reportable transaction disclosure requirements of the regulations under section 6011, and the taxpayer has satisfied that prerequisite to establishing the reasonable cause exception to the reportable transaction understatement penalty under section 6662A. *See* I.R.C. § 6664(d)(2). Satisfying that one element of section 6664, however, will not alone establish reasonable cause.

.08 Section 903 of the Act amended section 6404(g)(2) to provide an exception to the general rule that interest and certain penalties will be suspended if the Secretary fails to provide a taxpayer with timely notice of an adjustment to the taxpayer's liability. Under section 6404(g)(2)(E), interest and certain penalties will not be suspended with respect to any listed transaction as defined in section 6707A(c). Also, under section 6404(g)(2)(E), interest and certain penalties will not be suspended with respect to any reportable transaction (other than a listed transaction) that the

taxpayer did not disclose as required by regulations under section 6011. If the penalty imposed under section 6707A is rescinded under the provisions of section 6707A(d), then the taxpayer is treated as meeting the reportable transaction disclosure requirements of the regulations under section 6011 for purposes of section 6404(g)(2)(E).

.09 Notice 2005–11, 2005–1 C.B. 493, provides that, in determining whether rescission of the penalty under 6707A would promote compliance with the requirements of the Code and effective tax administration, the Commissioner (or the Commissioner's delegate) will take into account all of the relevant facts and circumstances, including: (1) whether the taxpayer has a history of complying with the tax laws; (2) whether the violation results from an unintentional mistake of fact; and (3) whether imposing the penalty would be against equity and good conscience. Further, Notice 2005–11 provides that the Commissioner's determination whether to rescind a penalty in whole or in part is not reviewable by the IRS Office of Appeals or any court. Notice 2005–11 is effective until further guidance is issued in the form of regulations or other guidance that explicitly supersedes Notice 2005–11.

SECTION 3. SCOPE

This revenue procedure applies to any person against whom a penalty under section 6707 or 6707A is assessed and who may also request rescission of all or a portion of the penalty from the Commissioner. A person may only request rescission of a penalty under section 6707 or 6707A if the violation relates to a reportable transaction other than a listed transaction. Further guidance will be issued providing preassessment administrative appeal rights to persons against whom the IRS proposes to assess a penalty under section 6707 or 6707A.

SECTION 4. APPLICATION

.01 *When rescission request must be made*. In accordance with sections 6707A(d) and 6707(c), a person (*i.e.*, a taxpayer under section 6707A or material advisor under section 6707) requesting rescission of a penalty assessed under either section 6707A or section 6707 must request rescission in writing within 30 days after the date the Service sends notice and demand for payment of the penalty pursuant to section 6303. If the person pays the penalty (not including interest) in full prior to the Service sending notice and demand for payment, the person must request rescission in writing within 30 days from the date of payment. The Service will apply sections 7502 and 7503 to determine whether a request for rescission is timely. A person may request rescission only after filing with the Service the complete return or statement required under section 6011 or 6111, as applicable. Additionally, in order to request rescission, a person must have exhausted the administrative remedies available within the IRS Office of Appeals regarding the proposed assessment of the penalty unless the person has agreed in writing to the assessment of the penalty and has agreed not to file or prosecute a claim for refund or credit of the penalty, administratively or through litigation, other than by requesting rescission. The method of requesting rescission that is provided in this revenue procedure is the exclusive method of requesting rescission. A person may not request rescission through a refund claim, in a collection due process hearing, or through any other avenue for approaching the Service.

.02 *Information required in rescission request*. The written request for rescission must include: (1) the name, address, telephone number, and Taxpayer Identification Number, as applicable, of the person against whom the relevant penalty is imposed; (2) the amount of the penalty imposed; (3) a copy of the complete return or statement required under section 6011 or 6111, as applicable, that the person filed with the Service; (4) a copy of the notice and demand for payment or a statement that the person made payment in full prior to receiving notice and demand; (5) a copy of the agreement to the assessment of the penalty and not to file or prosecute a claim for refund or credit of the penalty, if applicable; (6) a statement of the facts and circumstances relating to the violation, which includes the Code section under which the penalty was determined (*i.e.*, section 6707(a) or section 6707A(a)), the reason(s) the original return or statement was not timely filed or was incomplete, a description of the safeguards the person had in place to ensure the proper filing of the return or statement, any remedial measures the person has taken to prevent future violations, and any other facts or circumstances relevant to how rescission would promote compliance with the requirements of the Code and effective tax administration, including the factors listed under section 4.04 of this revenue procedure; (7) a statement of the person's history of compliance with the tax law over the past 10 years, including but not limited to, identification of any penalties that the Service assessed against the person with respect to any reportable transaction and compliance with any requirement to disclose a reportable transaction; (8) for a penalty assessed under section 6707A, copies of all offerings and promotional materials that the taxpayer received with respect to the reportable transaction involved in the rescission request; (9) a statement providing the identity of related parties (as defined in section 267(b)) to the transaction, the identity of tax exempt entities involved in the transaction, and parties to any designation agreement, if applicable; and (10) the following declaration signed by the person requesting rescission: "Under penalties of perjury, I declare that I have examined this rescission request, and to the best of my knowledge and belief the information in this rescission request is true, correct, and complete."

.03 *Information that will expedite the rescission request*. Including some or all of the following information in a rescission request will expedite processing of the request: (1) a copy of the notice of proposed assessment (*e.g.*, 30-day letter and Form 4549, *Income Tax Examination Changes*); (2) the name, telephone number, and address of the IRS revenue agent that examined the person with respect to the applicable penalty; and (3) the name, telephone number, and address of the IRS appeals officer that considered the proposed penalty assessment, if applicable.

.04 *Factors that weigh in favor of granting rescission*. In determining whether rescission would promote compliance with the requirements of the Code and effective tax administration, the Commissioner (or the Commissioner's delegate) will take into account the following list of factors that weigh in favor of granting rescission. This is not an exclusive list and no single factor will be determinative of

whether to grant rescission in any particular case. Rather, the Commissioner (or the Commissioner's delegate) will consider and weigh all relevant factors, regardless of whether the factor is included in this list.

(A) The person, upon becoming aware of its failure to disclose or report a reportable transaction properly, filed a complete and proper, albeit untimely, Form 8886 or 8264 (or any successor forms), as applicable. For a penalty assessed under section 6707A, this factor will weigh strongly in favor of rescission provided that (i) the taxpayer files the Form 8886 prior to the date the Service first contacts the taxpayer (including contacts by the Service with any partnership in which the taxpayer is a partner, any S corporation in which the taxpayer is a shareholder, or any trust in which the taxpayer is a beneficiary) concerning a tax examination for the tax period in which the taxpayer participated in the reportable transaction and (ii) other circumstances suggest that the taxpayer did not delay filing an untimely but properly completed Form 8886 until after the Service had taken steps to identify the taxpayer's participation in the reportable transaction in question. For a penalty assessed under section 6707, this factor will weigh strongly in favor of rescission provided that the material advisor files the form required under section 6111 prior to the earlier of the date that any taxpayer files a Form 8886 identifying the material advisor with respect to the reportable transaction in question or the date the Service contacts the material advisor concerning the reportable transaction.

(B) The failure to properly disclose was due to an unintentional mistake of fact that existed despite the person's reasonable attempts to ascertain the correct facts with respect to the transaction.

(C) The person has an established history of properly disclosing other reportable transactions and complying with other tax laws, including compliance with any requests made under section 6112, if applicable.

(D) The person demonstrates that the failure to include on any return or statement any information required to be disclosed under section 6011 or section 6111 arose from events beyond the person's control.

(E) The person cooperates with the Service by providing timely information with respect to the transaction at issue that the Commissioner (or the Commissioner's delegate) may request in consideration of the rescission request. In considering whether a person cooperates with the Service, the Commissioner (or the Commissioner's delegate) may take into account whether the person complies with requests for additional information described in section 4.09 of this revenue procedure.

(F) Assessment of the penalty would weigh against equity and good conscience, including whether the person demonstrates that there was reasonable cause for, and the person acted in good faith with respect to, the failure to timely file or to include on any return any information required to be disclosed under section 6011 or section 6111. For a penalty assessed under section 6707A, an important factor in determining reasonable cause and good faith is the extent of the taxpayer's efforts to ensure that persons who prepared the taxpayer's return were informed of the taxpayer's participation in the reportable transactions. For a penalty assessed under section 6707, an important factor in determining reasonable cause and good faith is the extent of the material advisor's efforts to determine whether there was a requirement to file the return required under section 6111. The presence of reasonable cause, however, will not necessarily be determinative of whether to grant rescission.

.05 *Absence of factors described in section 4.04 weigh against rescission.* The absence of facts establishing the factors described in section 4.04 of this revenue procedure weigh against granting rescission. The absence of any one of these factors, however, will not necessarily be determinative of whether to grant rescission.

.06 *Factors not considered.* In determining whether to grant rescission, the Commissioner (or the Commissioner's delegate) will not consider doubt as to liability for, or collectibility of, the penalties. For example, the Commissioner (or the Commissioner's delegate) will not consider whether the taxpayer will suffer "economic hardship," as defined in Treas. Reg. § 301.6343–1(b)(4), if rescission is not granted.

.07 *Effect of rescission request on collection.* A person need not pay the section 6707 or 6707A penalty assessed prior to requesting rescission. The Service, however, will not suspend collection efforts solely because a person has made a rescission request.

.08 *Where rescission request must be submitted.* The written request for rescission should be sent to the following address:

Internal Revenue Service
LM:PQA:JC:1953(RR)
Large & Mid-Size Business Division
110 West 44th St., 3rd Floor
New York, NY 10036

The person must send the written request to the above address prior to the date specified in section 4.01 of this revenue procedure.

.09 *Request for additional information.* After receiving the rescission request, the Service may make a written request seeking additional information and documents relating to the transaction, such as marketing materials and tax opinions, from the person requesting rescission. Requested information must be submitted to the Service within 30 days of the date of mailing of the request for additional information by the Service. The Service may grant an extension of time for good cause to persons who request additional time within the 30-day period. A person's failure to provide the requested information within the applicable time period may weigh against rescission. Meritless claims of privilege may weigh against rescission. Further, the examining revenue agent and other Service employees involved with the examination may be asked to review and comment on the rescission request.

SECTION 5. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545–2047.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is in section 4. This information is required to administer the provisions of sections 6707(c) and 6707A(d) and determine whether the Service should rescind penalties otherwise applicable. The likely respondents are taxpayers and material advisors who are subject to a penalty under section 6707 or 6707A.

The estimated total annual reporting or recordkeeping burden is 3865.5 hours.

The estimated annual burden per respondent/recordkeeper varies from 3 to 6 hours, depending on individual circumstances, with an estimated average of 4.5 hours. The estimated number of respondents or recordkeepers is 859.

The estimated annual frequency of responses (used for reporting requirements only) is 1.

Books or records relating to a collection 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.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for any rescission request that relates to a section 6707 or 6707A penalty for which notice and demand, or payment, is made after October 22, 2004.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Matthew S. Cooper of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions & Judicial Practice Division. For further information regarding this revenue procedure, contact Matthew S. Cooper at (202) 622–4940 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Release of Lien or Discharge of Property

REG–159444–04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations related to release of lien and discharge of property under sections 6325, 6503, and 7426 of the Internal Revenue Code (Code). The proposed regulations update existing regulations and contain procedures for processing a request made by a property owner for discharge of a Federal tax lien from his property, under section 6325(b)(4). The proposed regulations also clarify the impact of these procedures on sections 6503(f)(2) and 7426(a)(4) and (b)(5). The proposed regulations reflect the enactment of sections 6325(b)(4), 6503(f)(2), and 7426(a)(4) by the IRS Restructuring and Reform Act of 1998.

DATES: Written or electronic comments and requests for a public hearing must be received by April 11, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–159444–04), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–159444–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–159444–04).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Debra A. Kohn, (202) 622–7985; concerning submissions of comments and the hearing, Richard A. Hurst, Publications and Regulations Specialist, at *Richard.A.Hurst@irscounsel.treas.gov* or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) under sections 6325, 6503, and 7426 of the Code. Section 6325(b)(4) was enacted by section 3106(a) of the IRS Restructuring and Reform Act of 1998 (RRA 1998), Pub. L. No. 105–206 (112 Stat. 685). Section 6503(f)(2) was enacted by section 3106(b)(3) of RRA 1998. Sections 7426(a)(4) and (b)(5) were enacted by section 3106(b)(1) of RRA 1998. These provisions of RRA 1998 provide a statutory mechanism for a person other than the person against whom the underlying tax was assessed, upon furnishing a deposit or bond, to obtain a discharge of the Federal tax lien from property owned by him, and for the IRS or the courts to determine the disposition of the deposit or bond amount.

The provisions added by RRA 1998 were enacted in response to *United States v. Williams*, 514 U.S. 527 (1995). In *Williams*, the Supreme Court held that a third party who paid another person's tax liability under protest had standing to bring a civil suit for refund pursuant to 28 U.S.C. 1346(a)(1), which waives the Government's sovereign immunity with respect to refund suits for Federal taxes alleged to have been erroneously or illegally assessed or collected. The Government argued in *Williams* that section 1346(a)(1) was intended to afford a remedy only to the person against whom a tax is assessed, and not a third party in this situation. In rejecting this argument, the Supreme Court reasoned that the plaintiff in *Williams*, who was not the taxpayer and who needed a discharge of the Federal tax lien in order to sell her property, had no effective remedy other than to pay the tax giving rise to the lien and to institute a refund suit. Sections 6325(b)(4), 6503(f)(2), and 7426(a)(4) and (b)(5) afford such a remedy to an owner of the property in this situation if the owner is not the person whose unsatisfied liability gave rise to the lien (a third-party owner). In light of the addition of these provisions to the Code, the continuing applicability of *Williams* is extremely limited, as the IRS has noted in other published guidance. See Rev. Rul. 2005–50, 2005–2 C.B. 124 (2005).

The current Code of Federal Regulations contains both temporary and final regulations under sections 6325, 6503, and 7426. Neither the temporary regulations nor the final regulations reflect the amendments to the Code made by RRA 1998. These proposed regulations, if adopted as final, would constitute permanent regulations that would incorporate the amendments made by RRA 1998 by replacing the existing temporary regulations and updating the existing final regulations under sections 6325, 6503, and 7426. In particular, these proposed regulations contain procedures for processing a request for a certificate of discharge of a Federal tax lien under section 6325(b)(4). In addition, these proposed regulations clarify the impact of these procedures on the collection limitations period tolling provisions of section 6503(f)(2) and on the judicial remedy provisions of sections 7426(a)(4) and (b)(5).

The proposed regulations also incorporate, with updates, the language of the existing temporary regulations relating to release of lien under section 6325(a), while withdrawing the existing temporary regulations. Changes to the language of the existing temporary regulations have been made to account for the IRS's acceptance of additional forms of payment since the temporary regulations became effective in 1983. Although section 7805(e)(2) provides that temporary regulations expire after three years, this provision applies only to temporary regulations issued after November 20, 1988. Since the temporary regulations relevant here were issued prior to that date, they are not subject to the three-year statutory limit. The proposed regulations provide that the existing temporary regulations under section 6325(a) are removed as of the date the proposed regulations become effective as final regulations.

The existing permanent and temporary regulations do not account for the current organizational structure of the IRS. The

existing permanent regulations under sections 6325 and 6503(f) employ the title "district director," in numerous instances, in indicating the highest official of a local office of the IRS. That title was used under an organizational structure of the IRS that no longer exists. In order to account for the IRS's current organizational structure and to allow for future reorganizations of the IRS, the proposed regulations remove the title "district director" throughout §§301.6325–1 and 301.6503(f)–1, and replace that title with the term "appropriate official." Section 301.6325–1(h) and Section 301.6503(f)–1(c) of the proposed regulations state that as used throughout section 301.6325–1 and section 301.6503(f)–1, respectively, the term "appropriate official" means the official or office identified in the relevant IRS Publication, or if such official is not so identified, the Secretary or his delegate. In this context, the relevant publication is either IRS Publication 1450, "*Instructions on How to Request a Certificate of Release of Federal Tax Lien*," or IRS Publication 783, "*Instructions on How to Apply for a Certificate of Discharge of Property From Federal Tax Lien*."

Explanation of Provisions

I. *In General*

Under section 6325(a), the Secretary shall issue a certificate of release of a Federal tax lien within 30 days of finding that the liability for the underlying tax either has been fully satisfied or has become legally unenforceable, or if an appropriate bond has been furnished to and accepted by the Secretary.

Under section 6325(b)(4)(A), the Secretary shall issue a certificate of discharge of property from a Federal tax lien if the owner of the property requests the issuance of a certificate of discharge and either deposits an amount of money "equal to the value of the interest of the United States (as determined by the Secretary) in the property" or furnishes an acceptable bond in a like amount. Section 6325(b)(4)(D) renders section 6325(b)(4)(A) inapplicable "if the owner of the property is the person whose unsatisfied liability gave rise to the lien." This means that if undivided interests in the property at issue are owned by both the taxpayer and another person, neither the taxpayer nor the other person may obtain a discharge of the property from the Federal tax lien under section 6325(b)(4).

Under section 6325(b)(4)(B), the Secretary shall refund the amount deposited, with interest, or release the bond furnished, "to the extent that the Secretary determines that" either: (i) the unsatisfied liability giving rise to the lien "can be satisfied from a source other than such property"; or (ii) the value of the interest of the United States in the property "is less than the Secretary's prior determination of such value." Section 7426(a)(4) allows a person who has obtained a certificate of discharge under section 6325(b)(4) to bring a civil action in Federal district court against the United States "for a determination of whether the value of the interest of the United States (if any) in such property is less than the value determined by the Secretary." This action must be filed within 120 days after the date the certificate of discharge is issued. Section 7426(a)(4) states that "[n]o other action may be brought by such person for such a determination." Section 7426(b)(5) provides that if the Federal district court determines that the Secretary's determination of the value of the interest of the United States in the property under section 6325(b)(4) exceeds the value of such interest, the court shall grant a judgment ordering a refund of the deposit amount, or a release of the bond, to the extent that the amount furnished exceeds the value determined by the court.

Section 6325(b)(4)(C) states that if no action is filed under section 7426(a)(4) within the specified 120-day period, the Secretary shall, within 60 days after the expiration of that period: (i) apply the deposit, or collect on the bond, to the extent necessary to satisfy the liability secured by the lien; and (ii) refund, with interest, any portion of the deposit not used to satisfy such liability.

Section 6503(f)(2) suspends the running of the period provided in section 6502 for collecting an assessed tax liability from the time a person becomes entitled to a certificate of discharge under section 6325(b)(4) until 30 days after: (A) the earliest date on which the Secretary no longer holds any amount as a deposit or bond provided under section 6325(b)(4) because the deposit or bond either has been used to satisfy the unpaid tax liability or has been refunded or released; or (B) the date a judgment secured under section 7426(b)(5) becomes final. Suspension of the running of the collection limitations period under section 6503(f)(2) applies only with respect to the amount of the assessment equal to the value of the interest of the United States in the subject property, plus interest, penalties, and certain other additions to tax.

II. *Release of Lien*

Section 6325(a) provides that the Secretary shall issue a certificate of release of lien within 30 days of the satisfaction of certain conditions. Section 301.6325–1(a)(1) and (2) of the existing permanent regulations state that the Secretary "may" issue a certificate of release if such conditions are met. These proposed regulations change the word "may" to "shall" in the appropriate instances, and incorporate the 30-day requirement contained in the existing temporary regulations, consistent with section 6325(a).

Much of the remainder of the language of §401.6325–1(a) of the temporary regulations is essentially the same as the language of §301.6325–1(a) of the existing permanent regulations. Therefore, the remaining language need not be incorporated into these proposed regulations. The language of §401.6325–1(b), dealing with notices of Federal tax lien that also contain certificates of release that become effective as of a prescribed date, survives as an addition to §301.6325–1(a). The language of §401.6325–1(c), defining the phrase *satisfaction of the tax liability* for purposes of section 6325(a)(1), also survives as an addition to §301.6325–1(a). The language of §401.6325–1(d), defining the phrase *proof of full payment* for purposes of §401.6325–1(a), survives as part of a new subsection of the permanent regulations addressing payment via credit and debit cards and electronic funds transfers, consistent with 26 CFR §§31.6302–1(h)(8) and 301.6311–2(a). The language of §401.6325–1(e), dealing with Federal tax liens listing multiple tax liabilities, and the language of §401.6325–1(f), dealing with the requirements of a valid request for a certificate of release, is incorporated into the permanent regulations.

III. *Discharge of Property under Section 6325(b)(4)*

A. *Issuance of the certificate of discharge*

Section 6325(b)(4)(A) requires the Secretary to issue a certificate of discharge of a third-party owner's property from a Federal tax lien if the third-party owner meets certain requirements. The proposed regulations state that a certificate of discharge must be issued under section 6325(b)(4) if the third-party owner submits a proper request and either deposits an appropriate amount or furnishes an acceptable bond.

1. Request of third-party owner

Section 301.6325–1(b)(4) provides that a person seeking a certificate of discharge under section 6325(b) must submit an application in writing to the local IRS official responsible for collection of the tax at issue, and that the application must contain such information as the official may require. Section 301.6325–1(b)(4) as currently written applies to only certificates of discharge under section 6325(b)(1) through (3). The proposed regulations extend the applicability of the language of §301.6325–1(b)(4) (redesignated as §301.6325–1(b)(5)) to a request for a certificate of discharge under section 6325(b)(4) and indicate that the request should be submitted to the appropriate IRS official or office.

New §301.6325–1(b)(5) of the proposed regulations states that a request for a certificate of discharge made by a third-party owner will be viewed as a request under section 6325(b)(4), and not as a request made under section 6325(b)(2), unless the third-party owner expressly states otherwise in writing. Similarly, any amount the IRS receives from a third-party owner following a discharge request will be viewed as a deposit made under section 6325(b)(4)(A), rather than as a payment under section 6325(b)(2), unless the third-party owner in writing expressly states otherwise, and expressly waives the right to file a civil suit in Federal district court for a refund of the amount received in writing.

The waiver provisions included in the proposed regulations generally protect the third-party owner in that a certificate of discharge granted under section 6325(b)(4), unlike one granted under section 6325(b)(2), affords a third-party owner the right to pursue a civil action under section 7426(a)(4) regarding the IRS's determination of the value of its lien. Amounts paid under section 6325(b)(2) do not constitute deposits and are immediately credited to the taxpayer's account once paid by the taxpayer or another person.

2. Value of the interest of the United States (as determined by the Secretary) in the property

Section 6325(b)(4)(A) and (D) requires the Secretary to issue a certificate of discharge of a third-party owner's property from a Federal tax lien if the third-party owner either deposits with the Secretary an amount "equal to the value of the interest of the United States (as determined by the Secretary)" or furnishes a bond acceptable to the IRS in a like amount. The proposed regulations provide that the deposit should be made or the bond should be furnished to the appropriate IRS official or office.

Section 301.6325–1(b)(2)(iii) indicates that in determining the value of the interest of the United States under section 6325(b)(2), the appropriate official "shall give consideration to the value of the property and the amount of all liens and encumbrances thereon having priority over the Federal tax lien. In determining the value of the property, the [appropriate official] may, in his discretion, give consideration to the forced sale value of the property in appropriate cases."

The proposed regulations state that this language applies to the determination of the value of the United States' interest in a third-party owner's property under section 6325(b)(4) and provide that the appropriate official shall make the determination.

B. *Processing the deposit*

Section 6325(b)(4)(B) states that the Secretary shall refund the amount deposited, with interest at the overpayment rate determined under section 6621, and shall release the bond, to the extent that the Secretary determines that either: (i) the unsatisfied tax liability giving rise to the lien can be satisfied from a source other than the third-party owner's property; or (ii) the value of the United States' interest in the property is less than the Secretary's prior determination of such value.

The proposed regulations specify that any request for a refund of deposit or release of bond under section 6325(b)(4)(B) must be made in writing and must contain the information required by the appropriate IRS Publication. The proposed regulations also clarify that the phrase "unsatisfied liability giving rise to the lien" contained in section 6325(b)(4)(B)(i) refers to the entire tax liability listed on the notice of Federal tax lien, not just the portion of the liability equal to the value of the United States' interest in the third-party owner's property. The proposed regulations, in addition, indicate that the Secretary is afforded discretion as to whether he should make a determination, and if he does so, in determining whether a deposit should be refunded or a bond released under section 6325(b)(4)(B).

As discussed in part IV of this preamble, a third-party owner wishing to file a civil suit for disposition of his deposit or bond is required by section 7426(a)(4) to do so within 120 days of issuance of the certificate of discharge. Consistent with this limitation period for filing suit, the proposed regulations allow the same 120-day period for the IRS to make any administrative determination regarding refund of deposit or release of bond under section 6325(b)(4)(B). During that 120-day period, the third-party owner may request a refund of deposit or release of bond administratively under section 6325(b)(4)(B), file a civil suit in district court under section 7426(a)(4), or both.

IV. *Civil Action by Person Other Than Taxpayer for Substitution of Value*

Section 7426(a)(4) provides that a person to whom a certificate of discharge has been issued under section 6325(b)(4) with respect to any property may, within 120 days after the day the certificate is issued, bring a civil action in Federal district court for "a determination of whether the value of the interest of the United States (if any) in such property is less than the value determined by the Secretary."

A. *Allowable basis for judicial determination*

The existing permanent regulations under section 7426 do not address the cause of action afforded by section 7426(a)(4). The proposed regulations clarify that the

only allowable basis for a judicial determination under section 7426(a)(4) is that the value of the interest of the United States in the third-party owner's property is less than the value as determined by the Secretary under section 6325(b)(4)(A)(i). This follows from the express language of section 7426(a)(2) and is the case despite the fact that an additional basis for reevaluation of the Secretary's original determination – that the tax liability underlying the lien can be satisfied from another source – is provided under section 6325(b)(4)(B)(i).

B. *Exclusivity of remedy*

The proposed regulations emphasize that section 7426(a)(4) provides the only judicial remedy available to a third-party owner whose property is subject to a Federal tax lien to obtain a refund of the deposit or bond provided in exchange for a discharge of the lien from the property.

Section 7426(a)(4) explicitly provides that: "No other action may be brought by such person [to whom a certificate of discharge is issued under section 6325(b)(4)] for such a determination." Additionally, by the terms of section 7426(a)(4), a third-party owner must obtain a certificate of discharge under section 6325(b)(4) (and not under section 6325(b)(2)) to have standing to pursue the remedy offered by section 7426(a)(4).

C. *No tolling of 120-day period*

The proposed regulations state that an administrative request for refund of deposit or release of bond made under section 6325(b)(4)(B) does not affect the running of the 120-day period for bringing a civil suit under section 7426(a)(4). The statutory scheme makes the standing of a third-party owner to bring suit under section 7426(a)(4) independent of, rather than related to, events that might occur under section 6325(b)(4)(B). Thus, an administrative request for refund of deposit or release of bond under section 6325(b)(4)(B) is not a prerequisite to filing an action under section 7426(a)(4), and the 120-day period of section 7426(a)(4) will not be tolled by an administrative request for refund of deposit or release of bond made under section 6325(b)(4)(B).

D. *Court's authority to issue judgment*

The proposed regulations under section 7426 address section 7426(b)(5), which authorizes a Federal district court to decide whether the Secretary's determination of the value of the United States' interest in a third-party owner's property exceeds the actual value of its interest, and, if so, to grant a judgment ordering refund of all or part of the third-party owner's deposit accordingly.

V. *Secretary's Use of Deposit or Bond if Judicial Action Not Filed*

Section 6325(b)(4)(C) instructs the Secretary how to process the third-party owner's deposit or bond if the third-party owner does not institute suit under section 7426(a)(4) within the statutorily prescribed 120-day period. Under section 6325(b)(4)(C), the Secretary has 60 days after expiration of the 120-day period to: (i) apply the amount deposited (or collect on the bond furnished) "to the extent necessary to satisfy the unsatisfied liability secured by the lien"; and (ii) refund, with interest at the overpayment rate, any portion of the amount deposited "which is not used to satisfy such liability." Thus, the statute affords the Secretary a total of 180 days after issuing the certificate of discharge to complete processing of the third-party owner's deposit or bond.

The proposed regulations specify that the IRS may take these actions even after 180 days have passed. Prohibiting the IRS from either applying or refunding the deposit once the 180-day period has elapsed would prevent the IRS from ever relinquishing a deposit thereafter, in effect requiring IRS personnel to retain amounts deposited despite, in many cases, being aware that the amounts should be applied to outstanding tax liabilities or returned to third-party owners.

However, because section 6325(b)(4)(C) reflects Congress's intent that the deposit or bond be processed within 60 days after expiration of the 120-day period for bringing suit (or 180 days after the date a certificate of discharge is issued under section 6325(b)(4)(A)), the proposed regulations state that the deposit or bond will be deemed to have been processed as of the 60th day after expiration of the 120-day period for purposes of applying payments to the taxpayer's account. This means that if the IRS has not either applied or refunded any part of the deposit within the 180-day period, the IRS will be prohibited from charging the taxpayer interest and penalties on an outstanding liability to which the deposit should have been applied under section 6325(b)(4)(C)(i). On the other hand, the IRS will pay the third-party owner interest at the overpayment rate on any refund that should have been paid under section 6325(b)(4)(C)(ii) within the 60-day period until the refund is actually paid.

VI. *Suspension of Running of Period of Limitation*

Section 6503(f)(2) states that in the case of any assessment for which a lien was made on any property, the running of the period for collecting the assessed tax liability, under section 6502, shall be suspended from the date any person becomes entitled to a certificate of discharge with respect to the property under section 6325(b)(4) until the date which is 30 days after the earlier of: (A) the earliest date on which the Secretary no longer holds any amount as a deposit or bond provided under section 6325(b)(4) with respect to the property, because the deposit or bond either has been used to satisfy the unpaid tax or has been refunded; or (B) the date that a judgment secured under section 7426(b)(5) becomes final. Suspension of the running of the collection limitations period under section 6503(f)(2) applies only with respect to the amount of the assessment equal to the value of the interest of the United States in the subject property, plus interest, penalties and certain other additions to tax.

The proposed regulations under section 6503 address the suspension of the running of the period for collecting a tax liability provided by section 6503(f)(2).

Section 6325(b)(4)(A) provides that the Secretary shall issue a certificate of discharge when the third-party owner makes a request and deposits an appropriate amount or furnishes an acceptable bond. The proposed regulations state that the suspension of the running of the collection statute of limitations begins on the date a deposit or bond in the amount determined by the Secretary is received by the appropriate official under section

6325(b)(4)(A), as that is the date the third-party owner becomes entitled to a certificate of discharge under that provision.

Assuming that no judgment is obtained under section 7426(b)(5), section 6503(f)(2)(A) ties the end of the period for suspension of the running of the collection statute to the ultimate disposition of the third-party owner's deposit or bond, which is addressed by section 6325(b)(4)(B) and (C). The proposed regulations state that the suspension ends 30 days after the date the appropriate official no longer holds the deposit or bond by reason of taking actions prescribed under section 6325(b)(4)(B) and (C).

Because section 6325(b)(4)(C) contemplates that the deposit or bond will be processed within 60 days after the expiration of 120 days after the date the Secretary issues the certificate of discharge, as discussed in the previous section, the regulations state that the deposit or bond is deemed processed no later than that date for purposes of section 6503(f)(2)(A). This means that if the deposit or bond is not processed within the 180-day period, the running of the collection statute ceases to be suspended as of 90 days (60 days + the 30 days afforded by section 6503(f)(2)) after the 120-day period ends. Thus, the period for collection resumes running under section 6503(f)(2)(A) 31 days after the 180 days have passed.

Section 6503(f)(2)(B) ties the end of the suspension period to the finality of a judgment obtained under section 7426(b)(5). The proposed regulations state that if a judgment is obtained under section 7426(b)(5), the suspension of the running of the collection statute ends 30 days after all appeals of that judgment, if any, have been exhausted.

Proposed Effective Date

These regulations are proposed to apply to any release of lien or discharge of property that is requested after the date that these regulations are published 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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

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

Drafting Information

The principal author of these regulations is Debra A. Kohn of the Office of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6325–1 is amended as follows:

1. Paragraphs (a) and (b)(1)(i), (b)(2)(i), and (b)(2)(ii) are revised.

2. Paragraph (b)(2)(iii) is redesignated as paragraph (b)(6) and revised.

3. Paragraph (b)(4) is redesignated as paragraph (b)(5) and revised.

4. A new paragraph (b)(4) is added.

5. Paragraphs (c)(1) and (c)(2) are amended by removing the language "district director" and adding the language "appropriate official" in its place, wherever it appears.

6. The first sentence of paragraph (d)(1) is amended by removing the language "A district director" and adding the language "The appropriate official" in its place, by removing the word "Code" and adding the language "Internal Revenue Code" in its place, and by removing the language "the district director" and adding the language "the appropriate official" in its place. The third sentence is amended by removing the language "a district director" and adding the language "the appropriate official" in its place, and removing the language "the district director" and adding "the appropriate official" in its place.

7. Paragraph (d)(2)(i) is amended by removing the language "A district director" and adding the language "The appropriate official" in its place, by removing the word "Code" and adding the language "Internal Revenue Code" in its place, and by removing the language "the district director" and adding the language "the appropriate official" in its place.

8. Paragraph (d)(2)(ii), *Examples 1* through *4*, are amended by removing the language "district director" and adding the language "appropriate official" in its place, wherever it appears.

9. Paragraphs (d)(3) and (d)(4) are amended by removing the language "district director" and adding the language "appropriate official" in its place, wherever it appears.

10. The first sentence of paragraph (e) is amended by removing the language "a district director" and adding the language "the appropriate official" in its place, and by removing the language "the district director" and adding the language "the appropriate official" in its place. The third and fourth sentences are amended by removing the language "district director"

and adding the language "appropriate official" in its place.

11. Paragraphs (f)(1) and (f)(2)(i) are amended by removing the language "a district director" and adding the language "the appropriate official" in its place, paragraph (f)(2)(i)(*b*) is amended by removing the language "the district director" and adding the language "the appropriate official" in its place, and paragraph (f)(3) is amended by removing the word "Code" and adding the language "Internal Revenue Code" in its place.

12. Paragraphs (h), (i), and (j) are added.

The revisions and additions read as follows:

§301.6325–1 Release of lien or discharge of property.

(a) *Release of lien*—(1) *Liability satisfied or unenforceable*. The appropriate official shall issue a certificate of release for a filed notice of Federal tax lien, no later than 30 days after the date on which he finds that the entire tax liability listed in such notice of Federal tax lien either has been fully satisfied (as defined in paragraph (a)(4) of this section) or has become legally unenforceable. In all cases, the liability for the payment of the tax continues until satisfaction of the tax in full or until the expiration of the statutory period for collection, including such extension of the period for collection as is agreed to.

(2) *Bond accepted.* The appropriate official shall issue a certificate of release of any tax lien if he is furnished and accepts a bond that is conditioned upon the payment of the amount assessed (together with all interest in respect thereof), within the time agreed upon in the bond, but not later than 6 months before the expiration of the statutory period for collection, including any agreed upon extensions. For provisions relating to bonds, see sections 7101 and 7102 and §§301.7101–1 and 301.7102–1.

(3) *Certificate of release for a lien which has become legally unenforceable*. The appropriate official shall have the authority to file a notice of Federal tax lien which also contains a certificate of release pertaining to those liens which become legally unenforceable. Such release will become effective as a release as of a date prescribed in the document containing the notice of Federal tax lien and certificate of release.

(4) *Satisfaction of tax liability*. For purposes of paragraph (a)(1) of this section, satisfaction of the tax liability occurs when—

(i) The appropriate official determines that the entire tax liability listed in a notice of Federal tax lien has been fully satisfied. Such determination will be made as soon as practicable after tender of payment; or

(ii) The taxpayer provides the appropriate official with proof of full payment (as defined in paragraph (a)(5) of this section) with respect to the entire tax liability listed in a notice of Federal tax lien together with the information and documents set forth in paragraph (a)(7) of this section. See paragraph (a)(6) of this section if more than one tax liability is listed in a notice of Federal tax lien.

(5) *Proof of full payment*. As used in paragraph (a)(4)(ii) of this section, the term *proof of full payment* means—

(i) An internal revenue cashier's receipt reflecting full payment of the tax liability in question;

(ii) A canceled check in an amount sufficient to satisfy the tax liability for which the release is being sought;

(iii) A record, made in accordance with procedures prescribed by the Commissioner, of proper payment of the tax liability by credit or debit card or by electronic funds transfer; or

(iv) Any other manner of proof acceptable to the appropriate official.

(6) *Notice of a Federal tax lien which lists multiple liabilities*. When a notice of Federal tax lien lists multiple tax liabilities, the appropriate official shall issue a certificate of release when all of the tax liabilities listed in the notice of Federal tax lien have been fully satisfied or have become legally unenforceable. In addition, if the taxpayer requests that a certificate of release be issued with respect to one or more tax liabilities listed in the notice of Federal tax lien and such liability has been fully satisfied or has become legally unenforceable, the appropriate official shall issue a certificate of release. For example, if a notice of Federal tax lien lists two separate liabilities and one of the liabilities is satisfied, the taxpayer may request the issuance of a certificate of release with respect to the satisfied tax liability and the appropriate official shall issue a release.

(7) *Taxpayer requests*. A request for a certificate of release with respect to a notice of Federal tax lien shall be submitted in writing to the appropriate official. The request shall contain the information required in the appropriate IRS Publication.

(b) *Discharge of specific property from the lien*—(1) *Property double the amount of the liability*. (i) The appropriate official may, in his discretion, issue a certificate of discharge of any part of the property subject to a Federal tax lien imposed under chapter 64 of the Internal Revenue Code if he determines that the fair market value of that part of the property remaining subject to the Federal tax lien is at least double the sum of the amount of the unsatisfied liability secured by the Federal tax lien and of the amount of all other liens upon the property which have priority over the Federal tax lien. In general, fair market value is that amount which one ready and willing but not compelled to buy would pay to another ready and willing but not compelled to sell the property.

* * * * *

(2) *Part payment; interest of United States valueless*—(i) *Part payment*. The appropriate official may, in his discretion, issue a certificate of discharge of any part of the property subject to a Federal tax lien imposed under chapter 64 of the Internal Revenue Code if there is paid over to him in partial satisfaction of the liability secured by the Federal tax lien an amount determined by him to be not less than the value of the interest of the United States in the property to be so discharged. In determining the amount to be paid, the appropriate official will take into consideration all the facts and circumstances of the case, including the expenses to which the Government has been put in the matter. In no case shall the amount to be paid be less than the value of the interest of the United States in the property with respect to which the certificate of discharge is to be issued.

(ii) *Interest of the United States valueless*. The appropriate official may, in his discretion, issue a certificate of discharge of any part of the property subject to the Federal tax lien if he determines that the interest of the United States in the property to be so discharged has no value.

(3) *Discharge of property by substitution of proceeds of sale*. The appropriate official may, in his discretion, issue

a certificate of discharge of any part of the property subject to a Federal tax lien imposed under chapter 64 of the Internal Revenue Code if such part of the property is sold and, pursuant to a written agreement with the appropriate official, the proceeds of the sale are held, as a fund subject to the Federal tax liens and claims of the United States, in the same manner and with the same priority as the Federal tax liens or claims had with respect to the discharged property. This paragraph does not apply unless the sale divests the taxpayer of all right, title, and interest in the property sought to be discharged. Any reasonable and necessary expenses incurred in connection with the sale of the property and the administration of the sale proceeds shall be paid by the applicant or from the proceeds of the sale before satisfaction of any Federal tax liens or claims of the United States.

(4) *Right of substitution of value*—(i) *Issuance of certificate of discharge to property owner who is not the taxpayer*. If an owner of property subject to a Federal tax lien imposed under chapter 64 of the Internal Revenue Code submits an application for a certificate of discharge pursuant to paragraph (b)(5) of this section, the appropriate official shall issue a certificate of discharge of such property after the owner either deposits with the appropriate official an amount equal to the value of the interest of the United States in the property, as determined by the appropriate official pursuant to paragraph (b)(6) of this section, or furnishes an acceptable bond in a like amount. This paragraph does not apply if any owner of the property is the person whose unsatisfied liability gave rise to the Federal tax lien. Thus, if the property is owned by both the taxpayer and another person, neither the taxpayer nor the other person may obtain a certificate of discharge of the property under this paragraph.

(ii) *Refund of deposit and release of bond*. The appropriate official may, in his discretion, determine that either the entire unsatisfied tax liability listed on the notice of Federal tax lien can be satisfied from a source other than the property sought to be discharged, or the value of the interest in the United States is less than the prior determination of such value. The appropriate official shall refund the amount deposited with interest at the overpayment rate determined under section 6621 or release the bond furnished to the extent that he makes this determination.

(iii) *Refund request*. If a property owner desires an administrative refund of his deposit or release of the bond, the owner shall file a request in writing with the appropriate official. The request shall contain such information as the appropriate IRS Publication may require. The request must be filed within 120 days after the date the certificate of discharge is issued. A refund request made under this paragraph neither is required nor is effective to extend the period for filing an action in court under section 7426(a)(4).

(iv) *Internal Revenue Service's use of deposit if court action not filed*. If no action is filed under section 7426(a)(4) for refund of the deposit or release of the bond within the 120-day period specified therein, the appropriate official shall, within 60 days after the expiration of the 120-day period, apply the amount deposited or collect on such bond to the extent necessary to satisfy the liability listed on the notice of Federal tax lien, and shall refund, with interest at the overpayment rate determined under section 6621, any portion of the amount deposited that is not used to satisfy the liability. If the appropriate official has not completed the application of the deposit to the unsatisfied liability before the end of the 60-day period, the deposit will be deemed to have been applied to the unsatisfied liability as of the 60th day.

(5) *Application for certificate of discharge*. Any person desiring a certificate of discharge under this paragraph (b) shall submit an application in writing to the appropriate official. The application shall contain the information required by the appropriate IRS Publication. For purposes of this paragraph (b), any application for certificate of discharge made by a property owner who is not the taxpayer, and any amount submitted pursuant to the application, will be treated as an application for discharge and a deposit under section 6325(b)(4) unless the owner of the property submits a statement, in writing, that the application is being submitted under another paragraph of section 6325 and not under section 6325(b)(4), and the owner in writing waives the rights afforded under paragraph (b)(4), including the right to seek judicial review.

(6) *Valuation of interest of United States*. For purposes of paragraphs (b)(2) and (b)(4) of this section, in determining the value of the interest of the United States in the property, or any part thereof, with respect to which the certificate of discharge is to be issued, the appropriate official shall give consideration to the value of the property and the amount of all liens and encumbrances thereon having priority over the Federal tax lien. In determining the value of the property, the appropriate official may, in his discretion, give consideration to the forced sale value of the property in appropriate cases.

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(h) As used in this section, the term *appropriate official* means either the official or office identified in the relevant IRS Publication or, if such official or office is not so identified, the Secretary or his delegate.

(i) *Temporary regulations removed*. The provisions of §401.6325–1 of this chapter are removed on the date these regulations are published as final regulations in the **Federal Register**.

(j) *Effective date*. This section applies to any release of lien or discharge of property that is requested after these regulations are published as final regulations in the **Federal Register**.

Par. 3. Section 301.6503(f)–1 is amended as follows:

1. The section heading is revised.

2. The undesignated paragraph is designated as paragraph (a) and a paragraph heading is added.

3. In newly designated paragraph (a), the language "a district director" is removed and the language "the appropriate official" is added in its place, the language "the district director" is removed and the language "the appropriate official" is added in its place, and in the *Example* the language "district director" is removed and the language "appropriate official" is added in its place, wherever it appears.

4. Paragraphs (b), (c), and (d) are added.

The revisions and additions read as follows:

§301.6503(f)–1 Suspension of running of period of limitation; wrongful seizure of property of third-party owner and

discharge of wrongful lien for substitution of value.

(a) *Wrongful seizure.* * * *

(b) *Discharge of wrongful lien for substitution of value.* If a person other than the taxpayer submits a request in writing for a certificate of discharge for a filed Federal tax lien under section 6325(b)(4), the running of the period of limitations on collection after assessment under section 6502 for any liability listed in such notice of Federal tax lien shall be suspended for a period equal to the period beginning on the date the appropriate official receives a deposit or bond in the amount specified in §301.6325–1(b)(4)(i) and ending on the date that is 30 days after the earlier of—

(1) The date the appropriate official no longer holds, or is deemed to no longer hold, within the meaning of paragraph (b)(4)(iv) of this section, any amount as a deposit or bond by reason of taking such actions as prescribed in sections 6325(b)(4)(B) and (C); or

(2) The date the judgment secured under section 7426(b)(5) becomes final.

(c) As used in this section, the term *appropriate official* means either the official or office identified in the relevant IRS Publication or, if such official or office is not so identified, the Secretary or his delegate.

(d) *Effective date.* This section applies to any request for a certificate of discharge made after these regulations are published as final regulations in the **Federal Register**.

Par. 4. In §301.7426–1, paragraphs (a)(4), (b)(5), and (d) are added.

§301.7426–1 Civil actions by persons other than taxpayers.

(a) * * *

(4) *Substitution of value.* A person who obtains a certificate of discharge under section 6325(b)(4) with respect to any property may, within 120 days after the day on which the certificate is issued, bring a civil action against the United States in a district court of the United States for a determination of whether the value of the interest of the United States (if any) in such property is less than the value determined by the appropriate official. A civil action under this provision shall be the exclusive judicial remedy for a person other than the taxpayer who obtains a certificate of discharge for a filed notice of Federal tax lien.

(b) * * *

(5) *Substitution of value.* If the court determines that the determination by the appropriate official of the value of the interest of the United States in the property exceeds the actual value of such interest, the court may grant a judgment ordering a refund of the amount deposited, or a release of the bond, to the extent that the aggregate of those amounts exceeds the value as determined by the court.

* * * * *

(d) Paragraphs (a)(4) and (b)(5) of this section apply to any request for a certificate of discharge made after these regulations are published as final regulations in the **Federal Register**.

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

(Filed by the Office of the Federal Register on January 10, 2007, 8:45 a.m., and published in the issue of the Federal Register for January 11, 2007, 72 F.R. 1301)

Compliance Resolution Program for Employees Other Than Corporate Insiders for Additional 2006 Taxes Arising Under § 409A Due to the Exercise of Stock Rights

Announcement 2007–18

The Internal Revenue Service announces a compliance resolution program (the Program) that permits employers to pay the additional taxes arising under § 409A of the Internal Revenue Code due to the exercise of certain discounted stock options and stock appreciation rights (stock rights) in 2006. The Program provides a means to minimize the burdens of compliance on employees who are not corporate insiders, while ensuring that all applicable taxes are paid. As described in more detail below, the Program:

- Applies only to discounted stock rights exercised during 2006.
- Applies only to employees and former employees who are not subject to the disclosure requirements under section 16(a) of the Securities Exchange Act of 1934 (a non-insider), and were not subject to such requirements at the date of grant of the stock right.
- Requires full payment by the employer of the applicable § 409A taxes arising from the exercise of the stock right.
- Provides relief for the employees from the requirement to pay the § 409A taxes.
- Does not affect an employer's obligation to report the compensation income and wages arising from the exercise of the stock right on the Form W–2, in Box 1, 3 and 5, and to apply the appropriate employment taxes, and does not affect an employee's obligation to report such compensation income on the Form 1040 and pay the applicable income tax (other than the additional § 409A taxes).
- Requires treatment of the employer's payment of the employee's § 409A taxes as an additional payment of compensation to the employee in the employee's taxable year in which the payment is made.
- Requires notice to employees and to the IRS of the employer's participation in the Program.

Employers that wish to participate in this Program must notify the IRS no later than February 28, 2007 of their intent to participate, and must notify affected employees within 15 days of providing the notification to the IRS.

Section 1. Background

A. Section 409A

Section 409A was added to the Code by § 885 of the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418). Section 409A generally provides that, unless certain requirements are met, amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income. In addition, the amount includible in income under § 409A

is subject to certain additional taxes discussed below (referred to as § 409A taxes).

On December 20, 2004, the IRS issued Notice 2005–1, 2005–1 C.B. 274, setting forth initial guidance on the application of § 409A, and supplying transition guidance in accordance with the statutory provisions. A notice of proposed rulemaking (REG–158080–04, 2005–2 C.B. 786 [70 FR 57930]) was published in the Federal Register on October 4, 2005. The preamble to the proposed regulations clarified and extended certain provisions of the transition guidance provided in Notice 2005–1, generally through December 31, 2006. On October 4, 2006, the IRS issued Notice 2006–79, 2006–43 I.R.B. 763, which further clarified and extended certain provisions of the transition guidance through December 31, 2007.

Pursuant to Notice 2006–100, 2006–51 I.R.B. 1109, issued on November 30, 2006, service recipients generally are required to report amounts includible under § 409A for 2006 on a timely filed Form W–2 or 1099, as applicable. Service providers are required to report amounts includible under § 409A for the service provider's 2006 tax year and to pay any taxes due in accordance with the requirements of Notice 2006–100.

B. Application of § 409A to Certain Discounted Stock Rights

The IRS has become aware of numerous instances in which stock options were issued with an exercise price less than the fair market value of the underlying stock on the date of grant or in which stock appreciation rights were issued under which the compensation payable upon exercise of such right was more than the excess of the fair market value of the stock subject to such right on the date of exercise over the fair market value of such stock on the date of grant of such right (collectively such options and rights are referred to as discounted stock rights). In many cases, the discount resulted from a discrepancy between the purported grant date and the actual grant date. In some cases, the employee exercised the stock right during 2006.

Such discounted stock rights, to the extent they were issued or became earned and vested on or after January 1, 2005, are generally treated as providing nonqualified deferred compensation subject to § 409A. By contrast, a stock option granted with an exercise price that can never be less than the fair market value of the underlying stock on the date of grant, and that does not include any additional deferral feature, generally is not subject to § 409A, and the exercise of such stock option does not implicate § 409A. Similarly, a stock appreciation right that does not provide compensation in excess of the difference between the fair market value of the stock subject to such right on the date of exercise and the fair market value of such stock on the date of grant of such right, and that does not include any additional deferral feature, generally is not subject to § 409A, and the exercise of such stock right does not implicate § 409A.

C. Consequences Under § 409A of the Exercise of Certain Discounted Stock Rights in 2006

In the absence of affirmative steps taken before the exercise of a stock right to avoid a violation of § 409A, the exercise of a discounted stock right during 2006, where the term of the stock right otherwise extended beyond 2006, generally is treated as an impermissible payment of nonqualified deferred compensation under § 409A. Such an impermissible payment generally triggers adverse Federal income tax consequences under § 409A for the service provider, and reporting requirements for the service recipient, with respect to the stock rights that were exercised and with respect to any additional amounts that are treated as deferred under the same plan for purposes of § 409A under the applicable plan aggregation rules. Such tax consequences include immediate income inclusion; an additional 20% income tax (in accordance with § 409A(a)(1)(B)(i)(II)) on the amounts required to be so included (the 20% tax); and a second additional tax (in accordance with § 409A(a)(1)(B)(ii)) equal to the interest on unpaid taxes from the year of initial deferral (or if later, the first year the deferred amount was not subject to a substantial risk of forfeiture), calculated at the underpayment rate plus 1% (the interest tax).

Notice 2006–100 provides that where there is a required income inclusion under § 409A in the service provider's tax year 2006, the plan aggregation rules apply in determining the amount required to be included in income. For purposes of participation in, and the relief provided by, the Program, taxpayers may assume, in the case of a violation involving a stock right, that the plan aggregation rules apply only to aggregate all amounts deferred under stock rights subject to § 409A held by the employee with respect to whom the violation occurred. In the case of an unexercised stock right, Notice 2006–79 permits the service recipient to substitute for such a stock right a stock right that is not subject to § 409A. In the case of certain stock rights granted to a service provider who was subject to the disclosure requirements of section 16(a) of the Securities Exchange Act of 1934 on the date of grant of the stock right, the substitution was required to be completed by December 31, 2006. For other service providers, the substitution must be completed by December 31, 2007. If a taxpayer utilizes the available transition rules to exclude a right to an amount (including an unexercised stock right) from coverage under § 409A, then the amount is treated as always having been excluded from coverage under § 409A. Accordingly, the amount is not required to be aggregated for purposes of determining the amount includible in income under § 409A in 2006. If the right to the amount is not excluded from coverage under § 409A by the applicable deadline, the right to the amount will remain subject to the plan aggregation rules regardless of whether the right to the amount is, or is amended to be, compliant with the requirements of § 409A. However, because a stock right may be removed from coverage under § 409A retroactively, any income inclusion under § 409A with respect to an unexercised stock right due to the plan aggregation rules will not be treated as income for any of the service provider's taxable years before the 2007 tax year.

Section 2. Scope of Program

This Program addresses only the additional § 409A taxes for the employee's 2006 tax year resulting from the exercise of an applicable stock right (discussed below), and the information reporting requirements related to such § 409A taxes. The Program does not address other consequences that may arise from the grant or exercise of a stock right with an exercise

price less than the fair market value of the underlying stock on the date of grant. Accordingly, the Program does not address the employer's obligation to report the compensation income arising from the exercise of the stock right on the 2006 Form W–2, in Box 1, 3 and 5, as appropriate, and to apply the appropriate employment taxes to the payment of wages. The Program also does not address the employee's obligation to report such compensation income on the Form 1040 and pay the applicable income tax (other than any additional § 409A taxes). The Program also does not address the non-§ 409A tax consequences, including employment tax and information reporting consequences, that may arise from a failure of a purported incentive stock option to meet the requirements of § 422, or the application of § 162(m) to an employer's otherwise available deduction for compensation expense with respect to the exercise of a stock right.

Section 3. Eligibility Requirements

This Program is available to an employer that granted applicable stock rights that were subject to the requirements of § 409A because the exercise price was below the fair market value of the underlying stock on the date of grant, where such stock rights were exercised during the employee's 2006 tax year. For this purpose, an applicable stock right means any stock right granted in connection with the performance of services by an employee other than a stock right granted to an employee who is subject to the disclosure requirements of section 16(a) of the Securities Exchange Act of 1934 as of the date the employer provides a notice of intent to participate in the program under section 4.A or who was subject to such disclosure requirements on the date of grant of such stock right.

Section 4. Terms of Participation in the Program

If an employer complies with all of the requirements in this section 4 with respect to an employee, the employer and the employee will be eligible for the relief set forth in section 5 of this announcement.

A. Notice to the IRS of Intent to Participate

An employer must submit to the IRS by February 28, 2007 a notice of the employer's intent to participate in the Program. The notice of intent to participate must state, under penalties of perjury, the following:

> [Insert name of the employer and taxpayer identification number] hereby provides notice to the IRS of its intent to participate in the Program described in Announcement 2007–18. [Insert name] is the person for the IRS to contact regarding the participation of [Insert name of the employer] in the Program, and may be contacted at [Insert address and phone number]. *Choose either sentence A or sentence B*. *Sentence A*. [Insert name of the employer] hereby certifies that [Insert name of the employer] is not under examination by the IRS. *Sentence B*. [Insert name of the employer] hereby certifies that [Insert name of the employer] is under examination by the IRS and is providing a copy of this notice of intent to participate in the Program to the examining revenue agent.

An employer must also submit a Form 2848, *Power of Attorney and Declaration of Representative*, as appropriate. For information regarding the submission of this notice, see section 6 of this announcement.

B. Notices to Affected Employees and IRS

i. Notice to Affected Employees of Intent to Participate

No later than 15 days after the employer submits the notice of intent to participate described in section 4.A of this announcement, an employer must provide a notice to all employees that the employer reasonably anticipates may be affected by the employer's participation in the Program. Such notice must provide the following information:

(i) the employer has notified the IRS of the employer's intent to participate in the Program (the Program must be specifically referred to in the notice to employees as the program set forth in Announcement 2007–18, Compliance Resolution Program for Employees Other than Corporate Insiders for Additional 2006 Taxes Arising Under § 409A due to the Exercise of Stock Rights);

(ii) the employer intends to provide further notice to the employee on or before July 15, 2007 certifying that the employer has made a further submission to the IRS that to the best of its information, knowledge, and belief, satisfies the requirements of this announcement, or certifying that the employer has not made such a further submission;

(iii) the employer's participation in the Program may affect the employee's Federal income tax obligations solely with respect to the additional taxes imposed under § 409A of the Internal Revenue Code due to the exercise of discounted stock options or stock appreciation rights, but does not affect the employee's obligation to report on Form 1040 the compensation income arising from the exercise that is shown on the Form W–2 (or W–2c, if applicable) provided to the employee or to pay the applicable Federal taxes (other than the additional § 409A taxes).

The notice to affected employees may provide additional information that is not inconsistent with the required information. The notice must be provided directly to the individual employee, but may be provided electronically. If an employer provides such notices to employees that the employer reasonably anticipates may be affected by the employer's participation in the Program, and subsequently determines that an exercise of a stock right by an additional employee is eligible to be included in this Program, the employer may include such additional employee and exercise in a further submission without providing the notices required by this Section 4.B, provided all other requirements of this announcement are met with respect to such additional employee.

ii. Second Notice to IRS

No later than 15 days after the employer submits the notice of intent to participate described in section 4.A of this announcement, the employer must provide a notice to the IRS stating the number of employees to whom the notices required by section 4.B.i of this announcement were provided.

C. Employer's Further Submission of Information and Payment to the IRS

An employer must make a further submission of information and payment (a further submission) to the IRS by June 30, 2007 meeting all of the requirements of this section 4.C.

i. Information

An employer must include in the further submission to the IRS the following information, signed under penalties of perjury:

a. The employer's name and taxpayer identification number.

b. A list of employees for whom the employer is remitting the § 409A taxes due (the 20% tax and the interest tax) under section 4.C.ii below, including each such employee's taxpayer identification number.

c. For each identified employee, an identification of each stock right exercise resulting in the § 409A taxes, including information that specifically identifies the specific stock right that was exercised, the date of exercise, the exercise price, the fair market value of the underlying shares on the date of exercise, and the number of shares purchased or, in the case of a stock appreciation right, the number of shares used to calculate the payment made.

d. For each identified stock right exercise for each identified employee, the amount of § 409A taxes remitted, including the manner in which such § 409A taxes were calculated.

ii. Remittance of All § 409A Taxes Due

a. Remittance of Taxes

With respect to an exercise of a stock right subject to § 409A by an employee during 2006, the employer must remit to the IRS by June 30, 2007, an amount equal to the full amount of the additional tax liability of the employee under § 409A that results from such exercise. Such additional tax consists of the 20% tax and the interest tax described below. For purposes of determining the § 409A taxes, the amount of income includible under § 409A must be determined in accordance with applicable guidance under § 409A. With respect to such exercise of a stock right, an employer is treated as having remitted an amount equal to the full amount of the additional tax liability if the employer remits substantially all of the additional tax liability based upon a reasonable, good faith interpretation of the applicable guidance. Where it is determined that an employer has failed to submit substantially all of the additional tax liability that results from the exercise of a stock right subject to § 409A during 2006 based upon a reasonable, good faith interpretation of the applicable guidance, neither the employer nor the employee is entitled to any relief under this announcement with respect to the § 409A taxes resulting from the exercise of such stock right.

b. Calculation of the 20% tax

For purposes of this Program, the amount of the 20% tax equals 20% of the excess of the fair market value of the stock on the date of exercise over the sum of the exercise price paid by the employee and any other amount paid by the employee for the stock right. See Notice 2006–100.

c. Calculation of the Interest Tax

For purposes of this Program, the amount of the interest tax equals the amount of interest at the underpayment rate plus 1% on the underpayment of Federal income tax that would have occurred had the portion of the amount deferred under the stock right as of December 31, 2005, that was not subject to a substantial risk of forfeiture (as defined for purposes of § 409A) as of December 31, 2005, been includible in gross income as of December 31, 2005. For this purpose, the amount deferred under the stock right as of December 31, 2005 equals the excess of the fair market value of the underlying stock on December 31, 2005 over the sum of the exercise price and any other amount paid by the employee for the stock right. For purposes of this Program, employers must calculate the underpayment based on the highest marginal Federal income tax rate in effect for 2005 (35%). For purposes of determining the applicable interest, the underpayment is treated as due on April 17, 2006, and the interest runs from that date through the earlier of April 17, 2007 or the date the further submission is sent to the IRS with payment.

d. Additional Amount Due for Taxes Remitted After April 17, 2007

For payments sent to the IRS after April 17, 2007, the amount required to be submitted is increased by an amount equal to the underpayment interest rate applied to the amount that would otherwise be due on April 17, 2007 through the date the further submission (with payment) is sent to the IRS.

iii. Section 409A Tax Payments Constitute Compensation to the Employee

The payment of the § 409A taxes due as part of this Program constitutes additional compensation income to the employee for the employee's taxable year in which such payment is made. Accordingly, the employer must represent under penalties of perjury that the employer is treating such payment as additional compensation to the employee for the taxable year of such employee in which such payment is made, in accordance with this section iii. With respect to any employee for whom a payment of § 409A taxes has been made as part of the further submission, no relief shall be provided under this announcement with respect to the exercise of a stock right by such employee during 2006 if it is determined that the employer has failed to treat such payments as additional compensation for the taxable year of such employee in which such payment is made, in accordance with this section iii.

Payments made on behalf of an employee or former employee to cover § 409A taxes are wages for Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA), and Federal income tax withholding purposes for the employee's taxable year in which the payment is made. Such wages, as well as any additional wages resulting from the employer's payment of the employee's share of FICA tax and income tax without withholding such amounts from the employee, must be reported on Form 941, *Employer's QUARTERLY Federal Tax Return*, and in box 1, 3 and 5 of the employee's Form W–2, *Wage and Tax Statement*, for the year in which the payment is made. See Rev. Rul. 58–113, 1958–1 C.B. 362, and Rev. Proc. 81–48, 1981–2 C.B. 623, for methods of comput-

ing gross wages when paying FICA and Federal income tax withholding on behalf of an employee.

iv. Further Representations by the Employer

The further submission must include the following representations by the employer, signed under penalties of perjury:

a. In accordance with section 4.B.i of this announcement, the employer provided the notices of the employer's intent to participate in the Program to all employees the employer reasonably anticipated would be affected by the employer's participation in the program by no later than 15 days after the employer submitted its notice of intent to participate in the Program to the IRS.

b. With respect to any employee for which a payment of § 409A taxes has been made as part of the further submission, the employer has made reasonable, good faith efforts to identify all exercises of a stock right by such employee during 2006 that resulted in the inclusion of income under § 409A, applying a reasonable, good faith interpretation of the applicable guidance under § 409A, has listed all such identified exercises of a stock right in its further submission, and has accurately calculated and paid the § 409A taxes resulting from such identified exercises of a stock right in accordance with this announcement.

c. The employer will, upon a written request from an affected employee, disclose to the employee any portion of such information that is relevant to the employee's 2006 Federal income tax return, including information the employee reasonably needs to respond to an information request from the IRS, an examination, or tax litigation involving issues related to the exercise of a stock right and the application of § 409A.

D. Notice to Affected Employees of the Employer's Further Submission

An employer must provide a notice to all employees to whom a notice was provided pursuant to section 4.B.i, and any additional employees that are listed in the employer's further submission to the IRS, by no later than July 15, 2007, certifying the following:

(i) the employer has made a further submission under the Program, that is specifically referenced as the program provided under Announcement 2007–18, Compliance Resolution Program for Employees Other than Corporate Insiders for Additional 2006 Taxes Arising Under § 409A due to the Exercise of Stock Rights, that to the best of the employer's information, knowledge and belief, satisfies the requirements of this announcement, and that such further submission (a) includes the employee and makes payment of such employee's § 409A taxes addressed by this announcement or (b) does not include the employee because the employer has concluded that the employee does not owe any § 409A taxes addressed by this announcement, or

(ii) the employer has failed to make a further submission under the Program, that is specifically referenced as the program provided under Announcement 2007–18, Compliance Resolution Program for Employees Other than Corporate Insiders for Additional 2006 Taxes Arising Under § 409A due to the Exercise of Stock Rights, and the employee is therefore liable for any applicable § 409A taxes.

The notice to affected employees may provide additional information that is not inconsistent with the required information. The notice must be provided directly to the individual employee, but may be provided electronically.

Section 5. Scope of Relief

A. Employer's Information Reporting Requirements

If an employer complies fully with the provisions of section 4 with respect to an exercise of a stock right by an employee, the employer will not be required to report the § 409A inclusion amount with respect to such stock right exercise in box 12 of Form W–2 using code Z. If an employer complies fully with the provisions of section 4 with respect to an exercise of a stock right by an employee, but has already reported the § 409A inclusion amount with respect to such exercise of a stock right by an employee in box 12 of Form W–2 using Code Z, the employer may provide a Form W–2c that does not report the § 409A inclusion amount in box 12 of Form W–2c using Code Z, and such employer will not be subject to any penalties under § 6721 or § 6722 of the Code. Nothing in this Program relieves the employer of any information reporting requirements with respect to an employee or an exercise of a stock right that was not identified in the employer's further submission. Nothing in this announcement or Program affects the employer's obligation to report the amount that would be required, without regard to § 409A, to be included in income and wages due to the exercise of a stock right, and to withhold and pay the applicable employment taxes, or the employee's obligations to include such amounts in income and pay Federal taxes on them (other than § 409A taxes).

B. Employee's § 409A Taxes

If an employer complies fully with the provisions of section 4 of this announcement with respect to amounts includible in income under § 409A due to the exercise of an applicable stock right by an employee during 2006, the employee will not be required to pay the § 409A taxes on the applicable Federal income tax return for the 2006 tax year with respect to such amounts includible in income under § 409A. Nothing in this Program relieves the employee of any § 409A taxes with respect to an exercise of a stock right that was not identified in the employer's further submission, or relieves the employee or employer of any other tax, including Federal income tax and employment taxes that would otherwise arise from the exercise of the stock right. In addition, nothing in this Program addresses or relieves the employee of any § 409A taxes due to participation in a nonqualified deferred compensation plan, other than the exercise of an applicable stock right in 2006.

An employee who received a notice of application under section 4.B.i of this announcement, and who files a return before finding out that, due to a failure by the employer to comply with the requirements for relief set forth in this announcement, the employee is not relieved of the duty to report and pay § 409A taxes, will be treated as having had reasonable cause and as having acted in good faith with respect to the portion of any underpayment that

is due to the employee's failure to timely pay § 409A taxes arising from the exercise of an applicable stock right in 2006, and will not be subject to penalties for the 2006 tax year under § 6654 for any estimated tax underpayment attributable to such failure. An employee who received a notice of application under section 4.B.i of this announcement, requested an extension of time to file a return, and files a timely income tax return on extension after learning that he or she is not relieved of the duty to report and pay § 409A taxes due to a failure by the employer to comply with the requirements for relief set forth in this announcement, will not be subject to penalties under § 6651(a)(2) or § 6654 for the failure to timely pay § 409A taxes arising from the exercise of an applicable stock right in 2006, provided such § 409A taxes are paid with the filed return.

C. An Employer's Failure to Comply with Representations or Other Actions Required under the Program

Information and representations required under this Program are material, and an employer who knowingly makes a false statement or representation will be deemed to have failed to make a further submission under the Program so that no relief under this Program is available to the employer or any employee. Except as provided in paragraph 5.B with respect to certain penalties, no relief is provided under this Program with respect to an employer or to an employee if the employer fails to comply with the requirements of this announcement, provided that the Commissioner may, in his sole discretion, determine that the employer has substantially complied with the requirements of this announcement with respect to some or all of the employees identified by the employer and that, accordingly, such employer and some or all of such employees are entitled to the relief provided under this announcement.

D. An Employer's or Employee's State and Local Information Reporting, Filing and Tax Requirements

Nothing in this Program relieves the employer or employee of any requirements regarding information reporting, filing of tax returns, or the payment of any taxes, to the extent such requirements relate to any state or local tax. This includes any state or local tax information reporting requirement which relates to the Form W–2.

Section 6. Procedures for Submission of Notices and Further Submissions to the IRS

A. Submissions to the IRS

A notice of intent to participate in the Program in accordance with section 4.A of this announcement, a second notice to the IRS in accordance with section 4.B.ii of this announcement, or a further submission in accordance with section 4.C of this announcement, shall be submitted to the following address:

Internal Revenue Service
Attn: Announcement 2007–18
2001 Butterfield Road
LMSB Team 1160
Downers Grove, IL 60515

B. Requests for Further Information and Withdrawals of Applications and Further Submissions

The IRS reserves the right to request further information from an employer at any time following the employer's submission of a notice of intent to participate in the Program. In addition, nothing in this announcement or Program limits or otherwise affects the IRS's right to request further information, to examine a taxpayer's federal tax return, and except as otherwise explicitly provided in this announcement and Program, to assess any unpaid taxes, penalties or interest.

The employer retains the right to withdraw a notice of intent to participate or a further submission at any time on or before June 30, 2007, provided that notices are provided under section 4.D of this announcement that reflect the withdrawal. The employer also retains the right to modify a further submission at any time on or before June 30, 2007, provided that a modification after April 17, 2007 involving the payment of additional § 409A taxes is subject to the requirement of an additional amount due for further submissions after April 17, 2007 with respect to the additional § 409A taxes identified in the modification, and provided that notices are provided under section 4.D of this announcement that reflect the modification. Where an employer withdraws a submission on or before June 30, 2007, the employer is entitled to a return of the funds submitted to the IRS, without interest. Where an employer modifies a further submission in a manner that reduces the § 409A taxes covered by the further submission, the employer may obtain a return of amounts previously submitted to the IRS consistent with such modification, without interest, provided such modification is submitted on or before June 30, 2007. After June 30, 2007, an employer may obtain a return of any amount paid to the IRS with respect to an employee pursuant to the announcement if the employer demonstrates that the employee for whom the § 409A taxes were paid has paid the § 409A taxes in full.

For information about this announcement, call (630) 493–5167 (not a toll-free number).

Flat Rate Supplemental Wage Withholding; Correction

Announcement 2007–21

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to final regulations (T.D. 9276, 2006–37 I.R.B. 423) that were published in the **Federal Register** on Tuesday, July 25, 2006 (71 FR 42049), amending the regulations that provide for determining the amount of income tax withholding on supplemental wages. These regulations apply to all employers and others making supplemental wage payments to employees.

DATES: The correction will be effective January 1, 2007.

FOR FURTHER INFORMATION CONTACT: A. G. Kelley, (202) 622–6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections are under sections 3401 and 3402 of the Internal Revenue Code.

Need for Corrections

As published, final regulations (T.D. 9276) contain errors that may prove to be misleading and are in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR part 31 is corrected by making the following correcting amendments:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 continues to read, in part, as follows:

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

Par. 2. Section 31.3402(g)–1(a)(8) is amended by revising the fifth sentence of *Example 1* paragraph (iii), the fifth sentence of *Example 3* paragraph (i), the last sentence of *Example 3* paragraph (iv) and the third sentence of *Example 3* paragraph (vi). The revisions read as follows:

§ 31.3402(g)–1 Supplemental wage payments.

(a) * * *

(8) * * *

Example 1. * * *

(iii) * * * If Y elected to withhold income tax using paragraph (a)(7) of this section, Y would withhold on the $400,000 component at 25 percent (pursuant to paragraph (a)(7)(iii)(F) of this section), which would result in $100,000 tax withheld. * * *

* * * * *

Example 3. (i) * * * Unrelated company U pays D sick pay as an agent of the employer R and such sick pay is supplemental wages pursuant to § 31.3401(a)–1(b)(8)(i)(*b*)(2). * * *

* * * * *

(iv) * * * If R elects to use optional flat rate withholding provided under paragraph (a)(7)(iii)(f) of this section, withholding would be calculated at 25 percent of the $1,000,000 portion of the payment and would be $250,000.

* * * * *

(vi) * * * If U elects to withhold income tax at the flat rate provided under paragraph (a)(7)(iii)(F) of this section, withholding on the $50,000 of sick pay would be calculated at 25 percent of the $50,000 payment and would be $12,500. * * *

* * * * *

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on December 26, 2006, 8:45 a.m., and published in the issue of the Federal Register for December 27, 2006, 71 F.R. 77612)

Income Attributable to Domestic Production Activities; Correction

Announcement 2007–22

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to final regulations (T.D. 9263, 2006–25 I.R.B. 1063) which were published in the **Federal Register** on Thursday, June 1, 2006, (71 FR 31268), relating to the deduction for income attributable to domestic production activities under section 199 of the Internal Revenue Code (Code).

DATES: This correction is effective June 1, 2006.

FOR FURTHER INFORMATION CONTACT: Paul Handleman or Lauren Ross Taylor at (202) 622–3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations (T.D. 9263) that are subject to this correction are under section 199 of the Internal Revenue Code.

Need for Correction

On June 1, 2006, final regulations (T.D. 9263) were published in the **Federal Register** at 71 FR 31268. These regulations contain errors that may prove to be misleading and are in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR Part 1 is corrected by making the following correcting amendments:

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 * * *

§ 1.199–1 [Corrected]

Par. 2. Section 1.199–1(b)(1) is amended by revising the first sentence of the paragraph to read as follows:

§ 1.199–1 Income attributable to domestic production activities.

* * * * *

(b) * * *

(1) *In general.* For purposes of paragraph (a) of this section, the definition of taxable income under section 63 applies, except that taxable income (or alternative minimum taxable income, if applicable) is determined without regard to section 199 and without regard to any amount excluded from gross income pursuant to section 114 or pursuant to section 101(d) of the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418) (Act). * * *

* * * * *

§ 1.199–2 [Corrected]

Par. 3. Section 1.199–2 is amended by revising the first sentence of paragraph (a)(3)(ii) and the last sentence of paragraph (e)(3) to read as follows:

§ 1.199–2 Wage limitation.

(a) * * *

(3) * * *

(ii) *Corrected return filed to correct a return that was filed within 60 days of the due date.* If a corrected information return (Return B) is filed with SSA on or before the 60th day after the due date (including extensions) of Return B to correct an information return (Return A) that was filed with SSA on or before the 60th day after the due date (including extensions) of the

information return (Return A) and paragraph (a)(3)(iii) of this section does not apply, then the wage information on Return B must be included in determining W–2 wages. * * *

* * * * *

(e) * * *

(3) * * * For example, see Rev. Proc. 2006–22, 2006–23 I.R.B. 1033. (See § 601.601(d)(2) of this chapter).

§ 1.199–3 [Corrected]

Par. 4. Section 1.199–3(l)(4)(iv)(A) is amended by revising the first sentence of the paragraph to read as follows:

§ 1.199–3 Domestic production gross receipts.

* * * * *

(l) * * *

(4) * * *

(iv) * * *

(A) * * * *DPGR*. Notwithstanding paragraphs (l)(4)(i), (ii), and (iii) of this section, if less than 5 percent of a taxpayer's gross receipts derived from a sale, exchange, or other disposition of utilities are attributable to the transmission or distribution of the utilities and the storage of potable water after completion of treatment of the potable water, then the gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of the utilities that are attributable to the transmission and distribution of the utilities and the storage of potable water after completion of treatment of the potable water may be treated as being DPGR (assuming all other requirements of this section are met). * * *

* * * * *

§ 1.199–4 [Corrected]

Par. 5. Section 1.199–4(d)(6) is amended by revising paragraph (i) of *Examples 1* and *2* to read as follows:

§ 1.199–4 Costs allocable to domestic production gross receipts.

* * * * *

(d) * * *

(6) * * *

Example 1. * * *

(i) Facts. X, a United States corporation that is not a member of an expanded affiliated group (EAG) (as defined in § 1.199–7), engages in activities that generate both DPGR and non-DPGR. 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 2010, the adjusted basis of X's assets is $5,000, $4,000 of which generates gross income attributable to DPGR and $1,000 of which generates gross income attributable to non-DPGR. For 2010, X's taxable income is $1,380 based on the following Federal income tax items: * * *

* * * * *

Example 2. * * *

(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 in 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. For 2010, the adjusted basis of Y's assets is $45,000, $21,000 of which generates gross income attributable to DPGR and $24,000 of which generates 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 2010, Y's taxable income is $1,910 based on the following Federal income tax items: * * *

* * * * *

§ 1.199–6 [Corrected]

Par. 6. Section 1.199–6 is amended as follows:

1. The last sentence of paragraph (g) is revised.

2. The last sentence of *Example 2* (i) in paragraph (m) is revised.

The revisions read as follows:

§ 1.199–6 Agricultural and horticultural cooperatives.

* * * * *

(g) *Written notice to patrons.* * * * The cooperative must report the amount of the patron's section 199 deduction on Form 1099–PATR, "*Taxable Distributions Received From Cooperatives*," issued to the patron.

* * * * *

(m) * * *

Example 2. (i) * * * Cooperative X must report the amount of Patron A's section 199 deduction on Form 1099–PATR, "*Taxable Distributions Received From Cooperatives*," issued to Patron A for the calendar year 2008.

* * * * *

§ 1.199–7 [Corrected]

Par. 7. Section 1.199–7 is amended as follows:

1. By revising paragraph (a)(4), *Example 3*.

2. By revising paragraph (e), *Example 10* (i).

The revisions read as follows:

§ 1.199–7 Expanded affiliated groups.

(a) * * *

(4) * * *

Example 3. The facts are the same as in *Example 2* except that rather than reselling the machinery, B rents the machinery to unrelated persons and B takes the gross receipts attributable to the rental of the machinery into account under its methods of accounting in 2007, 2008, and 2009. In addition, as of the close of business on December 31, 2008, A and B cease to be members of the same EAG. With respect to the machinery acquired from C and the unrelated persons, B's gross receipts attributable to the rental of the machinery in 2007, 2008, and 2009 are non-DPGR because no member of the EAG MPGE the machinery and because C does not qualify as an EAG partnership. With respect to machinery acquired from A, B's gross receipts in 2007 and 2008 attributable to the rental of the machinery are DPGR because at the time B takes into account the gross receipts derived from the rental of the machinery under its methods of accounting, B is a member of the same EAG as A and B is treated as conducting A's previous MPGE activities. However, with respect to the rental receipts in 2009, because A and B are not members of the same EAG in 2009, B's rental receipts are non-DPGR.

* * * * *

(e) * * *

Example 10. (i) *Facts*. Corporation P owns all of the stock of Corporations S and T, and P, S, and T file a consolidated Federal income tax return on a calendar year basis. In 2007, P MPGE QPP in the

United States at a cost of $1,000. On November 30, 2007, P sells the QPP to S for $2,500. On February 28, 2008, P disposes of 60% of the stock of S. On June 30, 2008, S sells the QPP to an unrelated person for $3,000.

* * * * *

§ 1.199–8 [Corrected]

Par. 8. Section 1.199–8 is amended by revising paragraph (h) to read as follows:

§ 1.199–8 Other rules.

* * * * *

(h) *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 taxpayer that otherwise would be taken into account in computing the taxpayer's section 199 deduction are taken into account only if and to the extent the deductions are not disallowed by section 465 or 469, or any other provision of the Code. If only a portion of the taxpayer's share of the losses or deductions is allowed for a taxable year, the proportionate share of those allowable losses or deductions that are allocated to the taxpayer's qualified production activities, determined in a manner consistent with sections 465 and 469, and any other applicable provision of the Code, is taken into account in computing QPAI for purposes of the section 199 deduction for that taxable year. To the extent that any of the disallowed losses or deductions are allowed in a later year, the taxpayer takes into account a proportionate share of those losses or deductions in computing its QPAI for that later taxable year. Losses or deductions of the taxpayer that are disallowed for taxable years beginning on or before December 31, 2004, are not taken into account in a later year for purposes of computing the taxpayer's QPAI and the wage limitation of section 199(d)(1)(A)(iii) under § 1.199–9 for that taxable year, regardless of whether the losses or deductions are allowed for other purposes. For taxpayers that are partners in partnerships, see § 1.199–9(b)(2). For taxpayers that are shareholders in S corporations, see § 1.199–9(c)(2).

* * * * *

§ 1.199–9 [Corrected]

Par. 9. Section 1.199–9(b)(6) is amended as follows:

1. By revising *Example 1* paragraphs (i), (iii)(B)(*1*), and the seventh sentence of (iii)(B)(*2*).

2. By revising *Example 2* paragraphs (i), and (iii)(B)(*1*), and the table following (iii)(B)(*3*).

3. Paragraph (h) is revised.

The revisions read as follows:

§ 1.199–9 Application of section 199 to pass-thru entities for taxable years beginning on or before May 17, 2006, the enactment date of the Tax Increase Prevention and Reconciliation Act of 2005.

* * * * *

(b) * * *

(6) * * *

Example 1. * * * (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 50% each. Both X and Y are engaged in a trade or business. PRS 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 PRS's gross income, apportionment of CGS between DPGR and non-DPGR based on gross receipts is appropriate. For 2006, 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 2006, PRS has the following Federal income items: * * *

* * * * *

(iii) * * *

(B) * * * (*1*) For 2006, in addition to the activities of PRS, Y engages in production activities that generate both DPGR and non-DPGR. Y is able to specifically identify CGS allocable to DPGR and to non-DPGR. For 2006, 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: * * *

(*2*) * * * Y has $1,290 of gross income attributable 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)). * * *

* * * * *

Example 2. * * * (i) *Partnership items of income, gain, loss, deduction or credit*. 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 activities 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 50% each. 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 specifically identify CGS allocable to DPGR and to non-DPGR and, therefore, apportions CGS to DPGR and non-DPGR based on its gross receipts. 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. PRS incurs section 162 selling expenses (that include W–2 wage expense) that are not includible in CGS and are definitely related to all of PRS's gross income. For 2006, PRS has the following Federal income tax items: * * *

* * * * *

(iii) * * *

(B) * * * (*1*) For 2006, 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 specifically identify CGS allocable to DPGR and to non-DPGR. In this case, because CGS is definitely related under the facts and circumstances to all of Y's non-PRS gross receipts, apportionment of CGS between DPGR and non-DPGR based on Y's non-PRS gross receipts is appropriate. For 2006, Y has the following non-PRS Federal income tax items: * * *

* * * * *

(*3*) * * *

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 (including W–2 wages) ($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 ($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 and $4,500 from non-PRS activities))	(188)
Y's QPAI	1,282

* * * * *

(h) * * * Except as provided in paragraph (i) of this section regarding qualifying in-kind partnerships and paragraph (j) of this section 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*. This rule applies to all partnerships, including partnerships that have elected out of subchapter K under section 761(a). Accordingly, if a partnership MPGE 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 MPGE or other production, 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 MPGE 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 MPGE or other production, 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.

* * * * *

Guy R. Traynor,
Federal Register Liaison,
Legal Processing Division,
Associate Chief Counsel
(Procedure & Administration).

(Filed by the Office of the Federal Register on December 29, 2006, 8:45 a.m., and published in the issue of the Federal Register for January 3, 2007, 72 F.R. 5)

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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Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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