Internal Revenue bulletin

Bulletin No. 2003-34
August 25, 2003

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2003–96, page 386.

Lease stripping transaction. This ruling discusses whether section 482 of the Code may apply to allow allocations of the income and deductions arising from a lease stripping transaction entered into by parties that were unrelated at the time the income is stripped from the lease, solely on the basis that the parties were acting in concert or with a common goal or purpose, to arbitrarily shift income or deductions among themselves.

Rev. Rul. 2003–97, page 380.

Deductibility of interest. This ruling provides guidance on whether interest accruing on a note is deductible under section 163(a) of the Code, and whether the deduction is disallowed under section 163(1), when a corporation issues units, each consisting of instruments in the form of a note and a forward contract to purchase a quantity of the corporation's common stock. The holding of this ruling is modified for units issued on or before August 22, 2003. This ruling also requests comments concerning possible regulations under section 163(1).

Rev. Rul. 2003–98, page 378.

Deduction rules; compensatory stock options. This ruling addresses the application of the deduction rules under section 83(h) of the Code with regard to the exercise or disposition of compensatory stock options following certain corporate transactions.

Rev. Rul. 2003–99, page 388.

Obsolete revenue rulings. This ruling publishes a list of previously published rulings that have been identified as no longer determinative with respect to future transactions.

Rev. Rul. 2003–100, page 385.

LIFO; price indexes; department stores. The June 2003 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, June 30, 2003.

REG–132483–03, page 410.

Proposed regulations under section 141 of the Code revise the definition of nonqualified bonds contained in regulations section 1.141–12 by reducing the amount of outstanding bonds that are nonqualified bonds. Second, the proposed regulations simplify the rules for determining which bonds will be treated as the nonqualified bonds for purposes of the remedial action rules under sections 1.141–12 and 1.142–2. Finally, they clarify the remedial action rules applicable to bonds issued prior to May 16, 1997 (the effective date of the current private activity bond regulations). A public hearing is scheduled for November 4, 2003. Rev. Proc. 93–17 obsolete for actions that occur on or after May 16, 1997.

REG–141669–02, page 408.

Proposed regulations under section 6724 of the Code provide rules designed to determine whether the correction of a failure to file a correct information return is considered prompt for purposes of waiving information reporting penalties. A public hearing is scheduled for October 21, 2003.

Notice 2003–55, page 395.

This notice concerns the federal tax treatment of lease strips. Notice 95–53 modified and superseded.

(Continued on the next page)

Announcements of Disbarments and Suspensions begin on page 414.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Notice 2003–56, page 396.

Equity investment prior to allocation. The Treasury Department and the Service announce that they will amend section 1.45D–1T(c)(3)(ii) of the temporary regulations to provide an exception permitting certain equity investments made on or after the date the Community Development Financial Institutions Fund publishes a Notice of Allocation Availability in the Federal Register, and before the receipt of a new markets tax credit allocation under section 45D(f)(2), to be designated as qualified equity investments under section 45D(b)(1)(C) of the Code.

Rev. Proc. 2003–68, page 398.

This procedure restates and modifies Rev. Procs. 2002–13 and 2002–45. The modifications include permitting the use of expected term in connection with the safe harbor valuation method and the ability to recalculate the option value under certain circumstances. Rev. Procs. 2002–13 and 2002–45 revoked.

Rev. Proc. 2003–70, page 406.

This procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign insurance companies to compute their minimum effectively connected net investment income for taxable years beginning after December 31, 2001.

EXCISE TAX

Rev. Proc. 2003–68, page 398.

This procedure restates and modifies Rev. Procs. 2002–13 and 2002–45. The modifications include permitting the use of expected term in connection with the safe harbor valuation method and the ability to recalculate the option value under certain circumstances. Rev. Procs. 2002–13 and 2002–45 revoked.

TAX CONVENTIONS

Notice 2003–57, page 397.

This notice provides circumstances under which no Form 3520 or Form 3520–A with respect to certain Canadian retirement plans is required with respect to the 2002 taxable year, and guidance concerning compliance with Forms 3520 and 3520–A when required.

ADMINISTRATIVE

REG–141669–02, page 408.

Proposed regulations under section 6724 of the Code provide rules designed to determine whether the correction of a failure to file a correct information return is considered prompt for purposes of waiving information reporting penalties. A public hearing is scheduled for October 21, 2003.

Rev. Proc. 2003–67, page 397.

Low-income housing tax credit. This procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under section 42(h)(3)(D) of the Code for calendar year 2003.

Rev. Proc. 2003–69, page 403.

This procedure provides the requirements for completing and submitting Form 8655, *Reporting Agent Authorization for Magnetic Tape/Electronic Filers*. Rev. Proc. 96–17 modified and superseded.

The IRS Mission

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

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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

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

Section 83.—Property Transferred in Connection With Performance of Services

26 CFR 1.83–6: Deduction by employer.

Deduction rules; compensatory stock options. This ruling addresses the application of the deduction rules under section 83(h) of the Code with regard to the exercise or disposition of compensatory stock options following certain corporate transactions.

Rev. Rul. 2003–98

ISSUE

Under § 83 of the Internal Revenue Code, in the situations described below, which corporation is entitled to deduct the compensation income includible in Employee's gross income as a result of Employee's exercise or disposition of a nonstatutory option?

FACTS

Situation 1. On January 1, 2003, Employee begins employment with Company M and is granted a nonstatutory option to purchase a number of shares of M common stock ("the M Option"). The M Option has no readily ascertainable fair market value when it is granted and is not exercisable until January 1, 2006.

On November 15, 2006, Company N acquires all of the outstanding shares of M for cash. N does not make an election under § 338(g) to treat its acquisition of M as a deemed acquisition of the assets of M, thus treating it instead as an acquisition of the stock of M. Thereafter, M conducts its business as a wholly owned subsidiary of N. M and N are accrual basis taxpayers, and each has a taxable year ending on September 30.

On the acquisition date, either pursuant to the terms of the M Option or in response to an offer from N, Employee surrenders the M Option to N, and, in exchange, N grants an exercisable nonstatutory option to acquire a number of shares of N common stock ("the N Option") to Employee. The N Option has no readily ascertainable fair market value. On January 15, 2007, while still employed by M, Employee exercises the N Option and receives substantially vested N shares from N.

Situation 2. The facts are the same as in Situation 1, except that, under the terms of the N Option, N has the ability to cancel the option at any time in exchange for a payment in cash or in value-equivalent substantially vested N shares. On January 15, 2007, N cancels the N Option in exchange for a payment (in cash or shares) to Employee.

Situation 3. The facts are the same as in Situation 1, except that the M Option is not exchanged for the N Option on the acquisition date. Instead, the M Option remains outstanding after the acquisition date until January 15, 2007, when either pursuant to the terms of the M Option or with Employee's agreement, N cancels the M Option and pays the excess of the fair market value of the stock purchasable under the option over the option's exercise price in cash or in value-equivalent substantially vested N shares to Employee.

Situation 4. The facts are the same as in Situation 1, except that on November 15, 2006, M and N merge under state law, with N as the surviving corporation. The merger qualifies as a complete liquidation within the meaning of § 332.

LAW AND ANALYSIS

Under § 83(a), when property is transferred to any person in connection with the performance of services, the service provider must include in gross income (as compensation income) the excess of the fair market value of the property, determined at the first time that the transferee's rights in the property are either transferrable or not subject to a substantial risk of forfeiture ("substantially vested"), over the amount (if any) paid for the property.

Section 83(e)(3) provides that § 83 does not apply to the transfer of an option without a readily ascertainable fair market value on the date of grant. Under § 1.83–7 of the Income Tax Regulations, § 83 applies at the time such an option is exercised, or otherwise disposed of. If the option is exercised, § 83(a) applies to the transfer of property pursuant to the exercise. Under § 1.83–7(a), if the option is sold or otherwise disposed of in an arm's length transaction, §§ 83(a) and 83(b) apply to the transfer of money or other property received in the same manner as §§ 83(a) and 83(b) would have applied to the transfer of property pursuant to an exercise of the option. Under § 1.83–7T, the preceding sentence does not apply to a sale or other disposition of the option to a person related to the service provider that occurs on or after July 2, 2003. For this purpose, a person is not related to the service provider if the person is the service recipient with respect to the option or the grantor of the option.

Thus, in each of the above Situations, because the M Option has no readily ascertainable fair market value when granted, § 83 does not apply to the option at that time. Rather, § 83(a) applies to the consideration received by Employee upon the disposition of the M Option in the case of Situation 3 and the exercise or disposition of the N Option in the case of Situations 1, 2, and 4.

Under § 83(h) and § 1.83–6(a)(1), the service recipient is allowed a compensation expense deduction, under § 162, for the amount included in the service provider's gross income under § 83(a). Under the general timing rule of § 83(h), the deduction is allowed for the service recipient's taxable year in which or with which ends the service provider's taxable year in which the amount is included in gross income. Section 1.83–6(a)(3) provides an exception to that rule: in cases where the property transferred is substantially vested upon transfer, the deduction is allowed to the service recipient under its method of accounting.

Section 1.83–6(d)(1) generally provides that, if a shareholder of a corporation transfers property to an employee (or independent contractor) of the corporation in consideration for services performed by the employee for the corporation, the transaction is considered a contribution of the property by the shareholder to the corporation and, immediately thereafter, a transfer of the property by the corporation to the employee. The transfer of property to the employee is considered to be in consideration for services performed by the employee for the corporation if either the property is substantially nonvested at the time of transfer or if an amount

is includible in the gross income of the employee at the time of transfer under the rules of § 83. See § 1.1032–3 for special rules that may apply to a corporation's transfer of its own stock to any person in consideration of services performed for another corporation or partnership.

Section 332(a) provides that no gain or loss is recognized on the receipt by a corporation (the acquiring corporation) of property distributed in complete liquidation of another corporation (the liquidating corporation).

Section 381(a)(1) provides, in part, that, where the assets of a liquidating corporation are distributed to the acquiring corporation in a transaction to which § 332 applies, the acquiring corporation succeeds to and takes into account, as of the close of the day of distribution, the items described in § 381(c) of the liquidating corporation, subject to the conditions and limitations described in §§ 381(b) and (c).

In a transaction to which § 381(a) applies, § 381(c)(16) permits the acquiring corporation to deduct an assumed obligation of the liquidating corporation, as if it were the liquidating corporation, when that obligation is paid or accrued (1) if such obligation gives rise to a liability after the date of distribution and (2) if the liquidating corporation would have been entitled to deduct that liability in computing taxable income were that liability paid or accrued by the liquidating corporation. See § 1.381(c)(16)–1(a)(1).

Section 1.381(c)(16)–1(a)(4) provides that an obligation of a liquidating corporation gives rise to a liability when the liability would be accruable by a taxpayer using the accrual method of accounting, notwithstanding the fact that the liquidating corporation is not using the accrual method of accounting. See § 1.461–1(a)(2).

Section 1.461–1(a)(2)(i) provides that, under an accrual method of accounting, a liability is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which: (1) all the events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy, and (3) economic performance has occurred with respect the liability. A liability with respect to an option generally is incurred and taken into account in the year in which the employee exercises the option because that is when the liability becomes fixed and determinable with reasonable accuracy. Therefore, for purposes of § 381(c)(16), an option generally gives rise to a liability when it is exercised.

In Situations 1, 2, and 4, the substitution of the M Option for the N Option does not cause Employee to recognize compensation income under § 83(a). In Situations 1 and 4, Employee recognizes compensation income under § 83(a) in 2007, which is Employee's taxable year in which the N Option is exercised. In Situations 2 and 3, Employee also recognizes compensation income under § 83(a) in 2007, which is Employee's taxable year in which N cancels the substituted N Option or cancels the M Option.

Applying § 83(h) and § 1.83–6 to Situations 1, 2, and 3, because M is the service recipient with respect to either the M Option or the N Option, M, and only M, is permitted to deduct the compensation includible in Employee's gross income as a result of the disposition of the M Option or the exercise or disposition of the N Option. Although N actually pays the cash or transfers its stock directly to Employee, such payment (or transfer) is treated as a cash capital contribution by N to M (and M is treated as purchasing the stock from N in the case of a stock transfer to the Employee) and as a payment of cash (or transfer of stock) by M to the Employee. See §§ 1.83–6(d)(1), 1.1032–3(b)(1), and 1.1032–3(e), Example 8. Because the consideration received by Employee upon the disposition of the M Option or the exercise or disposition of the N Option is either cash or substantially vested N shares, the § 1.83–6(a)(3) exception to the general timing rule for deductions in § 83(h) applies. Accordingly, to the extent that the compensation is otherwise deductible, M, and only M, is entitled to deduct the compensation, using its method of accounting, for its taxable year ending September 30, 2007.

In Situation 4, because the merger of M into N qualifies as a liquidation within the meaning of § 332, under § 381, N succeeds to and takes into account those tax items of M described in § 381(c). Because (1) N assumed the obligation of M pursuant to the N Option, (2) after the date of the merger, the N Option gives rise to a liability under § 1.461–1(a)(2) by reason of its exercise, and (3) the liability, if paid or accrued by M would have been deductible in computing M's taxable income, N is entitled to deduct that item when paid or accrued as if it were M. See § 381(c)(16).

Under § 83(h) and § 1.83–6(a), N is entitled to a deduction for the amount of compensation income (if any) included in the gross income of Employee under § 83(a). The amount of compensation income (if any) included in the gross income of Employee is determined on January 15, 2007, when the option is exercised and the stock transferred to Employee. Because the stock is substantially vested when transferred to Employee, to the extent that the compensation recognized by Employee in Situation 4 is otherwise deductible, the deduction is allowed in accordance with N's method of accounting. Thus, the deduction is allowed for N's taxable year ending September 30, 2007.

HOLDINGS

In Situations 1, 2, and 3, the compensation attributable to Employee's disposition of the M Option or exercise or disposition of the N Option, if it is otherwise deductible, is deductible by M. In Situation 4, the compensation, if it is otherwise deductible, is deductible by N, as if it were M.

DRAFTING INFORMATION

The principal author of this revenue ruling is Norm Paul of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Norm Paul or Robert Misner at (202) 622–6030 (not a toll-free number).

Section 162.—Trade or Business Expenses

If one participant in a transaction claims to realize rental or other income from property and another participant claims the deductions related to that income, will the separation of income from related deductions be disallowed and will the transaction be a lease strip that is a listed transaction subject to the requirements of section 6111. See Notice 2003-55, page 395.

Section 163.—Interest

26 CFR 1.163–1: Interest deduction in general.
(Also § 7805(b)(8); 301.7805–1.)

Deductibility of interest. This ruling provides guidance on whether interest accruing on a note is deductible under section 163(a) of the Code, and whether the deduction is disallowed under section 163(1), when a corporation issues units, each consisting of instruments in the form of a note and a forward contract to purchase a quantity of the corporation's common stock. The holding of this ruling is modified for units issued on or before August 22, 2003. This ruling also requests comments concerning possible regulations under section 163(1).

Rev. Rul. 2003–97

ISSUE

Under the facts presented below, if a corporation issues units, each consisting of instruments in the form of a 5-year note and a 3-year forward contract to purchase a quantity of the corporation's common stock, is the "interest" accruing on the note deductible under § 163(a) of the Internal Revenue Code and not disallowed under § 163(*l*)?

FACTS

On August 18, 2003 ("Issue Date"), *X*, a corporation, issues units, each consisting of instruments in the form of a 3-year forward contract to purchase a quantity of *X*'s common stock ("Purchase Contract") and a 5-year note issued by *X* ("Note") (together, a "Purchase-Contract/Note unit"). The Purchase Contract requires the holder to purchase, and *X* to sell, on August 18, 2006 ("Settlement Date"), a quantity of *X*'s common stock that is determined by reference to the market price of the stock on the Settlement Date. The Note has a stated maturity date of August 18, 2008 ("Maturity Date").

Under the Purchase Contract, on the Settlement Date the holder must pay an amount ("Settlement Price") that is equal to the stated principal amount of the Note. If the market price of *X*'s common stock on the Settlement Date falls within a specific range of market prices (bounded by a "lower limit" based on the market price on the Issue Date and an "upper limit" equal to approximately 120 percent of the lower limit), the quantity of stock deliverable under the Purchase Contract will have a market value equal to the Settlement Price. If the market price on the Settlement Date is less than the lower limit or greater than the upper limit, the quantity of stock that is deliverable under the Purchase Contract is the quantity that would be deliverable if the market price on that date were equal to the lower limit or the upper limit, respectively.

X allocates the purchase price of a Purchase-Contract/Note unit between the Purchase Contract and the Note according to their respective fair market values, as if the Purchase Contract and the Note were separate instruments. The amount allocated to the Note is equal to the Note's stated principal amount.

The Note contained in a Purchase-Contract/Note unit is pledged to secure the holder's obligation to pay the Settlement Price under the Purchase Contract. As described below, the holder, however, has the legal right to separate the Note from the Purchase-Contract/Note unit in either of two ways (producing a "Separated Note"). The holder is not economically compelled to keep a unit unseparated.

The holder may separate the Note from the Purchase-Contract/Note unit before the Settlement Date without paying the Settlement Price. To do so, the holder must transfer the unit to *X*'s agent ("Purchase Contract Agent") together with a specific zero-coupon Treasury security ("Strip"), and then the holder will receive a "Purchase-Contract/Strip unit" together with the Separated Note (a "conversion"). The Strip contained in the Purchase-Contract/Strip unit replaces the Note as collateral. Once a holder has effected a conversion, the holder may transfer the Note and retain the Purchase-Contract/Strip unit or transfer the Purchase-Contract/Strip unit and retain the Note. The Strips mature shortly before the Settlement Date and pay an amount equal to the Settlement Price. On the Settlement Date, *X* will apply the proceeds from the Strip contained in any Purchase-Contract/Strip unit to satisfy the holder's obligation to pay the Settlement Price under the associated Purchase Contract.

In addition, before the completion of a successful remarketing (described below), the holder of a Purchase-Contract/Note unit or a Purchase-Contract/Strip unit may transfer the unit to the Purchase Contract Agent together with cash in an amount equal to the Settlement Price and receive a quantity of shares of *X*'s common stock together with the Separated Note or the Strip (a "settlement with separate cash").

The Note provides for quarterly payments of amounts denominated as interest, including a payment on the Settlement Date. This interest is payable at a single fixed rate ("Initial Rate"). The Notes are required to be remarketed on specific dates before the Settlement Date, including May 15, 2006, and August 15, 2006 ("Final Remarketing Date"). A successful remarketing of the Notes generally will result in the sale of the Notes to new holders effective on the next quarterly interest payment date (for example, May 18, 2006, and August 18, 2006) and will establish a new interest rate ("Reset Rate"), which will be effective after the remarketing for the remaining term of the Notes.

The Note is not subject to optional redemption by *X* at any time. Neither the written terms of the Note nor any other understanding or agreement requires the Note to be paid in, or converted into, *X*'s stock. Similarly, neither the written terms of the Note nor any other understanding or agreement grants *X* an option to pay the Note in, or convert the Note into, *X*'s stock.

X enters into a contract with an investment bank, *Y*, to serve as remarketing agent. *Y* will attempt to remarket the Notes with a Reset Rate that will permit the Notes to be sold for an amount equal to at least 100 percent of, and up to a target of 100½ percent of, a specific price ("Minimum Required Price"). There is no upper limit on the Reset Rate. For a remarketing on the Final Remarketing Date, the Minimum Required Price is the aggregate stated principal amount of the remarketed Notes. For remarketings before the Final Remarketing Date, the Minimum Required Price is the amount that could be invested in then-available zero-coupon Treasury securities ("Treasury Zeros") that mature shortly before the Settlement Date and pay an amount equal to the sum of the aggregate stated principal amount of the remarketed Notes, plus the aggregate interest at the Initial Rate that would have been payable on the Notes on the Settlement Date if the Notes had not been remarketed.

The remarketings will include all of the Notes contained in Purchase-Contract/Note units on the remarketing dates. In addition, holders of Separated Notes may elect to include those Notes in the remarketings. If a remarketing succeeds, the interest rate on all the Notes will be changed from the Initial Rate to the Reset Rate for the remaining term of the Notes, whether or not they were included in the remarketing.

A remarketing will not occur if a condition precedent to the remarketing (for example, the existence of an effective registration statement for the Notes) is not fulfilled. Moreover, even if all conditions are satisfied and a remarketing does occur, the remarketing will not succeed if *Y* is unable to obtain the Minimum Required Price. (In either case, the remarketing is said to "fail.") On the Issue Date, it is substantially certain that a remarketing of the Notes will succeed.

In the case of a Separated Note, if all of the remarketings fail, then, on the Settlement Date, the holder of the Note will have the right to put the Note to *X* in exchange for cash equal to the Note's stated principal amount plus any accrued but unpaid interest. If such a Note is not put to *X*, the Initial Rate will remain in effect for that Note until the Maturity Date.

In the case of a Note contained in a Purchase-Contract/Note unit, if all of the remarketings fail, *X* will exercise its rights as a secured party to dispose of the Notes in accordance with applicable law and satisfy in full the holder's obligation to purchase *X*'s common stock under the Purchase Contract. As a result, the holder will receive the interest payment due on the Settlement Date and the amount of *X*'s common stock deliverable under the Purchase Contract.

If a remarketing succeeds, the remarketing proceeds (or the proceeds of the Treasury Zeros in the case of a successful remarketing before the Final Remarketing Date) must be used by *X* in the following manner. If a Note was part of a Purchase-Contract/Note unit on the date of the successful remarketing, *X* must apply an amount equal to the stated principal amount of the Note to satisfy the former holder's obligation to pay the Settlement Price under the associated Purchase Contract.

In addition, *X* must pay the former holder cash in an amount equal to the interest (at the Initial Rate) that would have been payable to the holder on the Settlement Date had the Notes not been remarketed. If the successful remarketing occurs before the Final Remarketing Date, this amount will be paid out of the proceeds of the Treasury Zeros. If the successful remarketing occurs on the Final Remarketing Date, the amount will be paid out of *X*'s own funds. *X* will make similar payments to the former holders of any participating Separated Notes.

Y will receive a remarketing fee of one quarter of one percent of the Minimum Required Price. This remarketing fee will be paid first from the excess, if any, of the remarketing proceeds over the Minimum Required Price and then, if necessary, by *X* from its own funds. If any proceeds in excess of the Minimum Required Price are not applied to the remarketing fee (that is, if the proceeds are between 100¼ percent and 100½ percent of the Minimum Required Price), these excess proceeds will be distributed to the former holders of the remarketed Notes (including any participating Separated Notes).

Purchase-Contract/Note units are listed on a national securities exchange. Purchase-Contract/Strip units and Separated Notes are not so listed but are freely assignable without restrictions on their transferability.

The Purchase Contract provides that, in the event of *X*'s bankruptcy, the Purchase Contract will terminate and the associated Note or Strip will be released to the holder. On the Issue Date, *X* reasonably believes, based on advice from counsel, that this provision will be enforceable in bankruptcy and will result in the holder of a Purchase-Contract/Note unit being treated as a creditor in any bankruptcy proceeding.

Based on the terms of the Note and other facts and circumstances, if the Note were issued independently of the Purchase Contract in a transaction that did not link the rights and obligations under the Note with the rights and obligations under the Purchase Contract, then the Note would qualify as debt for federal income tax purposes, interest accruing on the Note would be deductible unless § 163(*l*) applies, and, under § 1.1001–3 of the Income Tax Regulations, the Note in existence before a successful remarketing would continue to exist after the remarketing. That is, the Note would not be treated as having been retired in conjunction with the issuance of a new debt instrument that bears an interest rate equal to the Reset Rate.

LAW AND ANALYSIS

As stated above, the Note would qualify as debt for federal income tax purposes if it were issued independently of the Purchase Contract in a transaction that did not link the rights and obligations under the Note with the rights and obligations under the Purchase Contract. Upon the earlier of a conversion, a settlement with separate cash, or a successful remarketing of the Note, the Note will no longer be linked with the Purchase Contract. At that time, the Note will qualify as debt for federal income tax purposes. Interest accruing on the Note after that time will be deductible under § 163(a).

On the other hand, during the time that the Note is contained in a Purchase-Contract/Note unit, there is an issue of whether the bundle of rights and obligations resulting from the unit should be treated for federal income tax purposes as consisting of a debt instrument and a stock purchase contract. An important initial inquiry bearing on whether the Note may be separately analyzed for federal income tax purposes is whether the Note is separable from the Purchase-Contract/Note unit. Even if the Note is separable, however, various features of the Note and Purchase Contract raise the possibility that, for federal income tax purposes, the Purchase-Contract/Note unit nevertheless is treated as some other combination of instruments. For example, a Purchase-Contract/Note unit could be treated as a prepaid forward contract to purchase a variable quantity of *X*'s stock together with options (1) to acquire a Note by tendering a Strip to be combined into a Purchase-Contract/Strip unit or (2) to purchase a Note for cash by settling the forward contract early, together with a commitment by *X* to issue new Notes in the context of a "remarketing."

The correct characterization for federal income tax purposes of a transaction creating multiple rights and obligations

depends on the facts and circumstances of the particular transaction. In deciding among multiple potential characterizations, the tax law seeks to find the best match between the bundle of rights and obligations and one or more categories of widely recognized instruments. In the instant case, the form chosen for the components of the unit reflects one reasonable division of the bundle of rights and obligations in the unit. Consequently, it is appropriate to begin the analysis of the issuer's tax consequences with respect to the unit by treating the unit as comprising these two components—namely, the Note and the Purchase Contract.

After the Note has been identified as one of the components of the Purchase-Contract/Note unit, determining whether *X* may deduct the amounts identified as interest on the Note contained in the Purchase-Contract/Note unit involves a multistep analysis:

- Is the Note separable from the associated Purchase Contract?
- If the Note is separable from the Purchase Contract but is not in fact separated from the Purchase Contract, does the Note qualify as debt?
- If the Note qualifies as debt, does § 163(*l*) prevent *X* from deducting the interest that accrues on the Note?

Is the Note separable from the associated Purchase Contract?

Two factors are particularly important in analyzing whether the Note should be treated as separable from the Purchase Contract: whether the Purchase Contract and Note are separately transferable, and whether any factors (economic or otherwise) prevent the holder from effecting such a separate transfer.

Separate Transferability

Rev. Rul. 88–31, 1988–1 C.B. 302, holds that a share of common stock and a contingent payment right issued together as an investment unit are separate items of property for federal income tax purposes because they are separately tradable on a national securities exchange shortly after issuance. Similarly, in cases involving bond-warrant investment units in which the bond and warrant were separately tradable, several courts have stated in *dicta* that, because of the potential for separate trading, the bond and warrant were properly treated as separate instruments. *See Chock Full O'Nuts Corp. v. United States*, 453 F.2d 300 (2d Cir. 1971); *Hunt Foods and Industries, Inc. v. Commissioner*, 57 T.C. 633 (1972). In contrast, when financial instruments cannot be separately traded, the courts have generally treated them as a single instrument. *See Universal Castings Corp. v. Commissioner*, 37 T.C. 107 (1961) (finding that a corporation's notes were "locked" to its stock by a shareholders' agreement so that neither the note nor the stock could be sold without the other, and therefore holding that the notes and stock constituted a "single investment" and the notes did not qualify as debt), *aff'd*, 303 F.2d 620 (7th Cir. 1962). *Cf. De Coppet v. Commissioner*, 38 B.T.A. 1381 (1938) (finding that an investment corporation's stock was "stapled" to a bank's stock through a trust arrangement so that neither could be sold without the other, and therefore holding that no part of the basis of the taxpayer's stapled stock could be recognized as a loss when the stock of the investment corporation became worthless), *aff'd*, 108 F.2d 787 (2d Cir.), *cert. denied*, 310 U.S. 646 (1940). These authorities indicate that, unless a holder has a legal right to separate linked instruments, they generally cannot be considered separable.

Economic Compulsion

The existence of a mere legal right to separate is insufficient for the Note and Purchase Contract to be considered separable. If the characterization of an instrument or a transaction for federal income tax purposes either depends on, or could be affected by, the existence of a person's legal right or option to elect a certain course of action, the tax consequences often depend on whether the exercise (or nonexercise) of the right or option is economically compelled based on all the facts and circumstances. *See American Realty Trust v. United States*, 498 F.2d 1194, 1199 (4th Cir. 1974) (upholding a verdict that a transaction was a good-faith sale and lease-back with a repurchase option, in part because the seller was not under "economic compulsion" to exercise the option); *Roberts v. Commissioner*, 71 T.C. 311, 323 (1978) (holding that a trust was not a mere conduit used by the taxpayer to obtain installment sale treatment under § 453 for a stock sale, in part because the trustees were under "no legal commitment or economic compulsion" to resell the stock when they did), *aff'd*, 643 F.2d 654 (9th Cir. 1981); Rev. Rul. 2003–7, 2003–5 I.R.B. 363 (holding that a collateralized forward contract to sell stock is not a current sale if the shareholder is not economically compelled to deliver the pledged shares); *see also Comtel Corp. v. Commissioner*, 45 T.C. 294, 307 (1965) (arrangement for stock purchase and subsequent sale of stock pursuant to an "option" was characterized as in substance a financing arrangement, in part because the Court concluded, after evaluation of the economic terms of the transaction, that taxpayer was "practically compelled" to exercise the option), *aff'd*, 376 F.2d 791, 796 (2d Cir.) (rejecting taxpayer's argument that it was not "economically compelled" to exercise the option), *cert. denied*, 389 U.S. 929 (1967); *cf.* Rev. Rul. 82–150, 1982–2 C.B. 110 (treating the holder of an option to purchase stock as the current owner because the holder paid 70 percent of the stock's value for the option and the strike price of the option was 30 percent of the stock's value).

For a Note to become separated from the Purchase-Contract/Note unit and transferable separately, one of three events must occur: (1) the holder effects a conversion, (2) the holder effects a settlement with separate cash, or (3) a successful remarketing occurs. If all of the remarketings fail, a Note in a Purchase-Contract/Note unit in effect will be exchanged on the Settlement Date for the *X* stock that is due to the holder under the Purchase Contract.

Notwithstanding these conditions and possibilities, however, under the facts stated in this ruling, the holder has the unrestricted legal right to separate the Note from the Purchase-Contract/Note unit and transfer the Note separately, and is not economically compelled to keep the unit unseparated. The need to take certain steps to effect a separation does not contradict the separateness that can ultimately be achieved. On the Issue Date, it is substantially certain that the remarketing will succeed; thus, the consequences of a hypothetical remarketing failure are not controlling. Accordingly, in light of all the facts and circumstances, when the

Notes and Purchase Contracts were issued they were separable instruments.

If the Note is separable from the Purchase Contract but is not in fact separated from the Purchase Contract, does the Note qualify as debt?

Whether an instrument is debt for federal income tax purposes depends on the facts and circumstances of each case. No particular fact is conclusive in making such a determination. *John Kelley Co. v. Commissioner*, 326 U.S. 521 (1946). Among the factors considered by the courts are (1) whether there is an unconditional promise to pay a sum certain in money on a specific date, (2) the intent of the parties, and (3) the holder's right to enforce the payment of principal and interest. *Bauer v. Commissioner*, 748 F.2d 1365, 1368 (9th Cir. 1984); *Estate of Mixon v. United States*, 464 F.2d 394, 402 (5th Cir. 1972); *Gilbert v. Commissioner*, 248 F.2d 399, 402 (2d Cir. 1957); *Litton Business Systems, Inc. v. Commissioner*, 61 T.C. 367, 377 (1973) ("Was there a genuine intention to create a debt, with a reasonable expectation of repayment, and did that intention comport with the economic reality of creating a debtor-creditor relationship?"), *acq.*, 1974–2 C.B. 3.

In form, the transaction provides for investors to make an initial payment of money that will be repaid to the holder of a Note upon the maturity of the Note. Although the Note is pledged as collateral for satisfaction of the separate Purchase Contract, the payment obligation under that contract is intended to be satisfied out of the proceeds of the remarketing of the Note. However, an initial holder is obligated in all events to acquire *X*'s stock and will not itself receive the principal payment on the Note unless the holder takes action to separate the Note from the Purchase Contract.

A question is thus presented whether the amount paid by an initial holder should be characterized as the purchase price for the Note or as a prepayment on the Purchase Contract, with the actual Notes being issued by *X* only if and when there is a conversion, a settlement for separate cash, or a successful remarketing. An important consideration in answering this question is whether the issuance and acquisition of the units create debt characteristics.

On the one hand, in addition to the conditions necessary to cause a separation of the Note from the Purchase-Contract/Note unit as described above, the following factors suggest that the amount paid by a holder to acquire a unit could be treated simply as a prepayment of the Settlement Price under the Purchase Contract:

1. Ownership of a Purchase-Contract/Note unit exposes the holder to no risk of loss from a decline in the value of the Note because (i) if the Note is sold through a successful remarketing, the holder of a Purchase-Contract/Note unit is assured of having on the Settlement Date the amount necessary to satisfy the holder's obligation under the Purchase Contract; and (ii) if all remarketings fail, the holder of a Purchase-Contract/Note unit nevertheless receives the stock the acquisition of which is provided for under the Purchase Contract.
2. Ownership of a Purchase-Contract/Note unit provides the holder virtually no opportunity for gain from an increase in the value of the Note because the Initial Rate will be reset and the gain to be received from a remarketing is limited to 25 basis points.
3. Absent bankruptcy or the holder's decision to effect a conversion or a settlement with separate cash, the holder of a Purchase-Contract/Note unit will receive *X*'s stock in all events under the Purchase Contract and will not receive any payments on the Note other than accrued interest and a distribution of excess proceeds in the event of a successful remarketing.
4. Upon a successful remarketing of the Note prior to the Final Remarketing Date, the holder will receive on the Settlement Date an amount equal to interest at the Initial Rate rather than the amount earned on the Treasury Zeros purchased with the proceeds from the remarketing.

On the other hand, the form in which the transaction is cast is a debt instrument, with a term that is substantially certain to last 5 years, with current interest payments, and with a remarketing that is to occur no later than 3 years after the Issue Date and that is not considered to be a reissuance under § 1001.

In addition, the Note has a critical debt characteristic even before the Note is separated from the Purchase Contract because the Purchase Contract provides that, in the event of *X*'s bankruptcy, the Purchase Contract will terminate and the associated Note will be released to the holder; and on the Issue Date, *X* reasonably believes, based on the advice of counsel, that the provision will be enforceable in bankruptcy and will result in the holders being treated as creditors in the bankruptcy proceeding. The existence of these bankruptcy rights is an important debt characteristic. *See P.M. Finance Corp. v. Commissioner*, 302 F.2d 786, 789–90 (3d Cir. 1962) (describing the right to share with general creditors in a corporation's assets in the event of dissolution or liquidation as "a most significant characteristic of the creditor-debtor relationship"); *Nestlé Holdings, Inc. v. Commissioner*, 94 T.C. 803, 813–14 (1990) (distinguishing mandatorily redeemable preferred stock from debt in part because preferred stockholders are always subordinate to creditors in liquidation).

In this context, the foregoing debt characteristics are sufficient to cause a Note included in a Purchase Contract/Note unit to be treated as debt for federal income tax purposes.

If the Note qualifies as debt, does § 163(l) prevent X from deducting the interest that accrues on the Note?

Section 163(*l*)(1) disallows a deduction for any interest paid or accrued on a "disqualified debt instrument." Section 163(*l*)(2) defines a "disqualified debt instrument" as indebtedness of a corporation that is payable in equity of the issuer or a related party. Section 163(*l*)(3) provides that indebtedness shall be treated as "payable in equity" of the issuer or a related party only if (A) a substantial amount of the principal or interest is required to be paid in or converted into, or at the option of the issuer or a related party is payable in or convertible into, such equity; (B) a substantial amount of the principal or interest is required to be determined, or at the option of the issuer or a related party is determined, by reference to the value of such equity; or (C) the indebtedness is part of an arrangement that is

reasonably expected to result in a transaction described in (A) or (B). Section 163(*l*)(3) further provides that principal or interest shall be treated as required to be so paid, converted, or determined if it may be required at the option of the holder or a related party and there is a substantial certainty the option will be exercised. The legislative history of § 163(*l*) states that an instrument is treated as payable in stock if it is part of an arrangement designed to result in payment with or by reference to such stock, including certain issuances of a forward contract in connection with the issuance of debt, nonrecourse debt that is secured principally by such stock, or certain debt instruments that are convertible at the holder's option when it is substantially certain that the right will be exercised. *See* H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 523–24 (1997), 1997–4 (Vol. 2) C.B. 1993–94.

All of the interest payments on all of the Notes will be made in cash. The principal payments on Separated Notes as well as Notes that have been sold in a remarketing will also be made in cash. Thus, if there is a successful remarketing, the principal payments on all of the Notes will be made in cash at the end of the 5-year term. If all of the remarketings fail, however, *X*'s obligation to pay the stated principal amount of the Notes contained in the Purchase-Contract/Note units will be offset against the obligation of the holders to pay the Settlement Price on the Purchase Contracts. In that case, although the Note contained in a Purchase-Contract/Note unit technically will be applied in satisfaction of the holder's obligation to pay the Settlement Price rather than paid in stock, the holder will effectively receive *X*'s stock in satisfaction of the stated principal amount of the Note. Thus, the Note may be considered to be "paid in" or "converted into" *X*'s stock for purposes of § 163(*l*)(3).

Even without either a provision in the written terms of the Notes or any other understanding or agreement, in certain situations the facts and circumstances might support a conclusion that the issuance was part of an arrangement reasonably expected, in effect, to give *X* an option either to repay the Note with *X*'s stock or to convert the Note into *X*'s stock, or otherwise to result in such a repayment or conversion. For example, if *X* does not use its best efforts to make the remarketing succeed and all of the remarketings fail, the holder in effect will be compelled to receive *X*'s stock in satisfaction of the stated principal amount of the Note.

In the instant transaction, however, several critical facts and contractual provisions support a contrary conclusion:

1. *X* has contracted to have the Notes remarketed and such an undertaking is subject to the requirements and sanctions of the Securities Act of 1933, 15 U.S.C. 77a–77aa (2000);
2. It is substantially certain that a remarketing of the Notes will succeed (in which case the Notes will remain outstanding until the Maturity Date and consequently will not be paid in, or converted into, *X*'s stock);
3. The remarketing dates and the Maturity Date are such that the Notes will remain outstanding after the remarketing for a period that is significant both absolutely and relative to the total term of the Notes; and
4. On the Maturity Date, *X* will have an obligation to pay the principal amount of the Notes.

Thus, absent specific evidence of bad faith with respect to *X*'s performance of its obligation to remarket the Notes, these critical facts and contractual provisions support the conclusion that the transaction is not reasonably expected to give *X* an option to pay the Notes in, or convert them into, *X*'s stock, or to otherwise result in such a repayment or conversion.

Conclusion

The interest accruing on a Note contained in a Purchase-Contract/Note unit is deductible under § 163(a), and the deduction is not disallowed under § 163(*l*).

Four factors critical to this conclusion are:

> Critical Factor I. The holder has the unrestricted legal right to convert the Purchase-Contract/Note unit into a Purchase-Contract/Strip unit or to settle the Purchase Contract with separate cash and retain the Note, and the holder is not economically compelled to keep the unit unseparated.
>
> Critical Factor II. The Purchase Contract provides that, in the event of *X*'s bankruptcy, the Purchase Contract will terminate and the associated Note or Strip will be released to the holder; and, on the Issue Date, *X* reasonably believes, based on advice from counsel, that the provision would be enforceable in bankruptcy and would result in the holder of a Purchase-Contract/Note unit being treated as a creditor in the bankruptcy proceeding.
>
> Critical Factor III. The period the Notes will remain outstanding after a remarketing is significant, both absolutely and relative to the total term of the Notes. For purposes of this factor, Notes are considered to remain outstanding only during the period when they are not subject to redemption at the option of the issuer.
>
> Critical Factor IV. On the Issue Date, it is substantially certain that a remarketing of the Notes will succeed. For purposes of this factor, a remarketing of the Notes is not substantially certain to succeed if the Reset Rate is capped.

HOLDING

Under the facts presented, the interest accruing on a Note contained in a Purchase-Contract/Note unit is deductible under § 163(a), and the deduction is not disallowed under § 163(*l*).

PROSPECTIVE APPLICATION

Under the authority of § 7805(b)(8), the holding of this revenue ruling will not be applied adversely with respect to a unit that was issued on or before August 22, 2003, provided that interest accruing on the unit would be deductible under this revenue ruling if—

(1) Critical Factor II required only that, under the transaction documents, in the event of the issuer's bankruptcy, the Purchase Contract will terminate and the associated Note or Treasury security will be released to the holder; and

(2) Critical Factor IV required only that the issuer of the unit undertook a legal obligation to attempt to cause a remarketing to succeed and reasonably believed that a remarketing would succeed.

REQUEST FOR COMMENTS

The Internal Revenue Service and the Treasury Department are considering whether to issue regulations under § 163(*l*)

to address the policy issues raised by the transaction described in this ruling. The Internal Revenue Service and the Treasury Department request comments as to whether regulations should be promulgated and, if so, what these regulations should provide.

Comments should be submitted by October 22, 2003. Comments may be submitted to CC:PA:RU (Rev. Rul. 2003–97), room 5203, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, DC 20044. Comments may be hand delivered between the hours of 8:00 a.m. and 4 p.m. Monday to Friday to CC:PA:RU (Rev. Rul. 2003–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, comments may be submitted via the Internet at *Notice.Comments@irscounsel.treas.gov*. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this revenue ruling is Charles Culmer of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Mr. Culmer at (202) 622–3960 (not a toll-free call).

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

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

LIFO; price indexes; department stores. The June 2003 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, June 30, 2003.

Rev. Rul. 2003–100

The following Department Store Inventory Price Indexes for June 2003 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, June 30, 2003.

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	June 2002	June 2003	Percent Change from June 2002 to June 2003[1]
1.	Piece Goods	494.9	464.3	-6.2
2.	Domestics and Draperies	577.6	557.0	-3.6
3.	Women's and Children's Shoes	634.3	629.1	-0.8
4.	Men's Shoes	905.7	849.5	-6.2
5.	Infants' Wear	603.3	588.9	-2.4
6.	Women's Underwear	525.1	516.1	-1.7
7.	Women's Hosiery	346.5	348.9	0.7
8.	Women's and Girls' Accessories	537.2	547.9	2.0
9.	Women's Outerwear and Girls' Wear	369.7	362.9	-1.8
10.	Men's Clothing	580.7	541.8	-6.7
11.	Men's Furnishings	581.7	570.2	-2.0
12.	Boys' Clothing and Furnishings	475.7	449.6	-5.5
13.	Jewelry	897.0	877.8	-2.1
14.	Notions	805.4	791.4	-1.7
15.	Toilet Articles and Drugs	981.0	990.0	0.9
16.	Furniture and Bedding	626.2	619.0	-1.0
17.	Floor Coverings	616.6	586.6	-4.9
18.	Housewares	756.2	726.0	-4.0
19.	Major Appliances	221.0	214.1	-3.1
20.	Radio and Television	49.4	45.4	-8.1
21.	Recreation and Education[2]	86.2	83.1	-3.6
22.	Home Improvements[2]	125.5	125.4	-0.1
23.	Auto Accessories[2]	110.9	111.5	0.5

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

Groups	June 2002	June 2003	Percent Change from June 2002 to June 2003[1]
Groups 1–15: Soft Goods	571.9	559.5	-2.2
Groups 16–20: Durable Goods	411.5	395.6	-3.9
Groups 21–23: Misc. Goods[2]	96.4	94.4	-2.1
Store Total[3]	512.9	500.1	-2.5

[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, including some not listed separately, except for the following: candy, food, liquor, tobacco and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael Burkom Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkom at (202) 622–7924 (not a toll-free call).

Section 482.—Allocation of Income and Deductions Among Taxpayers

26 CFR 1.482–1: Reallocation of income and deductions among unrelated parties to a lease strip.

Lease stripping transaction. This ruling discusses whether section 482 of the Code may apply to allow allocations of the income and deductions arising from a lease stripping transaction entered into by parties that were unrelated at the time the income is stripped from the lease, solely on the basis that the parties were acting in concert or with a common goal or purpose, to arbitrarily shift income or deductions among themselves.

Rev. Rul. 2003–96

ISSUE

Whether section 482 may apply to allow allocations of the income and deductions arising from the property that is the subject of a lease stripping transaction entered into and effected among parties that were unrelated up to and including the time income is stripped from the lease pursuant to a plan promoted to realize tax benefits for one or more of the parties, solely on the basis that at such time the parties were acting in concert or with a common goal or purpose to arbitrarily shift income or deductions among themselves.

FACTS

A, a foreign corporation, purchases property from B, an equipment leasing company. At the time of the purchase, the property was subject to pre-existing end user leases with varying terms extending over future years. A is not engaged in a trade or business within the United States and is exempt from U.S. taxation on U.S. source income, if any, from the end user leases under an applicable income tax treaty. A sells the right to all future rental income attributable to the end user leases to C.

D, a domestic corporation, is the parent of an affiliated group of corporations that files a U.S. consolidated income tax return. After the rights to the future rental income have been sold to C, A transfers the leased property subject to the end user leases to E, a domestic corporation, in a purported section 351 transaction entered into with D where immediately after the transaction, A has non-voting preferred stock in E and D has 100% of the voting stock of E. E is a member of the D consolidated group (the "D group") after the purported section 351 transaction. Subsequent depreciation deductions from the leased property are reflected on the consolidated return for the D group.

The foregoing steps were undertaken pursuant to a plan promoted by P to A, B, C, and the D group to achieve U.S. income tax benefits for one or more of the parties. A, B, C, the D group, and P were unrelated to one another at all times up to and including the time the income is stripped from the leases in the transaction between A and C, and A and D also were unrelated to one another throughout the period in which tax benefits are claimed with respect to the lease stripping transaction.

LAW AND ANALYSIS

Section 482 provides, in part:

> In the case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations.

In determining whether or not two or more organizations, trades, or businesses are controlled directly or indirectly by the

same interests, control is defined to include any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose. Treas. Reg. § 1.482–1(i)(4). It is the reality of control that is decisive, not its form or the mode of its exercise. *Id.; Ach v. Commissioner*, 42 T.C. 114 (1964), *aff'd*, 358 F.2d 342 (6th Cir.), *cert. denied*, 385 U.S. 899 (1966). A presumption of control arises if income or deductions have been arbitrarily shifted. Treas. Reg. § 1.482–1(i)(4).

The issue under section 482 is whether an allocation between or among organizations, trades, or businesses owned or controlled by the same interests is necessary to prevent the evasion of taxes or clearly to reflect the income of any of such organizations, trades or businesses. Therefore, situations in which two or more taxpayers act in concert to control another organization, trade or business with a common goal or purpose to arbitrarily shift income or deductions between one or more of such taxpayers and the controlled organization, trade or business are brought within the application of section 482 by the reference in section 1.482–1(i)(4) to "control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose."

An example would be three equal and otherwise unrelated shareholders in a corporation that, acting in concert, individually purchase from or sell items to the corporation at prices that differ from those that would be charged by unrelated parties in similar circumstances. Even though none of the shareholders individually has actual or effective control of the corporation, where the shareholders act in concert with a common goal of shifting income or deductions from or to the corporation, section 1.482–1(i)(4) provides that each shareholder is considered to control the corporation for purposes of the application of section 482. *See, e.g., B. Forman Co., Inc. v. Commissioner*, 453 F.2d 1144 (2d Cir. 1972), *cert. denied*, 407 U.S. 934, *rehearing denied*, 409 U.S. 899 (1972), *aff'g in part*, and *rev'g in part*, 54 T.C. 912 (1970); *South Texas Rice Warehouse Co. v. Commissioner*, 366 F.2d 890 (5th Cir. 1966), *aff'g* 43 T.C. 540 (1965), *cert. denied*, 386 U.S. 1016 (1967).

By contrast, the fact that unrelated parties engage in a transaction does not by itself evidence the type of control necessary to satisfy the "acting in concert or with a common goal or purpose" requirement of section 1.482–1(i)(4), regardless of whether such transaction may be viewed as having arbitrarily shifted income between the otherwise unrelated parties. An application of section 1.482–1(i)(4) to this type of situation would be inconsistent with the policies underlying section 482, which provides for allocations between or among organizations, trades or businesses "owned or controlled directly or indirectly by the same interests."

Under the facts, the lease stripping transaction occurred among parties that themselves were unrelated to one another up to and including the time the income is stripped from the leases. Up to and including the time the income is stripped from the leases, there were not two or more of such parties and another organization, trade or business which such parties acted in concert to control. Accordingly, at that time, the parties did not "act in concert or with a common goal or purpose" within the meaning of section 1.482–1(i)(4).

HOLDING

The facts described up to and including the time the income is stripped from the leases do not support the application of section 482 to allow the allocation among the parties of the income and deductions arising from the property that is the subject of the lease stripping transaction. The fact that parties that were unrelated up to and including the time of a transaction engage in that transaction in an attempt to arbitrarily shift income or deductions among themselves does not by itself evidence the type of control necessary to satisfy the "acting in concert or with a common goal or purpose" requirement of section 1.482–1(i)(4). This ruling does not address whether A is considered to control E for purposes of the application of section 482 by reason of A and D entering into the purported section 351 transaction with E.

No inference is intended concerning the treatment of lease stripping transactions for federal income tax purposes. The Internal Revenue Service will challenge lease stripping transactions on other legal grounds. *See* Notice 2003–55, 2003–34 I.R.B. 395, August 25, 2003.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Sheila Ramaswamy and J. Peter Luedtke of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Sheila Ramaswamy at 202–622–3870 or J. Peter Luedtke at 202–435–5265 (not toll-free calls).

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

26 CFR 1.6011–4(b)(2)

If one participant in a transaction claims to realize rental or other income from property and another participant claims the deductions related to that income, will the separation of income from related deductions be disallowed and will the transaction be a lease strip that is a listed transaction subject to the requirements of sections 6011 and 1.6011-4(b)(2). See Notice 2003-55, page 395.

Section 6111.—Registration of Tax Shelters

If one participant in a transaction claims to realize rental or other income from property and another participant claims the deductions related to that income, will the separation of income from related deductions be disallowed and will the transaction be a lease strip that is a listed transaction subject to the requirements of section 6111. See Notice 2003-55, page 395.

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

If one participant in a transaction claims to realize rental or other income from property and another participant claims the deductions related to that income, will the separation of income from related deductions be disallowed and will the transaction be a lease strip that is a listed transaction subject to the requirements of section 6112. See Notice 2003-55, page 395.

Section 7805.—Rules and Regulations

26 CFR 301.7805–1: Rules and regulations.

Rev. Rul. 2003-97 provides guidance on whether interest accruing on a note is deductible under section

163(a), and whether the deduction is disallowed under section 163(l), when a corporation issues units, each consisting of instruments in the form of a note and a forward contract to purchase a quantity of the corporation's common stock. The holding of the revenue ruling is modified for units issued on or before August 22, 2003. See Rev. Rul. 2003-97, page 380.

Obsolete revenue rulings. This ruling publishes a list of previously published rulings that have been identified as no longer determinative with respect to future transactions.

Rev. Rul. 2003–99

The Internal Revenue Service is continuing its program of reviewing rulings (including revenue rulings, revenue procedures, and notices) published in the Internal Revenue Bulletin to identify and publish lists of those rulings that, although not specifically revoked or superseded, are no longer considered determinative because (1) the applicable statutory provisions or regulations have been changed or repealed; (2) the ruling position is specifically covered by statute, regulations, or subsequent published position; or (3) the facts set forth no longer exist or are not sufficiently described to permit clear application of the current statute and regulations.

This revenue ruling publishes a list of rulings that have been identified under the Service's review program as no longer being determinative. The rulings are categorized by the Associate Chief Counsel offices that have primary jurisdiction over the subject matter of the rulings being obsoleted.

Accordingly, the rulings listed below are hereby declared obsolete.

Associate Chief Counsel (Income Tax and Accounting)

Ruling No.	*C.B. Citation*
Rev. Rul. 70–286	1970–1 C.B. 113
Rev. Proc. 68–41	1968–2 C.B. 943
Notice 95–50	1995–2 C.B. 333

Associate Chief Counsel (Passthroughs and Special Industries)

Ruling No.	*C.B. Citation*
Rev. Rul. 77–405	1977–2 C.B. 381
Rev. Rul. 79–29	1979–1 C.B. 358
Rev. Proc. 89–12	1989–1 C.B. 798
Rev. Proc. 91–13	1991–1 C.B. 477
Rev. Proc. 92–33	1992–1 C.B. 782
Rev. Proc. 92–35	1992–1 C.B. 790
Rev. Proc. 92–88	1992–1 C.B. 496
Rev. Proc. 94–46	1994–2 C.B. 688
Rev. Proc. 95–10	1995–1 C.B. 501

Associate Chief Counsel (Corporate)

Ruling No.	*C.B. Citation*
Rev. Rul. 54–139	1954–1 C.B. 105
Rev. Rul. 54–396[1]	1954–2 C.B. 147
Rev. Rul. 56–128	1956–1 C.B. 442
Rev. Rul. 56–160	1956–1 C.B. 633
Rev. Rul. 56–212	1956–1 C.B. 170
Rev. Rul. 56–220	1956–1 C.B. 191
Rev. Rul. 56–271	1956–1 C.B. 440

[1] Rev. Rul. 54–396 was declared obsolete by T.D. 8885, 2000–1 C.B. 1260, 1261, and is included in this ruling to allow easier confirmation of its obsolete status.

Associate Chief Counsel (Corporate)

Ruling No.	*C.B. Citation*
Rev. Rul. 56–344	1956–2 C.B. 195
Rev. Rul. 56–448	1956–2 C.B. 130
Rev. Rul. 56–451	1956–2 C.B. 208
Rev. Rul. 56–586	1956–2 C.B. 214
Rev. Rul. 56–680	1956–2 C.B. 597
Rev. Rul. 56–681	1956–2 C.B. 597
Rev. Rul. 57–296	1957–2 C.B. 234
Rev. Rul. 58–92	1958–1 C.B. 174
Rev. Rul. 59–108	1959–1 C.B. 72
Rev. Rul. 59–120	1959–1 C.B. 74
Rev. Rul. 59–122	1959–1 C.B. 230
Rev. Rul. 59–233	1959–2 C.B. 106
Rev. Rul. 59–326	1959–2 C.B. 197
Rev. Rul. 59–400	1959–2 C.B. 114
Rev. Rul. 59–412	1959–2 C.B. 108
Rev. Rul. 60–49	1960–1 C.B. 148
Rev. Rul. 60–246	1960–2 C.B. 462
Rev. Rul. 60–262	1960–2 C.B. 114
Rev. Rul. 61–96	1961–1 C.B. 68
Rev. Rul. 64–147	1964–1 C.B. 136
Rev. Rul. 64–177	1964–1 C.B. 141
Rev. Rul. 65–110	1965–1 C.B. 438
Rev. Rul. 66–23[2]	1966–1 C.B. 67
Rev. Rul. 66–290	1966–2 C.B. 112
Rev. Rul. 67–186	1967–1 C.B. 81
Rev. Rul. 67–189	1967–1 C.B. 255
Rev. Rul. 67–326	1967–2 C.B. 143
Rev. Rul. 68–388	1968–2 C.B. 122
Rev. Rul. 68–434	1968–2 C.B. 137
Rev. Rul. 69–18	1969–1 C.B. 188
Rev. Rul. 69–20	1969–1 C.B. 202
Rev. Rul. 69–241	1969–1 C.B. 200
Rev. Rul. 69–426	1969–2 C.B. 48
Rev. Rul. 70–6	1970–1 C.B. 172
Rev. Rul. 70–111	1970–1 C.B. 184
Rev. Rul. 70–378	1970–2 C.B. 178

[2] Rev. Rul. 66–23 was declared obsolete by T.D. 8760, 1998–1 C.B. 803, 805, and is included in this ruling to allow easier confirmation of its obsolete status.

Associate Chief Counsel (Corporate)

Ruling No.	*C.B. Citation*
Rev. Rul. 70–409	1970–2 C.B. 79
Rev. Rul. 70–496	1970–2 C.B. 74
Rev. Rul. 71–384	1971–2 C.B. 181
Rev. Rul. 71–440	1971–2 C.B. 326
Rev. Rul. 72–61	1972–1 C.B. 281
Rev. Rul. 72–212	1972–1 C.B. 291
Rev. Rul. 72–472	1972–2 C.B. 202
Rev. Rul. 72–603	1972–2 C.B. 517
Rev. Rul. 73–257	1973–1 C.B. 189
Rev. Rul. 73–277	1973–1 C.B. 296
Rev. Rul. 73–473	1973–2 C.B. 115
Rev. Rul. 73–490	1973–2 C.B. 110
Rev. Rul. 73–498	1973–2 C.B. 316
Rev. Rul. 74–73	1974–1 C.B. 254
Rev. Rul. 74–87	1974–1 C.B. 72
Rev. Rul. 74–211	1974–1 C.B. 76
Rev. Rul. 74–476	1974–2 C.B. 104
Rev. Rul. 74–610	1974–2 C.B. 288
Rev. Rul. 75–54	1975–1 C.B. 293
Rev. Rul. 75–160	1975–1 C.B. 112
Rev. Rul. 75–174	1975–1 C.B. 252
Rev. Rul. 75–179	1975–1 C.B. 103
Rev. Rul. 75–212	1975–1 C.B. 107
Rev. Rul. 75–248	1975–1 C.B. 125
Rev. Rul. 75–468	1975–2 C.B. 115
Rev. Rul. 75–515	1975–2 C.B. 117
Rev. Rul. 75–561	1975–2 C.B. 129
Rev. Rul. 76–90	1976–1 C.B. 101
Rev. Rul. 76–239	1976–1 C.B. 90
Rev. Rul. 76–347	1976–2 C.B. 253
Rev. Rul. 77–81	1977–1 C.B. 97
Rev. Rul. 77–150	1977–1 C.B. 88
Rev. Rul. 77–256	1977–2 C.B. 96
Rev. Rul. 77–284	1977–2 C.B. 97
Rev. Rul. 77–321	1977–2 C.B. 98
Rev. Rul. 77–456	1977–2 C.B. 102
Rev. Rul. 77–483	1977–2 C.B. 244

Associate Chief Counsel (Corporate)

Ruling No.	*C.B. Citation*
Rev. Rul. 78–89	1978–1 C.B. 272
Rev. Rul. 78–287	1978–2 C.B. 146
Rev. Rul. 78–441	1978–2 C.B. 152
Rev. Rul. 79–71	1979–1 C.B. 151
Rev. Rul. 79–82	1979–1 C.B. 141
Rev. Rul. 79–104	1979–1 C.B. 263
Rev. Rul. 79–314	1979–2 C.B. 132
Rev. Rul. 80–79	1980–1 C.B. 191
Rev. Rul. 80–101	1980–1 C.B. 70
Rev. Rul. 80–358	1980–2 C.B. 110
Rev. Rul. 81–190	1981–2 C.B. 84
Rev. Rul. 81–247	1981–2 C.B. 87
Rev. Rul. 82–164	1982–2 C.B. 77
Rev. Rul. 83–119	1983–2 C.B. 57
Rev. Rul. 84–30	1984–1 C.B. 114
Rev. Rul. 85–55	1985–1 C.B. 323
Rev. Rul. 85–136	1985–2 C.B. 194
Rev. Rul. 86–52	1986–1 C.B. 204
Rev. Rul. 87–1	1987–1 C.B. 132
Rev. Proc. 91–11	1991–1 C.B. 470
Rev. Proc. 91–39	1991–2 C.B. 694
Rev. Proc. 95–11	1995–1 C.B. 505
Rev. Proc. 95–39	1995–2 C.B. 399

Associate Chief Counsel (International)

Ruling No.	*C.B. Citation*
Rev. Rul. 56	1953–1 C.B. 303
Rev. Rul. 55–105	1955–1 C.B. 94
Rev. Rul. 55–372	1955–1 C.B. 339
Rev. Rul. 57–116	1957–1 C.B. 245
Rev. Rul. 57–542	1957–2 C.B. 462
Rev. Rul. 58–618	1958–2 C.B. 430
Rev. Rul. 59–356	1959–2 C.B. 177
Rev. Rul. 60–307	1960–2 C.B. 214
Rev. Rul. 63–157	1963–2 C.B. 296
Rev. Rul. 63–224	1963–2 C.B. 297
Rev. Rul. 63–248	1963–2 C.B. 623

Associate Chief Counsel (International)

Ruling No.	*C.B. Citation*
Rev. Rul. 64–285	1964–2 C.B. 184
Rev. Rul. 65–260	1965–2 C.B. 243
Rev. Rul. 65–273	1965–2 C.B. 240
Rev. Rul. 66–4	1966–1 C.B. 177
Rev. Rul. 68–309	1968–1 C.B. 338
Rev. Rul. 68–477	1968–2 C.B. 317
Rev. Rul. 68–522	1968–2 C.B. 320
Rev. Rul. 68–608	1968–2 C.B. 309
Rev. Rul. 68–640	1968–2 C.B. 321
Rev. Rul. 68–641	1968–2 C.B. 325
Rev. Rul. 69–361	1969–1 C.B. 193
Rev. Rul. 69–485	1969–2 C.B. 158
Rev. Rul. 69–517	1969–2 C.B. 149
Rev. Rul. 70–229	1970–1 C.B. 164
Rev. Rul. 70–230	1970–1 C.B. 166
Rev. Rul. 70–264	1970–1 C.B. 165
Rev. Rul. 71–13	1971–1 C.B. 217
Rev. Rul. 71–453	1971–2 C.B. 292
Rev. Rul. 71–454	1971–2 C.B. 294
Rev. Rul. 71–495	1971–2 C.B. 311
Rev. Rul. 71–518	1971–2 C.B. 293
Rev. Rul. 71–565	1971–2 C.B. 266
Rev. Rul. 71–582	1971–2 C.B. 274
Rev. Rul. 72–116	1972–1 C.B. 220
Rev. Rul. 72–357	1972–2 C.B. 456
Rev. Rul. 72–526	1972–2 C.B. 450
Rev. Rul. 72–599	1972–2 C.B. 458
Rev. Rul. 73–46	1973–1 C.B. 342
Rev. Rul. 73–119	1973–1 C.B. 348
Rev. Rul. 73–182	1973–1 C.B. 350
Rev. Rul. 74–6	1974–1 C.B. 191
Rev. Rul. 74–59[3]	1974–1 C.B. 183
Rev. Rul. 74–83	1974–1 C.B. 184
Rev. Rul. 74–376	1974–2 C.B. 215
Rev. Rul. 74–521	1974–2 C.B. 208
Rev. Rul. 75–53	1975–1 C.B. 234

[3] Rev. Rul. 74–59 was declared obsolete by T.D. 8708, 1997–1 C.B. 137, 139, and is included in this ruling to allow easier confirmation of its obsolete status.

Associate Chief Counsel (International)

Ruling No.	*C.B. Citation*
Rev. Rul. 75–105	1975–1 C.B. 29
Rev. Rul. 75–106	1975–1 C.B. 31
Rev. Rul. 75–107	1975–1 C.B. 32
Rev. Rul. 75–111	1975–1 C.B. 251
Rev. Rul. 75–134	1975–1 C.B. 33
Rev. Rul. 75–298	1975–2 C.B. 290
Rev. Rul. 75–341	1975–2 C.B. 308
Rev. Rul. 75–426	1975–2 C.B. 292
Rev. Rul. 76–44	1976–1 C.B. 127
Rev. Rul. 76–67	1976–1 C.B. 208
Rev. Rul. 76–329	1976–2 C.B. 223
Rev. Rul. 76–535	1976–2 C.B. 219
Rev. Rul. 77–41	1977–1 C.B. 226
Rev. Rul. 77–343	1977–2 C.B. 255
Rev. Rul. 77–482	1977–2 C.B. 242
Rev. Rul. 79–116	1979–1 C.B. 213
Rev. Rul. 79–424	1979–2 C.B. 405
Rev. Rul. 80–78	1980–1 C.B. 171
Rev. Rul. 80–167	1980–1 C.B. 176
Rev. Rul. 80–170	1980–1 C.B. 285
Rev. Rul. 82–226	1982–2 C.B. 156
Rev. Rul. 83–101	1983–2 C.B. 147
Rev. Rul. 84–28	1984–1 C.B. 177
Rev. Rul. 88–7	1988–1 C.B. 269
Rev. Rul. 89–72	1989–1 C.B. 257
Rev. Proc. 68–23	1968–1 C.B. 821
Rev. Proc. 90–19	1990–1 C.B. 495
Notice 87–5	1987–1 C.B. 416
Notice 87–66	1987–2 C.B. 376
Notice 94–46	1994–1 C.B. 356

The Service will continue to review other rulings to ascertain those that, for the reasons stated above, are inapplicable to future transactions. Therefore, failure to include any particular ruling in the above list should not be construed as an indication that the ruling necessarily is determinative with respect to future transactions.

DRAFTING INFORMATION

The principal author of this revenue ruling is Marnette Myers of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding the rulings obsoleted in this revenue ruling, contact the following persons from the appropriate Associate Chief Counsel offices (not a toll-free call):

Name	*Associate Chief Counsel*	*Telephone No.*
Marnette Myers	Income Tax and Accounting	(202) 622–4920
Louis Solomon	Passthroughs and Special Industries	(202) 622–3010
Wayne Murray	Corporate	(202) 622–7700
Kelly Myers Kogan	International	(202) 622–3810

Part III. Administrative, Procedural, and Miscellaneous

Accounting for Lease Strips and Other Stripping Transactions

Notice 2003–55

Notice 95–53, 1995–2 C.B. 334, addresses certain tax consequences of lease strips or stripping transactions. Lease strips are transactions in which one participant claims to realize rental or other income from property and another participant claims the deductions related to that income (for example, depreciation or rental expenses). Lease strips may take a variety of forms, including, but not limited to, those in the following examples.

(a) *A lease strip effected through a transferred basis transaction.* In exchange for consideration, one participant sells, assigns, or otherwise transfers ("assigns") the right to receive future payments under a lease of tangible property, and treats the amount realized from the assignment as its current income. The participant later transfers the property (subject to the lease) in a transaction intended to qualify as a transferred basis transaction, such as a transaction described in § 351 of the Internal Revenue Code. The transferee often is not identified until after the transferor has assigned the future payments. Typically, the transferor (or a partner in a partnership that is a transferor) is generally not subject to U.S. federal income tax or has available net operating losses, and the equity of the transferee is owned predominantly by persons other than the transferor.

(b) *A lease strip effected through a transfer of an interest in a partnership (or other pass-through entity).* In exchange for consideration, the partnership assigns its right to receive future payments under a lease of tangible property and allocates the amount realized from the assignment to its current partners (many of whom are generally not subject to federal income tax or have available net operating losses). The partnership retains the underlying property, and thereafter, there is a transfer or redemption of a partnership interest by one or more partners to whom the partnership allocated the income that it reported from the assignment. The transfer or redemption is structured to avoid a reduction in the basis of partnership property.

(c) *A lease strip effected by a single participant.* A participant assigns its right to receive future payments under a lease of tangible property at a time when that participant is not subject to U.S. federal income tax or in a manner in which the realized amount is not includible in computing the participant's U.S. federal income tax and that same participant or a successor claims deductions related to that income for purposes of U.S. federal income tax.

In addition to transactions described above, this notice applies to lease strips involving licenses of intangible property, service contracts, leaseholds or other non-fee interests in property, and the prepayment, front-loading, or retention (rather than assignment) of rights to receive future payments.

DISCUSSION

The Internal Revenue Service has concluded that lease strips improperly separate income from related deductions and generally do not produce the tax consequences desired by the participants. Depending on the facts of a particular case, the Service may apply one or more Code sections or theories to challenge a lease strip. For example, the Service may apply §§ 165, 269, 382, 446(b), 701, or 704. The Service also may challenge certain assignments or accelerations of future payments as financings. Finally, the Service, as appropriate, may assert that there is no valid partnership or may apply various judicial doctrines, such as the doctrines of assignment-of-income, business purpose, substance-over-form, step transaction, or sham.

Recently, the Court of Appeals for the District of Columbia Circuit held that the partnership used in a lease strip was not a valid partnership because the participants did not join together for a non-tax business purpose. *Andantech L.L.C. v. Commissioner*, Nos. 02–1213; 02–1215, (D.C. Cir. June 17, 2003), 2003 U.S. App. LEXIS 11908, *aff'g in part and remanding for reconsideration of other issues* T.C. Memo 2002–97 (2002). Also, in *Nicole Rose v. Commissioner*, 320 F.3d 282 (2d Cir. 2002), *aff'g per curiam* 117 T.C. 328 (2001), the United States Court of Appeals for the Second Circuit upheld the Tax Court's determination that a lease transfer did not have economic substance.

Transactions that are the same as, or substantially similar to, the lease strips described in this notice are identified as "listed transactions" for purposes of § 1.6011–4(b)(2) of the Income Tax Regulations and §§ 301.6111–2(b)(2) and 301.6112–1(b)(2) of the Procedure and Administration Regulations. Independent of their classification as "listed transactions" for purposes of §§ 1.6011–4(b)(2), 301.6111–2(b)(2), and 301.6112–1(b)(2), transactions that are the same as, or substantially similar to, the transaction described in this notice may already be subject to the disclosure requirements of § 6011, the tax shelter registration requirements of § 6111, or the list maintenance requirements of § 6112 (§§ 1.6011–4, 301.6111–1T, 301.6111–2, and 301.6112–1). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under § 6707(a). Persons required to maintain a list of investors under § 6112 may be subject to the penalty under § 6708(a) if the requirements of § 6112 are not satisfied.

Finally, the Service may impose penalties on participants in lease strip transactions or, as applicable, on persons who participate in the promotion or reporting of lease strips, including the accuracy-related penalty under § 6662 and the return preparer penalty under § 6694.

In addition, the Service is currently evaluating other situations in which tax benefits are claimed as a result of transactions in which the ownership of property has been separated from the right to income from the property. For example, the Service is evaluating situations in which, in exchange for consideration, one participant assigns its interest in property but retains the right to income from the property, and, by allocating all of its basis to the transferred property and none to the retained future payments, the transferor claims a loss on the transfer.

This Notice 2003–55 modifies and supersedes Notice 95–53.

DRAFTING INFORMATION

The principal author of this notice is Pamela Lew of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Ms. Lew at (202) 622–3950 (not a toll-free call).

Section 45D.—New Markets Tax Credit

Notice 2003–56

PURPOSE

The purpose of this notice is to announce that the Treasury Department and the Internal Revenue Service will amend § 1.45D–1T(c)(3)(ii) of the temporary Income Tax Regulations to provide an additional exception permitting certain equity investments made before the receipt of a new markets tax credit allocation under § 45D(f)(2) of the Internal Revenue Code to be designated as qualified equity investments under § 45D(b)(1)(C).

BACKGROUND

Section 45D(a)(1) provides a new markets tax credit on certain credit allowance dates described in § 45D(a)(3) with respect to a qualified equity investment in a qualified community development entity (CDE).

Section 45D(b)(1)(C) provides that an equity investment in a CDE is a qualified equity investment only if the CDE designates the investment as a qualified equity investment.

Section 45D(c)(1) provides that an entity is a CDE only if, among other requirements, the entity is certified by the Secretary of the Treasury Department as a CDE.

Section 45D(b)(2) provides that the maximum amount of equity investments issued by a CDE that may be designated by the CDE as qualified equity investments shall not exceed the portion of the new markets tax credit limitation set forth in § 45D(f)(1) that is allocated to the CDE by the Secretary under § 45D(f)(2).

Section 1.45D–1T(c)(3)(i) provides that, except as provided in § 1.45D–1T(c)(3)(ii), an equity investment in an entity is not eligible to be designated as a qualified equity investment if it is made before the entity enters into an allocation agreement with the Secretary. An "allocation agreement" is an agreement between the Secretary and a CDE relating to a new markets tax credit allocation under § 45D(f)(2).

Section 1.45D–1T(c)(3)(ii) provides that, notwithstanding § 1.45D–1T(c)(3)(i), an equity investment in an entity is eligible to be designated as a qualified equity investment if — (A) the equity investment is made on or after April 20, 2001; (B) the entity in which the equity investment is made is certified by the Secretary as a CDE under § 45D(c) before January 1, 2003; (C) the entity in which the equity investment is made receives notification of the credit allocation (with the actual receipt of such credit allocation contingent upon subsequently entering into an allocation agreement) from the Secretary before January 1, 2003; and (D) the equity investment otherwise satisfies the requirements of § 45D and § 1.45D–1T.

The Secretary has delegated certain administrative functions relating to the new markets tax credit program to the Under Secretary (Domestic Finance), who in turn has delegated those functions to the Community Development Financial Institutions Fund (CDFI Fund). The delegated administrative functions include CDE certifications and new markets tax credit allocations.

Notice 2003–9, 2003–5 I.R.B. 369, announces that the Treasury Department and the Service will amend § 1.45D–1T(c)(3)(ii) to provide that, notwithstanding § 1.45D–1T(c)(3)(i), an equity investment in an entity is eligible to be designated as a qualified equity investment under § 1.45D–1T(c)(1)(iii) if—(1) the equity investment is made on or after April 20, 2001; (2) the designation of the equity investment as a qualified equity investment is made for a credit allocation received pursuant to an allocation application submitted to the CDFI Fund no later than August 29, 2002; and (3) the equity investment otherwise satisfies the requirements of § 45D and § 1.45D–1T.

DISCUSSION

In order to encourage equity investments in CDEs, the Treasury Department and the Service will amend § 1.45D–1T(c)(3)(ii) to provide an additional exception permitting an equity investment made on or after the date the CDFI Fund publishes a Notice of Allocation of Availability (NOAA) in the **Federal Register** to be designated as a qualified equity investment. Accordingly, § 1.45D–1T(c)(3)(ii) will be revised to provide that, notwithstanding § 1.45D–1T(c)(3)(i), an equity investment in an entity is eligible to be designated as a qualified equity investment under § 1.45D–1T(c)(1)(iii) if:

1. The equity investment is made on or after the date the CDFI Fund publishes a NOAA in the **Federal Register**;
2. The designation of the equity investment as a qualified equity investment is made for a credit allocation received pursuant to an allocation application submitted to the CDFI Fund under that NOAA; and
3. The equity investment otherwise satisfies the requirements of § 45D and § 1.45D–1T.

If the entity in which the equity investment is made does not receive an allocation under that NOAA, the equity investment will not be eligible to be designated as a qualified equity investment under future NOAAs.

The temporary regulations will be revised to incorporate the guidance set forth in this notice and Notice 2003–9. The revision to the temporary regulations reflecting the additional exception under this notice will be effective for equity investments made on or after July 18, 2003.

DRAFTING INFORMATION

The principal author of this notice is Paul Handleman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Handleman at (202) 622–3040 (not a toll-free call)

Canadian Retirement Plan Trust Reporting

Notice 2003–57

Section 1. General Foreign Trust Reporting Requirements for Certain Canadian Retirement Plans

Internal Revenue Code section 6048 requires information reporting with respect to certain foreign trusts. Persons subject to these information reporting rules must file Form 3520 (*Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*) or Form 3520–A (*Annual Information Return of Foreign Trust With a U.S. Owner*), as applicable.

In Notice 2003–25, 2003–18 I.R.B. 855, Treasury and the Internal Revenue Service recognized that some taxpayers with interests in certain Canadian retirement savings plans, as well as the custodians of such plans, were unfamiliar with the requirements for filing Forms 3520 and 3520–A. Accordingly, Notice 2003–25 provides an automatic extension until August 15, 2003, for any person who is required to file a 2002 Form 3520 or Form 3520–A with respect to a Registered Retirement Savings Plan ("RRSP"), Registered Retirement Income Fund ("RRIF") or other eligible plan within the meaning of section 3 of Revenue Procedure 2002–23, 2002–1 C.B. 744. Notice 2003–25 further provides that Treasury and the IRS are considering establishing for future taxable years a simplified reporting regime for RRSPs and persons with interests in RRSPs and coordinating the reporting requirements with the election described in section 4 of Revenue Procedure 2002–23.

Section 2. Relief from 2002 Foreign Trust Reporting Requirements for Certain Canadian Retirement Plans

Treasury and the IRS are continuing to work toward implementation of an alternative, simplified reporting regime for Canadian retirement plans for future taxable years. Treasury and the IRS have concluded, however, that additional relief with respect to 2002 Form 3520 and Form 3520–A reporting requirements should be provided to RRSPs and RRIFs and their beneficiaries.

First, with respect to the 2002 taxable year, if the beneficiary of an RRSP or RRIF (a) makes or has made an election with respect to the plan in accordance with section 4 of Revenue Procedure 2002–23 or section 3 of this notice, (b) complies or has complied with the annual reporting requirements of Revenue Procedure 2002–23 for the taxable year, and (c) received no distributions from the plan during his or her 2002 taxable year, then no Form 3520 or Form 3520–A with respect to the plan is required.

Second, an individual, RRSP or RRIF that has filed or files a Form 3520 or Form 3520–A for the 2002 taxable year that does not provide all appropriate information may be requested by the IRS to provide such information. Unless the IRS requests such information and the individual or plan fails to provide the IRS with the information identified in such request, no individual or plan that has filed or files a Form 3520 or Form 3520–A with respect to the 2002 taxable year will be subject to failure to file penalties. The individual or plan should write the following on the top of the first page of the Form 3520 or Form 3520–A: "CANADIAN RRSP" OR "CANADIAN RRIF" as the case may be.

Section 3. Automatic Extension of Time to Make Election Described in Section 4 of Revenue Procedure 2002–23

Section 4 of Revenue Procedure 2002–23 provides procedures under which a beneficiary of an RRSP or RRIF may elect to defer U.S. income tax on the beneficiary's share of income accrued in the plan until that income is distributed to the beneficiary. A beneficiary makes this election by attaching to his or her timely filed (including extensions) United States federal income tax return for the current year the statement described in section 4.01. The election applies to the beneficiary's current taxable year and all subsequent taxable years. Pursuant to section 301.9100–2(b) through (d) of the Procedure and Administration Regulations, an individual who timely filed his or her United States federal income tax return for the 2002 taxable year without making the election described in section 4 of Revenue Procedure 2002–23 with respect to an RRSP or RRIF, and who would like to make the election for the 2002 taxable year, may make the election by filing an amended 2002 federal income tax return by the date that is 6 months after the due date of the return, excluding extensions, and attaching to the amended return the statement described in section 4.01 of Revenue Procedure 2002–23. The individual must provide the following statement at the top of the amended return: "FILED PURSUANT TO SECTION 301.9100–2."

The principal author of this notice is Amanda A. Ehrlich of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Amanda A. Ehrlich or Willard W. Yates at (202) 622–3880 (not a toll-free call).

---

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, § 42; 1.42–14.)

Rev. Proc. 2003–67

SECTION 1. PURPOSE

This revenue procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under § 42(h)(3)(D) of the Internal Revenue Code for calendar year 2003.

SECTION 2. BACKGROUND

Rev. Proc. 92–31, 1992–1 C.B. 775, provides guidance to state housing credit agencies of qualified states on the procedure for requesting an allocation of unused housing credit carryovers under § 42(h)(3)(D). Section 4.06 of Rev. Proc. 92–31 provides that the Internal Revenue Service will publish in the Internal Revenue Bulletin the amount of unused housing credit carryovers allocated to qualified states for a calendar year from a national pool of unused credit authority (the National Pool). This revenue procedure publishes these amounts for calendar year 2003.

SECTION 3. PROCEDURE

The unused housing credit carryover amount allocated from the National Pool by the Secretary to each qualified state for calendar year 2003 is as follows:

Qualified State	*Amount Allocated*
Alabama	$133,549
California	1,045,289
Connecticut	103,008
Florida	497,496
Indiana	183,335
Kentucky	121,832
Maine	38,532
Maryland	162,471
Massachusetts	191,335
Michigan	299,169
Minnesota	149,421
Mississippi	85,484
Missouri	168,854
Nebraska	51,472
New Hampshire	37,954
New Jersey	255,705
New York	570,257
Ohio	339,974
Oregon	104,824
Rhode Island	31,842
South Carolina	122,257
Tennessee	172,566
Texas	648,316
Utah	68,947
Vermont	18,354
Virginia	217,105
Washington	180,654

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for allocations of housing credit dollar amounts attributable to the National Pool component of a qualified state's housing credit ceiling for calendar year 2003.

DRAFTING INFORMATION

The principal author of this procedure is Christopher J. Wilson of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Wilson at (808) 539–2874 or Susan Reaman at (202) 622–3040 (not toll-free calls).

---

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also, Part 1, 280G.)

Rev. Proc. 2003–68

SECTION 1. PURPOSE

This revenue procedure provides guidance on the valuation of stock options solely for purposes of §§ 280G and 4999 of the Internal Revenue Code. This revenue procedure restates and modifies Revenue Procedure 2002–13, 2002–1 C.B. 549, as modified by Revenue Procedure, 2002–45, 2002–27 I.R.B 40.

SECTION 2. BACKGROUND

Section 280G denies a deduction for any excess parachute payment. Section 4999 imposes a nondeductible 20-percent excise tax on the recipient of any excess parachute payment, within the meaning of § 280G(b).

An excess parachute payment is defined in § 280G(b)(1) as an amount equal to the excess of any parachute payment over the portion of the disqualified individual's base amount that is allocated to such payment.

Section 280G(b)(2)(A) defines a parachute payment as any payment in the nature of compensation to (or for the benefit of) a disqualified individual if (i) such payment is contingent on a change in the ownership of a corporation, the effective control of a corporation, or the ownership of a substantial portion of the assets of a corporation (a change in ownership or control), and (ii) the aggregate present value of the payments in the nature of compensation which are contingent on such change equals or exceeds an amount equal to 3 times the base amount. A parachute payment also includes any payment in the nature of compensation to, or for the benefit of, a disqualified individual if the payment is pursuant to an agreement that violates any generally enforced securities laws or regulations.

A payment in the nature of compensation for purposes of § 280G includes the transfer of an option (including an option to which § 421 applies), without regard to whether the option has a readily ascertainable fair market value within the meaning of § 83. An option is considered transferred when the option becomes substantially vested (within the meaning of § 1.83–3(b) and (j) of the Income Tax Regulations). Thus, for purposes of § 280G, stock options must be valued when a payment in the nature of compensation includes the transfer of a stock option, such as the grant or vesting of a stock option, in connection with a change in ownership or control. This revenue procedure provides guidance on the valuation of a stock option for this purpose. However, this revenue procedure does not apply for purposes of valuing a payment in cash (or property), even though the amount of the payment is determined by reference to the cancellation of a stock option.

Pursuant to §1.280G–1, Q/A–13, the value of an option is determined under all the facts and circumstances in the particular case. Factors relevant to such a determination include, but are not limited to: the difference between the option's exercise price and the value of the property subject to the option at the time of vesting; the probability of the value of such property increasing or decreasing; and the length of the period during which the option can be exercised. For purposes of Q/A–13, valuation may be determined by any method prescribed by the Commissioner in published guidance of general applicability.

The determination of when there has been a change in ownership or control for purposes of section 280G is made under § 1.280G–1, Q/A–27 through Q/A–29.

Section 1.280G–1, Q/A–33, provides that, to the extent provided in published guidance of general applicability, an initial estimate of the value of an option is permitted to be made, with the valuation subsequently re-determined, and the base amount reallocated.

Rev. Proc. 98–34, 1998–1 C.B. 983, provides a methodology for the valuation of certain stock options for purposes of gift, estate, and generation-skipping transfer taxes. The methodology described in Rev. Proc. 98–34 is an option pricing model that takes into account factors similar to those established by the Financial

Accounting Standards Board in Accounting for Stock-Based Compensation, Statement of Financial Accounting Standards No. 123 (Fin. Accounting Standards Bd. 1995) (FAS 123). The methodology in Rev. Proc. 98–34 applies only to the valuation of a nonpublicly traded stock option for stock that, on the valuation date, is publicly traded on an established securities market.

Concurrently with the issuance of proposed regulations under section 280G (see § 1.280G–1 of the Proposed Income Tax Regulations at 67 Fed. Reg. 7630), Rev. Proc. 2002–13 was issued concerning the valuation of stock options (including a safe harbor valuation method) for purposes of §§ 280G and 4999. Rev. Proc. 2002–45 modified various portions of Rev. Proc. 2002–13.

This revenue procedure restates and further modifies Rev. Proc. 2002–13 and Rev. Proc. 2002–45 to address additional issues regarding the valuation of stock options in connection with a change in ownership or control under §§ 280G and 4999.

SECTION 3. STOCK OPTION VALUATION

.01 *General rule.* A taxpayer may value a stock option, without regard to whether the option is on publicly or nonpublicly traded stock, using any valuation method that (i) is consistent with generally accepted accounting principles (such as FAS 123 or a successor standard) and (ii) takes into account the factors provided in § 1.280G–1, Q/A 13. The safe harbor method provided in section 4 of this revenue procedure and Rev. Proc. 98–34 are considered consistent with generally accepted accounting principles and take into account the factors provided in § 1.280G–1, Q/A 13. For purposes of §§ 280G and 4999 and this revenue procedure, the value of a stock option will not be considered properly determined if the option is valued solely by reference to the spread between the exercise price of the option and the value of the stock at the time of the change in ownership or control.

.02 *Payment date.* For purposes of this revenue procedure, the valuation date is the payment date as determined in accordance with § 280G. Thus, the valuation of a stock option is determined based on the spread, the volatility of the underlying stock, the option term, and any other relevant factors as of that date.

.03 *Substitution of an option.* If, in addition to vesting, there is, contingent on the change in ownership or control, a substitution of an option on different stock for the option, the valuation is based on the substituted option.

.04 *Recalculation.* Pursuant to § 1.280G–1, Q/A–33, for purposes of §§ 280G and 4999, the payor is permitted to re-determine the value of an option, during the 18-month period beginning on the date of the change in ownership or control (the re-determination period), in accordance with this revenue procedure. Recalculation is permitted if, during the re-determination period, either of the following occurs: (1) there is a change in the term of the option due to a termination of employment, or (2) there is a change in the volatility of the stock.

Without regard to whether the value of the option will be re-determined, an initial determination of the value of the option must be made in accordance with this revenue procedure. This initial valuation is the amount of the payment, subject to adjustment as otherwise applicable (*e.g.*, pursuant to § 1.280G–1, Q/A–24). This amount is used both to determine whether there are parachute payments and to calculate excess parachute payments and any excise tax liability associated with the transfer of the option.

A recalculation under this revenue procedure must be determined as of the date of payment used in the initial calculation (*i.e.*, the valuation date). Thus, while the term assumption and the volatility assumption are permitted to be re-determined, the spread and the interest rate assumptions continue to be determined as of the valuation date.

For purposes of re-determining the value of the option, an employer is permitted to use a method other than the method used in making the initial determination, provided that both methods are otherwise permitted under this revenue procedure.

If the value of an option is recalculated under this revenue procedure, parachute payments and excess parachute payments must be recalculated using the re-determined valuation. However, the base amount does not have to be re-apportioned; instead, the base amount allocated to the parachute payment is permitted to remain the same, with any adjustment to the excise tax made with respect to the option. This adjustment may be claimed only by filing an amended return for the taxable year that includes the payment date.

SECTION 4. VALUATION SAFE HARBOR

.01 *In general.* The safe harbor valuation method provided by this revenue procedure is based on the Black-Scholes model and takes into account, as of the valuation date, the following factors: (1) the volatility of the underlying stock, (2) the exercise price of the option, (3) the value of the stock at the time of the valuation (the "spot price"), and (4) the term of the option on the valuation date. The safe harbor value of the option equals (i) the number of shares covered by the options multiplied by (ii) the spot price of the stock, and then multiplied by (iii) a valuation factor determined using the factors described above and reflected in the Table at the end of this revenue procedure. Other relevant factors, including risk-free rate of interest and assumptions related to dividend yields, are included in the Table. To determine the valuation factor, the taxpayer must determine the volatility, spread, and option term factors, as described below. To rely on this revenue procedure, assumptions made for purposes of this revenue procedure and the determination of each factor must be reasonable and consistent with assumptions made with respect to other options that may be valued in connection with the change in ownership or control.

.02 *Volatility.* The taxpayer must determine whether the volatility of the underlying stock is low, medium, or high. If the valuation is based on a substituted option pursuant to section 3.03, volatility is determined based on the stock under the substituted option. For this purpose, a low volatility stock has an annual standard deviation of 30 percent or less. A medium volatility stock has an annual standard deviation greater than 30 percent but less than 70 percent. A high volatility stock has an annual standard deviation of 70 percent or greater. If the stock is publicly traded on

an established securities market (or otherwise), the expected volatility of the underlying stock used for purposes of volatility under this revenue procedure must be the volatility for the most recent year disclosed in the most recent financial statements of the corporation. If the stock is not publicly traded on an established securities market or otherwise, but the stock is required to be registered under the Securities Exchange Act of 1934, the volatility for such stock is assumed to be the same as the volatility for a comparable corporation that is publicly traded. For this purpose, whether a corporation is considered comparable is determined by comparing relevant characteristics such as industry, corporate size, earnings, market capitalization, and debt-equity structure. If the stock is not publicly traded and the corporation is not required to register under the Securities Exchange Act of 1934, the taxpayer must assume medium volatility. If the stock is not required to be registered under the Securities Exchange Act of 1934, but the corporation voluntarily registers its stock and its stock is publicly traded, the corporation must use the volatility of the underlying stock.

.03 *Spread between exercise price and spot price.* The factor based on the spread between the exercise price and the spot price is calculated by dividing the spot price by the exercise price and subtracting 1. If the stock is not publicly traded, the determination of the spot price for this purpose must be reasonable and consistent with the price, if any, otherwise determined for the stock in connection with the transaction giving rise to the change in ownership or control under § 280G(b)(2)(A). For purposes of determining the factor based on the spread between the exercise price and the spot price under the Table, the resulting percentage may be rounded down to the next lowest interval. If this factor exceeds 220%, this safe harbor valuation method cannot be used to value the stock option.

.04 *Term of the option.* The term of the option is the number of full months between the valuation date and the latest date on which the option will expire. For purposes of determining the term factor under the table, the number of full months may be rounded down to the next lowest 12-month interval. If the term of the option exceeds 10 years (120 months), then this safe harbor valuation method cannot be used to value the stock option. If the remaining term of the option is less than 12 months, the taxpayer may round down to the 3-month interval. For purposes of this paragraph, the taxpayer is permitted to use the expected term of the option calculated in accordance with Rev. Proc. 98–34.

SECTION 5. EXAMPLE

E is an employee of Corporation A, a publicly traded corporation. On September 1, 2004, in connection with E's performance of services, A grants E options to purchase 100,000 shares of A stock at $10 per share. The options are exercisable for 10 years. The options will vest on September 1, 2007, if E continues to be employed by A through that date, or on a change in ownership or control, if earlier. Under the terms of the option, if E's employment is terminated after the option is vested, the option must be exercised on or before the date that is 3 months after the termination of employment.

On September 15, 2005, Corporation B acquires all of the stock of A, and A is merged into B. Contingent on the change in ownership, E's options become fully vested and are converted into B options with the same aggregate spread and the same ratio between the exercise price and the value of the stock (determined immediately before the conversion). At the time of the vesting, A stock has a fair market value of $20, and B stock has a fair market value of $50. Thus, in connection with the change in ownership, E receives fully vested options for 40,000 shares of B stock with an exercise price of $25. The date of the vesting and substitution is the payment date and, therefore, the valuation date.

Using a valuation method that complies with this revenue procedure, B determines that, as of the valuation date, it is reasonable to assume that the volatility of B stock is .25, that the remaining expected term of the option is 36 months, and that the risk-free interest rate is 5%. B determines that the value of the option is $1,096,000 (or $27.40 per share).

Without regard to the change in ownership, this payment was contingent only on continued performance of services for Corporation A for a specified period of time and the payment is attributable, in part, to the performance of services before the date the payment was made. Therefore, the portion of the payment that is contingent on the change in ownership is determined under § 1.280G–1, Q/A–24(c). The acceleration of the vesting of a stock option is considered to significantly increase the value of the payment. Therefore, the future value of the payment is assumed to be equal to the payment. Under § 1.280G–1, Q/A–31 and 32, the present value of the option is determined to be $975,000. The vesting of the option has been accelerated by 23 full months. Therefore, the portion of the payment that is contingent on the change in ownership is $373,080, the sum of (1) $121,000 (the amount by which $1,096,000, exceeds $975,000), and (2) $252,080 (23 months times 1% times $1,096,000).

The value of the payment related to the options, $373,080, is taken into account for purposes of determining whether A has received parachute payments and, if so, the portion of the parachute payments that are excess parachute payments. For purposes of this example, assume E is receiving parachute payments and that $50,000 in base amount is allocated to this payment. In that case, $323,080 of the payment is an excess parachute payment, and the excise tax under section 4999 is $64,616. B must satisfy its obligations under section 4999(c) with respect to this amount, and E is responsible for the excise tax related to this payment for E's 2005 taxable year. B cannot claim the amount of the excess parachute payment as a deduction.

On July 1, 2006, E's employment is terminated, shortening the term of the option. As a result, the actual term of the option, measured from the date of the change in ownership, is 12 months (the 9 full months that E was employed following the change in ownership plus the 3 months following a termination of employment during which E can exercise the option). B decides to recalculate the value of the options as of the valuation date in accordance with section 3.04 of this revenue procedure, using the value of B stock at the change of ownership, $50, and the exercise price of $25 a share. In addition, B uses the same 5% risk-free assumption rate used in the initial valuation. Finally, B determines that .25 continues to be a reasonable assumption for volatility. The value of the option, as recalculated, is $1,030,000 (or $25.75 a share).

This value is then used to re-determine the portion of the payment that is contingent on the change in ownership under § 1.280G–1, Q/A–24(c). This amount is $350,800, the sum of (1) $113,900 (the amount by which the value of the payment, $1,030,000, exceeds the present value of the payment, determined to be $916,100), and (2) $236,900 (23 times 1% times $1,030,000). Using the base amount initially allocated to this payment, $50,000, the portion of the payment that is an excess parachute payment is $300,800, and the excise tax is $60,160. E is permitted to file an amended return for 2005 using the revised calculations as a basis for claiming a refund of $4,456.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–13, 2002–1 C.B. 549, and Rev. Proc. 2002–45, 2002–27 I.R.B. 40, are revoked as of January 1, 2004.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective January 1, 2004. Taxpayers are permitted to apply this revenue procedure with respect to a change in ownership or control occurring prior to such date.

SECTION 8. DRAFTING INFORMATION

The principal author of this procedure is Erinn Madden of the Office of Chief Counsel of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities. However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this revenue procedure, contact Ms. Madden (202) 622–6030 (not a toll-free call).

TABLE

	Term (months)	3	12	24	36	48	60	72	84	96	108	120
Volatility	Spread Factor*											
Low	200%	66.8%	67.3%	67.9%	68.4%	69.0%	69.5%	69.9%	70.3%	70.7%	71.0%	71.2%
	180%	64.5%	65.0%	65.7%	66.4%	67.1%	67.7%	68.3%	68.8%	69.3%	69.6%	69.9%
	160%	61.8%	62.4%	63.3%	64.1%	65.0%	65.8%	66.5%	67.1%	67.7%	68.1%	68.5%
	140%	58.6%	59.4%	60.4%	61.5%	62.5%	63.5%	64.4%	65.1%	65.8%	66.4%	66.9%
	120%	54.9%	55.8%	57.1%	58.4%	59.7%	60.9%	62.0%	62.9%	63.7%	64.5%	65.1%
	100%	50.4%	51.5%	53.2%	54.8%	56.4%	57.9%	59.1%	60.3%	61.3%	62.2%	63.0%
	80%	44.9%	46.3%	48.5%	50.6%	52.6%	54.3%	55.9%	57.3%	58.5%	59.6%	60.5%
	60%	38.0%	40.0%	42.9%	45.6%	48.0%	50.1%	52.0%	53.7%	55.2%	56.5%	57.6%
	40%	29.3%	32.3%	36.3%	39.7%	42.6%	45.2%	47.4%	49.4%	51.2%	52.7%	54.1%
	20%	18.1%	23.3%	28.5%	32.7%	36.2%	39.3%	41.9%	44.3%	46.4%	48.2%	49.9%
	0%	6.4%	13.6%	19.9%	24.7%	28.8%	32.3%	35.4%	38.1%	40.5%	42.7%	44.7%
	-20%	0.6%	5.4%	11.2%	16.1%	20.4%	24.2%	27.6%	30.6%	33.4%	35.9%	38.1%
	-40%	0%	0.9%	4.1%	7.9%	11.6%	15.2%	18.5%	21.7%	24.6%	27.3%	29.9%
	-60%	0%	0.0%	0.6%	2.0%	4.0%	6.4%	9.0%	11.6%	14.3%	16.8%	19.3%

	Term (months)	3	12	24	36	48	60	72	84	96	108	120
Volatility	Spread Factor*											
Medium	200%	66.8%	67.4%	68.6%	69.9%	71.1%	72.2%	73.1%	73.9%	74.5%	75.0%	75.4%
	180%	64.5%	65.2%	66.7%	68.2%	69.6%	70.9%	71.9%	72.8%	73.5%	74.1%	74.6%
	160%	61.8%	62.7%	64.5%	66.3%	68.0%	69.4%	70.6%	71.6%	72.5%	73.2%	73.7%
	140%	58.6%	59.8%	62.0%	64.2%	66.1%	67.7%	69.1%	70.3%	71.2%	72.0%	72.7%
	120%	54.9%	56.4%	59.2%	61.7%	63.9%	65.8%	67.4%	68.8%	69.9%	70.8%	71.6%
	100%	50.4%	52.5%	55.9%	58.9%	61.5%	63.7%	65.5%	67.0%	68.3%	69.4%	70.3%
	80%	44.9%	47.9%	52.2%	55.7%	58.7%	61.2%	63.2%	65.0%	66.5%	67.7%	68.8%
	60%	38.2%	42.6%	47.8%	52.0%	55.4%	58.3%	60.6%	62.7%	64.3%	65.8%	67.0%
	40%	30.0%	36.3%	42.7%	47.6%	51.6%	54.8%	57.6%	59.9%	61.8%	63.5%	64.9%
	20%	20.3%	29.1%	36.8%	42.5%	47.0%	50.8%	53.9%	56.5%	58.8%	60.7%	62.3%
	0%	10.4%	21.2%	30.0%	36.4%	41.6%	45.8%	49.4%	52.4%	55.0%	57.2%	59.1%
	-20%	3.0%	13.0%	22.2%	29.2%	34.9%	39.7%	43.7%	47.2%	50.2%	52.8%	55.0%
	-40%	0.3%	5.7%	13.8%	20.8%	26.8%	32.0%	36.4%	40.4%	43.8%	46.8%	49.5%
	-60%	0%	1.2%	5.9%	11.4%	16.9%	22.1%	26.7%	31.0%	34.8%	38.3%	41.4%
High	200%	66.8%	68.1%	70.7%	73.1%	75.0%	76.6%	77.8%	78.8%	79.5%	80.0%	80.4%
	180%	64.5%	66.1%	69.1%	71.7%	73.9%	75.6%	77.0%	78.1%	78.9%	79.5%	79.9%
	160%	61.8%	63.8%	67.3%	70.3%	72.7%	74.6%	76.1%	77.3%	78.2%	78.9%	79.4%
	140%	58.6%	61.3%	65.3%	68.6%	71.3%	73.4%	75.1%	76.4%	77.4%	78.2%	78.8%
	120%	54.9%	58.3%	63.0%	66.8%	69.7%	72.1%	73.9%	75.4%	76.6%	77.4%	78.1%
	100%	50.6%	55.0%	60.4%	64.6%	67.9%	70.6%	72.6%	74.3%	75.6%	76.6%	77.3%
	80%	45.3%	51.1%	57.4%	62.2%	65.9%	68.8%	71.1%	73.0%	74.4%	75.6%	76.5%
	60%	39.1%	46.6%	54.0%	59.4%	63.5%	66.8%	69.4%	71.4%	73.1%	74.4%	75.4%
	40%	31.7%	41.4%	50.0%	56.1%	60.7%	64.4%	67.3%	69.6%	71.5%	73.0%	74.2%
	20%	23.2%	35.4%	45.3%	52.1%	57.4%	61.5%	64.8%	67.4%	69.6%	71.3%	72.7%
	0%	14.3%	28.5%	39.6%	47.4%	53.3%	57.9%	61.6%	64.7%	67.1%	69.1%	70.8%
	-20%	6.4%	20.8%	32.9%	41.5%	48.1%	53.4%	57.6%	61.1%	64.0%	66.4%	68.3%
	-40%	1.5%	12.7%	24.8%	34.0%	41.4%	47.3%	52.2%	56.3%	59.7%	62.5%	64.8%
	-60%	0.1%	5.2%	15.2%	24.3%	32.1%	38.8%	44.4%	49.1%	53.2%	56.6%	59.5%

*Spot (market) Price/Exercise Price — 1 or (S/X–1)

---

26 CFR 601.602: Tax forms and instructions.
(Also Part 1, §§ 3504, 6011, 6061, 6302; 31.3504–1, 31.6011(a)–7, 31.6061–1, 31.6302–1.)

Rev. Proc. 2003–69

TABLE OF CONTENTS

SECTION 1. PURPOSE 403

SECTION 2. BACKGROUND 403

SECTION 3. SIGNIFICANT CHANGES TO REV. PROC. 96–17 404

SECTION 4. DEFINITIONS 404

SECTION 5. SCOPE OF REPORTING AGENT AUTHORIZATION 404

SECTION 6. COMPLETING A REPORTING AGENT AUTHORIZATION 406

SECTION 7. SUBMITTING A REPORTING AGENT AUTHORIZATION 406

SECTION 8. INTERNAL REVENUE SERVICE CONTACTS 406

SECTION 9. OTHER RELATED DOCUMENTS 406

SECTION 10. EFFECT ON OTHER DOCUMENTS 406

SECTION 11. EFFECTIVE DATE 406

SECTION 1. PURPOSE

.01 This revenue procedure provides the requirements for completing and submitting Form 8655, *Reporting Agent Authorization for Magnetic Tape/Electronic Filers (“Authorization”)*. An Authorization allows a taxpayer to designate a Reporting Agent (“Agent”) to perform the following acts on behalf of the taxpayer:

(1) Sign and file on magnetic tape or electronically Form 940, *Employer’s Annual Federal Unemployment (FUTA) Tax Return*; and Form 941, *Employer’s Quarterly Federal Tax Return*.

(2) Sign and file on paper Form 940–PR, *Planilla Para La Declaración Anual Del Patrono — La Contribución Federal Para El Desempleo (FUTA)*; Form 941–PR, *Planilla Para La Declaracion Trimestral Del Patrono — La Contribucion Federal Al Seguro Social Y Al Seguro Medicare*; Form 941–SS, *Employer’s Quarterly Federal Tax Return (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands)*; Form 943, *Employer’s Annual Tax Return for Agricultural Employees*; Form 943–PR, *Planilla Para La Declaración Anual De La Contribución Del Patrono De Empleados Agrícolas*; Form 945, *Annual Return of Withheld Federal Income Tax*; Form 1042, *Annual Withholding Tax Return For U.S. Source Income of Foreign Persons*; and Form CT–1, *Employer’s Annual Railroad Retirement Tax Return*.

(3) Make federal tax deposits (“FTDs”) and other federal tax payments (“FTPs”) and submit FTD information and FTP information electronically for the taxes deposited and payments reported on Form 720, *Quarterly Federal Excise Tax Return*; Form 940, *Employer’s Annual Federal Unemployment (FUTA) Tax Return*; Form 941, *Employer’s Quarterly Federal Tax Return*; Form 943, *Employer’s Annual Tax Return for Agricultural Employees*; Form 945, *Annual Return of Withheld Federal Income Tax*; Form 990–C, *Farmer’s Cooperative Association Income Tax Return*; Form 990–PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*; Form 990–T, *Exempt Organization Business Income Tax Return*; Form 1041, *U.S. Income Tax Return for Estates and Trusts*; Form 1042, *Annual Withholding Tax Return For U.S. Source Income of Foreign Persons*; Form 1120, *U.S. Corporation Income Tax Return*; and Form CT–1, *Employer’s Annual Railroad Retirement Tax Return*.

(4) Receive duplicate copies of official notices, correspondence, deposit requirements, tax rates, transcripts, or other information with respect to the tax returns described in section 1.01(1) or (2) of this revenue procedure.

(5) Receive duplicate copies of official notices, correspondence, deposit requirements, tax rates, transcripts, or other information with respect to FTDs and FTPs.

.02 The technical specifications for filing Authorization information are published separately in Publication 1474, *Technical Specifications Guide For Reporting Agent Authorization For Magnetic Tape/Electronic Filers And Federal Tax Depositors*.

SECTION 2. BACKGROUND

.01 Section 1.6011–1 of the Income Tax Regulations and section 31.6011(a)–7 of the Employment Taxes and Collection of Income Tax at Source Regulations (“Employment Tax Regulations”) provide that each return required under the regulations, together with any prescribed copies or supporting data, must be filled in and disposed of in accordance with the applicable

forms, instructions, and regulations. Section 31.6011(a)–7 provides that the return may be made by an agent authorized by the person required to make the return.

.02 Section 31.6061–1 of the Employment Tax Regulations provides that a return may be signed for the taxpayer by an agent who is duly authorized in accordance with section 31.6011(a)–7 to make the return. Section 1.6061–1 provides that a return may be signed by an agent who is duly authorized under section 1.6012–1(a)(5) or (b) to make the return.

.03 Section 31.6302–1 of the Employment Tax Regulations provides the rules for depositing employment taxes. Section 31.6302–1(h) implements section 6302(h) of the Internal Revenue Code, which requires the use of an electronic fund transfer system for the collection of federal depository taxes. The Electronic Federal Tax Payment System ("EFTPS") is the electronic fund transfer system developed to collect these taxes. Rev. Proc. 97–33, 1997–2 C.B. 371, provides general information about EFTPS, and Rev. Proc. 98–32, 1998–1 C.B. 935, provides information about EFTPS programs for Agents making FTDs and FTPs on behalf of multiple taxpayers.

.04 The Service has prescribed Form 8655 as the appropriate authorization form for a taxpayer to use to designate an Agent to perform the following acts on behalf of the taxpayer:

(1) Sign and file Form 940 and Form 941 on magnetic tape or electronically.

(2) Sign and file certain tax returns on paper.

(3) Make FTDs and FTPs and submit FTD information and FTP information electronically for certain tax returns.

(4) Receive duplicate copies of official notices, correspondence, deposit requirements, tax rates, transcripts, or other information with respect to the returns filed by the Agent.

(5) Receive duplicate copies of official notices, correspondence, deposit requirements, tax rates, transcripts, or other information with respect to FTDs and FTPs submitted or to be submitted by the Agent.

SECTION 3. SIGNIFICANT CHANGES TO REV. PROC. 96–17

.01 This revenue procedure modifies and supersedes Rev. Proc. 96–17, 1996–1 C.B. 633, by making the following changes to Rev. Proc. 96–17:

(1) Form 945, *Annual Return of Withheld Federal Income Tax*, can no longer be filed on magnetic tape or electronically.

(2) An Authorization may now be used to allow an Agent to sign and file on paper Form 940–PR, Form 941–PR, Form 941–SS, Form 943, Form 943–PR, Form 945, Form 1042, and Form CT–1.

(3) An Authorization may now be used to allow an Agent to make FTDs and FTPs for the taxes reported on Form 720, Form 940, Form 941, Form 943, Form 945, Form 990–C, Form 990–PF, Form 990–T, Form 1041, Form 1042, Form 1120, and Form CT–1.

(4) All references to submitting FTD information on magnetic tape are removed because the magnetic tape FTD program was terminated by Notice 99–42, 1999–2 C.B. 325.

(5) The procedures in section 2.05 of Rev. Proc. 96–17 are removed to eliminate the references to an election box that is no longer on Form 8655.

(6) Sections 5.01 and 5.02 clarify that an Agent may provide information that will assist the Service in determining whether it is appropriate to grant relief from penalties that may arise from returns filed and FTDs and FTPs made by the Agent.

(7) Section 5.04 clarifies the effect of submitting a new Authorization.

(8) Section 6.05 updates the information regarding the requirement to replace a previously submitted Authorization.

(9) Section 7.02 adds a requirement that an Agent must submit an Agent's List on magnetic tape if the number of taxpayer/clients exceeds 100.

(10) Section 8 updates the contact information.

(11) Section 9 updates the list of other related documents.

SECTION 4. DEFINITIONS

.01 *Reporting Agent*. A Reporting Agent ("Agent") is an accounting service, franchiser, bank, service bureau, or other entity authorized to perform one or more of the following acts on behalf of a taxpayer:

(1) Sign and file on magnetic tape or electronically Form 940 and Form 941.

(2) Sign and file on paper Form 940–PR, Form 941–PR, Form 941–SS, Form 943, Form 943–PR, Form 945, Form 1042, and Form CT–1.

(3) Make FTDs and FTPs and submit FTD information and FTP information electronically for the taxes reported on Form 720, Form 940, Form 941, Form 943, Form 945, Form 990–C, Form 990–PF, Form 990–T, Form 1041, Form 1042, Form 1120, and Form CT–1.

.02 *Reporting Agent Authorization*. A Reporting Agent Authorization ("Authorization") allows a taxpayer to designate an Agent to sign and to file on magnetic tape or electronically Form 940 and Form 941; to sign and file on paper Form 940–PR, Form 941–PR, Form 941–SS, Form 943, Form 943–PR, Form 945, Form 1042, and Form CT–1; and to make FTDs and FTPs and submit FTD information and FTP information electronically for the taxes deposited and reported on the forms listed in section 1.01 of this revenue procedure. The Authorization may also permit the Agent to receive duplicate copies of official notices, correspondence, deposit requirements, tax rates, transcripts, or other information with respect to these tax returns. In addition, an Authorization may permit the Agent to receive duplicate copies of official notices, correspondence, deposit requirements, tax rates, transcripts, or other information with respect to FTDs and FTPs. The Service has prescribed Form 8655 as the appropriate authorization form for a taxpayer to use to designate an Agent.

.03 *Reporting Agent's List*. A Reporting Agent's List ("Agent's List") identifies all taxpayers for whom an Agent will file tax returns, make FTDs and FTPs, or submit FTD information and FTP information electronically. A separate Authorization must be submitted for each taxpayer on the Agent's List.

SECTION 5. SCOPE OF REPORTING AGENT AUTHORIZATION

.01 The scope of an Authorization for the filing of forms listed on Form 8655 is as follows:

(1) A taxpayer may authorize an Agent to sign and file on the taxpayer's behalf all or any of the forms listed on Form 8655.

(2) A taxpayer may authorize an Agent to receive duplicate copies of notices, correspondence, deposit requirements, tax rates, transcripts or other information with respect to the returns filed by the Agent.

(3) An Authorization that permits an Agent to make returns also permits an Agent to request information or submit information on the returns filed by the Agent, including any information concerning penalties that may arise from the returns. It further permits the Agent to provide information that will assist the Service in determining whether it would be appropriate to grant relief from any penalties that may arise from the returns.

(4) An Authorization does not permit the Agent to request the abatement of any penalties that may arise from the returns filed by the Agent or in any other way to perform any acts that constitute representation of the taxpayer as set forth in section 601.501(b)(13) of the Statement of Procedural Rules.

.02 The scope of an Authorization for making FTDs and FTPs and submitting FTD information and FTP information electronically is as follows:

(1) A taxpayer may authorize an Agent to prepare and make FTDs and FTPs for any taxes reported on any of the forms listed on Form 8655 and submit FTD information and FTP information electronically on the taxpayer's behalf.

(2) Regardless of the taxpayer's designated method, an Agent must make FTD payments and submit payment information through the EFTPS system for a taxpayer that is required to make FTD payments and submit FTD information through the EFTPS system pursuant to section 6302(h) of the Code.

(3) A taxpayer may authorize an Agent to receive duplicate copies of notices and correspondence for FTDs and FTPs made by the Agent for the taxpayer.

(4) An Authorization that permits an Agent to make FTDs and FTPs also permits the Agent to request information or submit information on the FTDs and FTPs submitted by the Agent, including any information concerning penalties that may arise from the FTDs and FTPs. It further permits the Agent to provide information that will assist the Service in determining whether it would be appropriate to grant relief from any penalties that may arise from the FTDs or FTPs.

(5) An Authorization does not permit the Agent to request the abatement of any penalties that may arise from the FTDs or FTPs submitted by the Agent or in any other way to perform any acts that constitute representation of the taxpayer as set forth in section 601.501(b)(13) of the Statement of Procedural Rules.

.03 An Authorization becomes effective for the tax period designated by the Agent and taxpayer and remains in effect for subsequent periods until revoked by the taxpayer, terminated by the Agent, or terminated by the Service, subject to the following:

(1) In the case of an Agent filing a return on behalf of a taxpayer, the Service must accept the Authorization and Agent's List before the Agent may file the return.

(2) In the case of an Agent using EFTPS to make a FTD or FTP on behalf of a taxpayer, the Agent must comply with the requirements of Rev. Proc. 98–32, 1998–1 C.B. 935, before the Agent may make the FTD or FTP and submit the FTD information or FTP information electronically.

(3) See section 9 of this revenue procedure for a list of other applicable revenue procedures.

.04 A new Authorization must be submitted for any increase or decrease in the scope of the authority of an Agent to act on behalf of the taxpayer, or if the taxpayer appoints a new Agent. Receipt by the Service of a new Authorization terminates the authority of the prior Agent to file tax returns and make FTDs or FTPs for tax periods beginning on or after the effective date of the new Authorization. A new Authorization also terminates the authority of the prior Agent to receive duplicate copies of notices. The prior Agent, however, may present information regarding taxpayer accounts for the tax periods beginning before the effective date of the new Authorization, and the Service may disclose otherwise confidential tax information relating to the returns filed by the Agent or relating to FTDs and FTPs made by the Agent, unless the taxpayer specifically revokes the prior Agent's authorization to present information and receive otherwise confidential tax information relating to the returns filed by the Agent or relating to the FTDs and FTPs made by the Agent.

.05 An Authorization filed under this revenue procedure does not constitute the appointment of a recognized representative as described in section 601.502 of the Statement of Procedural Rules.

.06 An Authorization does not relieve the taxpayer of the responsibility to ensure that all tax returns are filed timely; all FTPs are made timely; and any taxes, required to be deposited, are deposited timely.

.07 An Agent may use an Authorization to file paper forms listed on Form 8655 on behalf of a taxpayer only if—

(1) The late receipt of payroll information from a taxpayer has jeopardized the timely submission of the taxpayer's return;

(2) The paper forms amend returns filed under the magnetic tape or electronic filing programs referenced in section 9 of this revenue procedure;

(3) The rejection of a magnetic tape/electronic filing has jeopardized the timely submission of the taxpayer's return;

(4) The forms are listed in section 4.01(2) of this revenue procedure; or

(5) The magnetic tape/electronic filing coordinator for an Agent participating in a magnetic tape/electronic filing program referenced in section 9 of this revenue procedure has requested paper returns.

.08 An Agent covered by Form 8655 may prepare a paper tax return for the taxpayer's signature. A taxpayer's authorized representative that is not an Agent covered by Form 8655 must have a valid power of attorney in accordance with section 601.504(6) of the Statement of Procedural Rules (usually Form 2848, *Power of Attorney and Declaration of Representative*) to sign and file a paper tax return on behalf of the taxpayer.

.09 Each paper tax return must be signed by the taxpayer, by the taxpayer's authorized representative, or by an Agent permitted in section 5.07 of this revenue procedure to file returns on behalf of the taxpayer.

.10 The Agent must keep a copy of each Authorization at the Agent's principal place of business for examination by the Service until the period of limitations for assessment for the last return filed under that Authorization expires.

SECTION 6. COMPLETING A REPORTING AGENT AUTHORIZATION

.01 An Authorization may be submitted on Form 8655 or any other document that clearly contains the same information required to be provided on Form 8655. The taxpayer may strike out the nonapplicable portions of the Form 8655. An Agent may fax the Authorization to the Service.

.02 An Authorization must be signed by the taxpayer, an authorized representative holding a power of attorney that specifically authorizes the representative to sign returns on behalf of the taxpayer, or a person who is duly authorized in accordance with section 31.6011(a)–7 of the Employment Tax Regulations. If the Authorization provides that the Agent is authorized to receive tax return notices, correspondence, deposit requirements, tax rates and transcripts from the Service, or discuss taxpayer account information with Service representatives and is signed by a person other than the taxpayer, the authorized representative or other duly authorized person signing the Authorization must be authorized both to receive, and to designate others to receive, tax return information (as defined in section 6103(b)(2)) of the taxpayer.

.03 An Authorization executed after December 31, 2001, must be made on Form 8655 (with a revision date of July 2000 or later) or its equivalent.

.04 Except to the extent provided in section 6.05 of this revenue procedure, an Authorization will remain in effect until the Service receives a new Authorization.

.05 A revised Authorization is not required to replace an Authorization made on Form 8655 with a revision date before October 1995 (or its equivalent) that was previously submitted to the Service by an Agent if the Authorization places no restriction on the medium for filing Forms 941 and 940, and the Agent advises the taxpayer/client that its Forms 941 and/or 940 may be filed electronically and that the taxpayer/client has the option to reject electronic filing for Forms 941 and 940. An Agent may use the most efficient and timely method of clearly providing this notification to the taxpayer/client. A taxpayer/client's rejection of electronic filing for Form 941 or 940 must be submitted in writing to the Agent, and the Agent must immediately remove any taxpayer/client that rejects electronic filing for Form 941 or 940 from its electronic filing taxpayer/client base.

SECTION 7. SUBMITTING A REPORTING AGENT AUTHORIZATION

.01 An Agent that wishes to use an Authorization to file on magnetic tape or electronically Form 940 and Form 941, or make FTDs or FTPs, and submit FTD information or FTP information electronically, must formally apply to the Service for these privileges. Currently, the required information for the applications for magnetic tape or electronic filing of Form 940 and Form 941 and participation in EFTPS are contained in the documents listed in section 9 of this revenue procedure. The applications covered in these documents must be accompanied by the individual Authorizations, signed as provided in section 6.02 of this revenue procedure, and an Agent's List (if required by the applicable revenue procedure).

.02 The Agent's List must contain each taxpayer's employer identification number. Agent's Lists may be filed on magnetic tape or electronically, if appropriate, but if the number of taxpayer/clients exceeds 100, the Agent's List must be filed on magnetic tape. For specific information concerning the requirements for submitting and updating Agent's Lists, see Publication 1474, the Service contacts listed in section 8 of this revenue procedure, and the documents listed in section 9 of this revenue procedure.

SECTION 8. INTERNAL REVENUE SERVICE CONTACTS

.01 Publication 1474 may be obtained electronically via the Internal Revenue Service Internet web site (IRS web site) at *http://www.irs.gov*. In addition, requests for Publication 1474 and questions regarding this revenue procedure may be addressed to the Service at the following address:

Internal Revenue Service
Accounts Management Service Center
MS 6748 RAF Team
1973 N Rulon White Blvd
Ogden, UT 84201

.02 The principal author of this revenue procedure is Michael Hara of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. Mr. Hara may be contacted at (202) 622–4910 (not a toll-free number).

SECTION 9. OTHER RELATED DOCUMENTS

The programs requiring an Authorization as a prerequisite to participation are described in the following documents:

(1) For magnetic tape filing of Forms 940 and/or 941, see Rev. Proc. 96–18, 1996–1 C.B. 637.

(2) For electronic filing of Form 941, see Rev. Proc. 99–39, 1999–2 C.B. 532.

(3) For electronic filing of Form 940, see Rev. Proc. 2001–9, 2001–1 C.B. 328.

(4) For participation in EFTPS, see Rev. Proc. 98–32, 1998–1 C.B. 935.

SECTION 10. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies and supersedes Rev. Proc. 96–17, 1996–1 C.B. 633.

SECTION 11. EFFECTIVE DATE

This revenue procedure is effective August 25, 2003.

---

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.

Rev. Proc. 2003–70

SECTION 1. PURPOSE

This revenue procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Internal Revenue Code for taxable years beginning after December 31, 2001. Instructions are provided for computing foreign insurance companies' liabilities for the estimated tax and installment payments of estimated

tax for taxable years beginning after December 31, 2001. For more specific guidance regarding the computation of the amount of net investment income to be included by a foreign insurance company on its U.S. income tax return, see Notice 89–96, 1989–2 C.B. 417. For the domestic asset/liability percentage and domestic investment yield, as well as instructions for computing foreign insurance companies' liabilities for estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 2000, see Rev. Proc. 2002–58, 2002–40 I.R.B. 644.

SECTION 2. CHANGES

.01 DOMESTIC ASSET/LIABILITY PERCENTAGES FOR 2002. The Secretary determines the domestic asset/liability percentage separately for life insurance companies and property and liability insurance companies. For the first taxable year beginning after December 31, 2001, the relevant domestic asset/liability percentages are:

123.3 percent for foreign life insurance companies, and

171.9 percent for foreign property and liability insurance companies.

.02 DOMESTIC INVESTMENT YIELDS FOR 2002. The Secretary is required to prescribe separate domestic investment yields for foreign life insurance companies and for foreign property and liability insurance companies. For the first taxable year beginning after December 31, 2001, the relevant domestic investment yields are:

7.0 percent for foreign life insurance companies, and

5.7 percent for foreign property and liability insurance companies.

.03 SOURCE OF DATA FOR 2002. The section 842(b) percentages to be used for the 2002 tax year are based on tax return data following the same methodology used for the 2001 year.

SECTION 3. APPLICATION — ESTIMATED TAXES

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 2001, a foreign insurance company must compute its estimated tax payments by adding to its income other than net investment income the greater of (i) its net investment income as determined under section 842(b)(5), that is actually effectively connected with the conduct of a trade or business within the United States for the relevant period, or (ii) the minimum effectively connected net investment income under section 842(b) that would result from using the most recently available domestic asset/liability percentage and domestic investment yield. Thus, for installment payments due after the publication of this revenue procedure, the domestic asset/liability percentages and the domestic investment yields provided in this revenue procedure must be used to compute the minimum effectively connected net investment income. However, if the due date of an installment is less than 20 days after the date this revenue procedure is published in the Internal Revenue Bulletin, the asset/liability percentages and domestic investment yields provided in Rev. Proc. 2002–58 may be used to compute the minimum effectively connected net investment income for such installment. For further guidance in computing estimated tax, see Notice 89–96.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is Garrett D. Gregory of the Office of the Associate Chief Counsel (International). For further information regarding this revenue procedure, please contact Mr. Gregory at (202) 622–4461 (not a toll-free call), or write to the Internal Revenue Service, Office of the Associate Chief Counsel (International), 1111 Constitution Avenue, NW, Washington, DC 20224, Attention: CC:INTL:Br5, Room 4554.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Waiver of Information Reporting Penalties – Determining Whether Correction is Prompt

REG–141669–02

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to waiver under section 6724 of the Internal Revenue Code (Code) of a penalty imposed by section 6721 for failure to file a correct information return. The proposed regulations provide guidance on the requirement of prompt correction of the failure to file or file correctly. The proposed regulations provide that the IRS will deem information returns promptly corrected if corrected within 30 days of the required filing date, or by August 1 following that required filing date. After August 1, a correction is prompt if made by the time announced by the IRS in published guidance. The proposed regulations do not change the rules for determining reasonable cause for waiving the penalty for failure to furnish correct payee statements under section 6722 or the time to comply with other information reporting requirements under section 6723.

DATES: Written and electronic comments are due by October 7, 2003. Requests to speak (with outlines of topics to be discussed) at the public hearing scheduled for October 21, 2003, are due by September 30, 2003.

ADDRESSES: Send submissions to: CC:PA:RU (REG–141669–02), Room 5526, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Commenters may hand deliver submissions Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (REG–141669–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, commenters may submit comments electronically to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, contact Robert A. Desilets, Jr. at (202) 622–4910; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Treena Garrett at (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 section 6724(a) of the Code. Section 301.6724–1(d)(1)(ii)(D) of the proposed regulations will clarify when a correction of an information return is prompt for purposes of establishing reasonable cause to waive the penalty under section 6721 of the Code. Existing §301.6724–1(d)(1)(ii)(D), adopted on December 31, 1991 (56 FR 67178), provides in pertinent part that a correction is prompt if it occurs on the earliest date of a regular submission of corrections, defining regular submissions as occurring at intervals of 30 or fewer days. Many information return filers have urged the IRS to replace the 30-day correction interval with an interval corresponding to the schedule for tiered penalties.

Explanation of Provisions

I. Section 6721

Section 6721 imposes penalties on failures to file, or file correct, information returns. Section 6721 creates a three-tiered penalty structure to encourage timely filing and prompt correction of errors in previously filed returns. Congress enacted the three-tiered penalty structure in the Omnibus Budget Reconciliation Act of 1989 (Public Law 101–239, 103 Stat. 2388, 2389). Section 6721 generally imposes a penalty in the amount of $50 for each return with respect to which a failure occurs, but not to exceed $250,000 per person per calendar year. However, if a filer corrects a failure within 30 days after the required filing date, the penalty with respect to such return shall be $15 in lieu of $50, but not to exceed $75,000 per filer per calendar year. Moreover, if a filer corrects a failure more than 30 days after the required filing date, but before August 1 of the calendar year in which the required filing date occurs, the penalty with respect to each return shall be $30 in lieu of $50, but not to exceed $150,000 per filer per calendar year. Section 6721 provides these penalties to encourage prompt corrections of failures to file, or file correct, information returns. H.R. Rep. 101–386, at 648–649 (1989).

II. Section 6724

Section 6724(a) provides for a waiver of information reporting penalties under sections 6721 through 6723 if the failure giving rise to such penalties was due to reasonable cause and not willful neglect. Under §301.6724–1(a) of the regulations, to prove reasonable cause for a failure, the filer must establish either that there are significant mitigating factors with respect to the failure or that the failure arose from an event beyond the filer's control (an impediment). In addition, the filer must have acted in a responsible manner both before and after the failure.

Under §301.6724–1(d) of the regulations, a filer is considered as acting in a responsible manner if the filer exercises reasonable care, *i.e.*, the care that a reasonably prudent person would use under the circumstances in the course of business in determining filing obligations and in handling account information such as account numbers and balances. Section 301.6724–1(d) of the regulations also refers to the promptness of correction, *i.e.*, when the filer undertook significant steps to avoid or mitigate the failure.

Section 301.6724–1(d)(1)(ii)(D) currently provides, in part, that a correction is considered prompt if it is made within 30 days after the date of removal of an impediment or discovery of a failure, or on the earliest date thereafter on which a regular submission of corrections occurs.

Submissions are regular only if they occur at intervals of 30 days or fewer. Under the 30-day rule, a filer of a large number of information returns that discovers errors over a period of several months would be required to submit multiple corrections in a series of filings. Information return filers have urged the IRS to allow filers to "bundle" their corrections, *i.e.*, submit the corrected information returns less frequently according to a defined timetable. The IRS agrees that the current rule may be burdensome and that bundling should be permitted.

The proposed regulations provide that a correction of an information return is prompt if the filer makes the correction within 30 days of the required filing date, or by August 1 following that required filing date. After August 1, a correction is prompt if the filer makes the correction by the date or dates announced in guidance governing the electronic or magnetic filing of information returns, or in other guidance including forms and instructions. It is anticipated that the date or dates will be in November and/or December of the calendar year in which the required filing date occurs. After the dates announced in the guidance, the proposed regulations provide that a correction is prompt if it is made within 30 days after the date the impediment is removed or the failure is discovered.

The proposed regulations apply solely for the purpose of determining whether there is reasonable cause for waiving the penalty for failure to file correct information returns imposed by section 6721. The proposed regulations do not apply for the purpose of determining whether there is reasonable cause for waiving the penalties imposed by sections 6722 and 6723. The IRS and Treasury Department believe that a filer should correct promptly a failure to furnish a correct payee statement or a failure to satisfy the reporting requirements described in section 6724(d)(2) and (3) with regard to sections 6722 and 6723, respectively. Therefore, the proposed regulations retain the 30-day correction period for waiving the penalties imposed by sections 6722 and 6723.

The proposed regulations do not affect or alter the tiered penalty rate schedule of section 6721. To ensure that a reduced penalty amount under section 6721 will apply, in the event that the IRS does not grant a reasonable cause waiver, a filer should file correct information returns with the IRS within 30 days after the required filing date, or before August 1 of the calendar year in which the required filing date occurs.

Proposed Effective Date

The proposed regulations apply to corrections of information returns made after the date of publication of a Treasury decision adopting the proposed regulations as final regulations in the **Federal Register**. However, filers may cite these rules for purposes of requesting a reasonable cause waiver prior to the date that the proposed regulations become final.

Special Analyses

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

Comments and Public Hearing

Before adoption of these proposed regulations as final regulations, the IRS will consider any electronic or written comments (a signed original and eight (8) copies) that a commenter submits timely (in the manner described in the **ADDRESSES** portion of this preamble) to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed regulations and how they can be easier to understand. All comments will be available for public inspection and copying. Written comments on the proposed regulations are due by October 7, 2003.

A public hearing has been scheduled for October 21, 2003, beginning at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit electronic or written comments and an outline of the topics for discussion and the time for each topic (a signed original and eight (8) copies) by September 30, 2003. Each person making comments will have 10 minutes to present comments. The IRS will prepare an agenda showing the scheduling of the speakers after the deadline for reviewing outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Robert A. Desilets, Jr., Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

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

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

Par. 2. Section 301.6724–1 is amended by:

1. Revising paragraph (d)(1)(ii)(D).
2. Adding paragraph (d)(3).

The revision and addition read as follows:

§301.6724–1 Reasonable cause.

* * * * *

(d) * * *

(1) * * *

(ii) * * *

(D) Correcting the failure as promptly as possible upon removal of the impediment or discovery of the failure. A person may correct a failure by filing or correcting the information return, by furnishing or correcting the payee statement, or by providing or correcting the information to satisfy the specified information reporting requirement with respect to which the failure occurs. This paragraph (d)(1)(ii)(D) does not apply with respect to information that specific information reporting rules prohibit the filer from altering. See §1.6045–4(i)(5) of this chapter. In the case of a waiver of a penalty imposed by section 6722 or 6723 of the Internal Revenue Code, correction is prompt if it is made within 30 days after the date of removal of the impediment or discovery of the failure. For purposes of section 6721 of the Internal Revenue Code, a correction is prompt if the Internal Revenue Service receives the correction—

(i) On or before 30 days after the required filing date;

(ii) On or before August 1 following that required filing date;

(iii) On or before the date or dates announced in guidance governing the electronic or magnetic filing of information returns;

(iv) On or before the date or dates announced in other guidance including forms and instructions; or

(v) Within 30 days after the date the impediment is removed or the failure is discovered if the correction is not submitted within the time frames set forth in paragraphs (d)(1)(ii)(D)(*i*) through (*iv*).

* * * * *

(3) [Reserved] For further guidance, see §301.6724–1T(d)(3).

* * * * *

Robert E. Wenzel,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 8, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 9, 2003, 68 F.R. 40857)

Notice of Proposed Rulemaking and Notice of Public Hearing

Remedial Actions for Tax-Exempt Bonds

REG–132483–03

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that amend the final regulations that provide certain permitted remedial actions for tax-exempt bonds issued by state and local governments. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by October 14, 2003. Outlines of topics to be discussed at the public hearing scheduled for November 4, 2003, at 10 a.m., must be received by October 14, 2003.

ADDRESSES: Send submissions to CC:PA:RU (REG–132483–03), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:RU (REG–132483–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Gary W. Bornholdt, (202) 622–3980; concerning submissions of comments, the hearing, and requests to be placed on the building access list to attend the meeting, Sonya M. Cruse, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 103(a) of the Internal Revenue Code (Code) provides that, generally, interest on any State or local bond is not included in gross income. However, this exclusion does not apply to any private activity bond that is not a qualified bond.

A. Governmental Bonds

Under section 141, a bond is a private activity bond if the bond is issued as part of an issue that meets either (1) the private business use test and the private security or payment test (the private business tests), or (2) the private loan financing test.

The private business use test is met if more than 10 percent of the proceeds of an issue are to be used for any private business use. Section 141(b)(6) defines private business use as use directly or indirectly in a trade or business that is carried on by any person other than a governmental unit.

The private security or payment test is met if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of an issue is directly or indirectly (1) secured by an interest in property used or to be used for a private business use, (2) secured by an interest in payments in respect of such property, or (3) to be derived from payments, whether or not to the issuer, in respect of property, or borrowed money, used or to be used for a private business use.

The private loan financing test is satisfied if more than the lesser of $5 million or 5 percent of the proceeds of an issue are to be used to make or finance loans to persons other than governmental units.

Under §1.141–2(d) of the Income Tax Regulations, an issue is an issue of private activity bonds if the issuer reasonably expects, as of the issue date, that the issue will meet either the private business tests or the private loan financing test. Under §1.141–2(d), an issue is also an issue of private activity bonds if the issuer takes a deliberate action, subsequent to the issue date, that causes the conditions of either the private business tests or the private loan financing test to be met.

Section 1.141–12 sets forth certain remedial actions that prevent a deliberate action with respect to property financed by an issue from causing that issue to meet the private business use test or the private loan

financing test. Specifically, if an issuer satisfies certain conditions, an issuer may take one of the following three remedial actions to cure a deliberate action. First, the issuer may redeem or defease the nonqualified bonds. However, a defeasance is not a permitted remedial action if the period between the issue date and the first call date of the bonds is more than 10½ years (the 10½ year limitation). Second, if the deliberate action is a disposition of the bond-financed property for which the consideration is exclusively cash, and certain other requirements are met, the issuer may use the cash for an alternative qualifying use. Third, in certain cases, the facility with respect to which the deliberate action occurs may be used in an alternative qualifying manner (for example, the facility may be used for a qualifying purpose by a nongovernmental person or used by a 501(c)(3) organization rather than a governmental person). The second and third types of remedial action may cause a deemed reissuance of the nonqualified bonds (that is, a deemed issuance of new bonds to refund the nonqualified bonds) for certain purposes of the Code.

Section 1.141–12(j) provides that the percentage of outstanding bonds that are nonqualified bonds equals the highest percentage of private business use in any 1-year period commencing with the deliberate action. In addition, §1.141–12(j) provides that the determination of the bonds of an issue that are treated as the nonqualified bonds must be made on a *pro rata* basis, except that, for purposes of the remedial action that involves the redemption or defeasance of the nonqualified bonds, an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds.

In general, §1.141–15 provides that §1.141–12 applies to bonds issued on or after May 16, 1997, that are subject to section 1301 of the Tax Reform Act of 1986. However, issuers may apply the remedial action provisions in §1.141–12 to any bonds to which §1.141–12 does not otherwise apply.

B. Qualified 501(c)(3) Bonds

Under section 141(e), a qualified 501(c)(3) bond issued under section 145 may be a qualified bond. Section 145(a) provides that, in general, a qualified 501(c)(3) bond is any private activity bond issued as part of an issue if: (1) all of the property that is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit; and (2) such bond would not be a private activity bond if section 501(c)(3) organizations were treated as governmental units with respect to their activities that do not constitute unrelated trades or businesses, determined by applying section 513(a). For this purpose, the private business tests are applied by using "5 percent" instead of "10 percent" each place it appears and "net proceeds" for "proceeds" each place it appears. Section 1.145–2 provides, in general, that §§1.141–0 through 1.141–15 apply to section 145(a).

C. Exempt Facility Bonds

Under section 141(e), an exempt facility bond issued under section 142 may be a qualified bond. Under section 142(a), an exempt facility bond is any bond issued as part of an issue if 95 percent or more of the net proceeds are to be used to provide certain exempt facilities.

Under §1.142–2, if less than 95 percent of the net proceeds of an exempt facility bond are actually used to provide an exempt facility, and for no other purpose, the issue will be treated as meeting the use of proceeds requirement of section 142(a) if the issue meets a reasonable expectations test, and the issuer takes the remedial action described §1.142–2. The reasonable expectations test requires that the issuer must have reasonably expected on the issue date of the bonds that at least 95 percent of the net proceeds of the issue would be used to provide an exempt facility and for no other purpose for the entire term of the bonds (disregarding any redemption provisions). The remedial action provided in §1.142–2 requires that the issuer redeem or defease the nonqualified bonds of the issue. However, a defeasance is not a permitted remedial action if it does not satisfy the 10½ year limitation on defeasances.

For purposes of §1.142–2, the nonqualified bonds are a portion of the outstanding bonds in an amount that, if the remaining bonds were issued on the date on which the failure to properly use the proceeds occurs, at least 95 percent of the net proceeds of the remaining bonds would be used to provide an exempt facility. If no proceeds have been spent to provide an exempt facility, all of the outstanding bonds are nonqualified bonds. The nonqualified bonds must be determined on a *pro rata* basis, except that an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds.

In general, §1.141–16 provides that §1.142–2 applies to bonds issued on or after May 16, 1997. However, §1.142–2, together with certain other regulations, may be applied in whole, but not in part, to bonds outstanding on May 16, 1997.

D. Prior Remedial Action Rules

Prior to the release of §§1.141–12 and 1.142–2, Rev. Proc. 93–17 (1993–1 C.B. 507), provided remedial action rules. Rev. Proc. 93–17 does not contain the 10½ year limitation on defeasances. The preamble to the regulations that include §§1.141–12 and 1.142–2 provides that for actions that occur on or after May 16, 1997, Rev. Proc. 93–17 is obsolete.

Explanation of Provisions

Comments have been received suggesting that the definition of the amount of nonqualified bonds contained in §1.141–12 be limited to the excess of the actual amount of the private business use or private loans over the permitted amount of private business use or private loans under section 141. The comments note that this approach is consistent with the statutory language of section 141, which permits certain *de minimis* amounts of private business use and private loans without jeopardizing the tax-exempt status of bonds, and with the definition of the amount of nonqualified bonds contained in §1.142–2.

The comments also suggest simplifying the rules for determining the bonds to be treated as the nonqualified bonds. The comments recommend granting an issuer greater discretion in its selection of bonds, to the extent that the issuer, through such selection, does not effectively extend the remaining weighted average maturity of the bond issue with respect to which the deliberate action occurred.

Finally, the comments request clarification of the remedial action rules applicable

to bonds issued prior to May 16, 1997. In particular, the comments request that issuers be permitted to apply §§1.141–12 and 1.142–2 to bonds issued before May 16, 1997, without regard to the 10½ year limitation on defeasances contained in those regulations. The comments indicate that it is unfair to require issuers to comply with the 10½ year limitation for bonds issued prior to the release of §§1.141–12 and 1.142–2 because issuers could not have known about the limitation when structuring those bonds.

The proposed regulations generally adopt these suggestions.

First, the proposed regulations reduce the amount of outstanding bonds that are nonqualified bonds under §1.141–12. The proposed regulations provide that the nonqualified bonds are a portion of the outstanding bonds in an amount that, if the remaining bonds were issued on the date on which the deliberate action occurs, the remaining bonds would not satisfy the private business use test or private loan financing test, as applicable. For this purpose, the amount of private business use is the greatest percentage of private business use in any one-year period commencing with the deliberate action.

Second, the proposed regulations amend the provisions of §1.141–12 relating to redemption or defeasance and the provisions of §1.142–2 relating to allocations of nonqualified bonds. Under the proposed regulations, allocations of nonqualified bonds must be made on a *pro rata* basis, except that an issuer may treat any bonds of an issue as the nonqualified bonds so long as (i) the remaining weighted average maturity of the issue, determined as of the date on which the nonqualified bonds are redeemed or defeased (determination date), and excluding from the determination the nonqualified bonds redeemed or defeased by the issuer, is not greater than (ii) the remaining weighted average maturity of the issue, determined as of the determination date, but without regard to the redemption or defeasance of any bonds (including the nonqualified bonds) occurring on the determination date.

Finally, the proposed regulations amend §§1.141–15(e) and 1.141–16(c) to provide that for bonds issued before May 16, 1997, issuers may apply §§1.141–12 and 1.142–2 without regard to the 10½ year limitation on defeasances contained in those regulations.

Proposed Effective Dates

The proposed regulations that amend §§1.141–12 and 1.142–2 will apply to deliberate actions or failures to properly use proceeds, as applicable, that occur on or after the date of publication of final regulations in the **Federal Register**, to the extent §1.141–12 or 1.142–2, as applicable, applies to the bonds. The proposed regulations that amend §§1.141–15(e) and 1.141–16(c) will apply to bonds issued before May 16, 1997, that are subject to §§1.141–12 or 1.142–2, as applicable, for purposes of deliberate actions or failures to properly use proceeds, as applicable, that occur on or after April 21, 2003. Issuers may apply the proposed regulations to deliberate actions or failures to properly use proceeds, as applicable, that occur on or after April 21, 2003 and before the date of publication of final regulations in the **Federal Register**, to the extent (1) §1.141–12 or §1.142–2, as applicable, applies to the bonds, and (2) with respect to the amendments to §§1.141–15(e) and 1.141–16(c), the bonds were issued before May 16, 1997.

Special Analyses

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

Comments and Public Hearing

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

A public hearing has been scheduled for November 4, 2003, at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the lobby more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments by October 14, 2003, and submit an outline of the topics to be discussed and the amount of time to be devoted to each topic by October 14, 2003.

A period of 10 minutes will be allotted to each person for making comments.

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

Comments are requested on all aspects of the proposed regulations.

Drafting Information

The principal authors of these regulations are Rebecca L. Harrigal and Gary W. Bornholdt, Office of Associate Chief Counsel (Tax-Exempt and Government Entities), IRS, and Bruce M. Serchuk, Office of Tax Policy, Treasury Department. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.141–0 is amended by adding an entry to the table for §1.141–16(d) to read as follows:

§1.141–0 Table of contents.

* * * * *

§1.141–16 Effective dates for qualified private activity bond provisions.

* * * * *

(d) Certain remedial actions.

* * * * *

Par. 3. In §1.141–12, paragraphs (j) and (k) *Example 8* are revised to read as follows:

§1.141–12 Remedial Actions.

* * * * *

(j) *Nonqualified bonds*—(1) *Amount of nonqualified bonds*. The nonqualified bonds are a portion of the outstanding bonds in an amount that, if the remaining bonds were issued on the date on which the deliberate action occurs, the remaining bonds would not satisfy the private business use test or private loan financing test, as applicable. For this purpose, the amount of private business use is the greatest percentage of private business use in any one-year period commencing with the deliberate action.

(2) *Allocation of nonqualified bonds*. Allocations of nonqualified bonds must be made on a *pro rata* basis, except that, for purposes of paragraph (d) of this section (relating to redemption or defeasance), an issuer may treat any bonds of an issue as the nonqualified bonds so long as—

(i) The remaining weighted average maturity of the issue, determined as of the date on which the nonqualified bonds are redeemed or defeased (determination date), and excluding from the determination the nonqualified bonds redeemed or defeased by the issuer in accordance with this section, is not greater than

(ii) The remaining weighted average maturity of the issue, determined as of the determination date, but without regard to the redemption or defeasance of any bonds (including the nonqualified bonds) occurring on the determination date.

(k) * * *

Example 8. Compliance after remedial action. In 2000, City G issues bonds with proceeds of $10 million to finance a courthouse. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the courthouse. G uses $1 million of the proceeds for a private business use and more than 10 percent of the debt service on the issue is secured by private security or payments. In 2004, in a *bona fide* and arm's length arrangement, G enters into a management contract with a nongovernmental person that results in private business use of 40 percent of the courthouse per year during the remaining term of the bonds. G immediately redeems the nonqualified bonds, or 44.44 percent of the outstanding bonds. This is the portion of the outstanding bonds that, if the remaining bonds were issued on the date on which the deliberate action occurs, the remaining bonds would not satisfy the private business use test, if the amount of private business use is the greatest percentage of private business use in any one-year period commencing with the deliberate action (50 percent). This percentage is computed by dividing the percentage of the facility used for a government use (50 percent) by the minimum amount of government use required (90 percent), and subtracting the resulting percentage (55.56 percent) from 100 percent (44.44 percent). For purposes of subsequently applying section 141 to the issue, G may continue to use all of the proceeds of the outstanding bonds in the same manner (that is, for the courthouse and the private business use) without causing the issue to meet the private business use test. The issue, however, continues to meet the private security or payment test. The result would be the same if G, instead of redeeming the bonds, established a defeasance escrow for those bonds, provided that the requirement of paragraph (d)(4) of this section was met.

Par. 4. Section 1.141–15 is amended as follows:

1. Paragraph (b)(4) is added.
2. Paragraph (e) is revised.

The amendments read as follows:

§1.141–15 Effective dates.

* * * * *

(b) *Effective dates*. * * *

(4) *Certain remedial actions*. For bonds subject to §1.141–12, the provisions of §§1.141–12(j) and 1.141–12(k), *Example 8*, apply to deliberate actions that occur on or after the date of publication of final regulations in the **Federal Register** and may be applied by issuers to deliberate actions that occur on or after April 21, 2003, and before the date of publication of final regulations in the **Federal Register**.

* * * * *

(e) *Permissive application of certain sections* — (1) *In general*. Except as otherwise provided in paragraph (b)(4) of this section and this paragraph (e), the following sections may each be applied by issuers to any bonds—

(i) Section 1.141–3(b)(4);

(ii) Section 1.141–3(b)(6); and

(iii) Section 1.141–12.

(2) *Transition rule for pre-effective date bonds*. For purposes of paragraphs (e)(1) and (h) of this section, issuers may apply §1.141–12 to bonds issued before May 16, 1997, without regard to paragraph (d)(4) thereof with respect to deliberate actions that occur on or after April 21, 2003.

* * * * *

Par. 5. Section 1.141–16 is amended by revising paragraph (c) and adding paragraph (d) to read as follows:

§1.141–16 Effective dates for qualified private activity bond provisions.

* * * * *

(c) *Permissive application*. The regulations designated in paragraph (a) of this section may be applied by issuers in whole, but not in part, to bonds outstanding on the effective date. For this purpose, issuers may apply §1.142–2 without regard to paragraph (c)(3) thereof to failures to properly use proceeds that occur on or after April 21, 2003.

(d) *Certain remedial actions*. For bonds subject to §1.142–2, the provisions of §1.142–2(e) apply to failures to properly use proceeds that occur on or after the date of publication of final regulations in the **Federal Register** and may be applied by issuers to failures to properly use proceeds that occur on or after April 21, 2003, and before the date of publication of final regulations in the **Federal Register**.

Par. 6. Section 1.142–0 is amended by revising the entries to the table for §1.142–2 paragraph (d), (d)(1) and (d)(2) to read as follows:

§1.142–0 Table of contents.

* * * * *

§1.142–2 Remedial actions.

* * * * *

(d) * * * * *

(1) Amount of nonqualified bonds.

(2) Allocation of nonqualified bonds.

* * * * *

Par. 7. Section 1.142–2 is amended by revising paragraph (e) to read as follows:

§1.142–2 Remedial actions.

* * * * *

(e) *Nonqualified bonds* — (1) *Amount of nonqualified bonds*. The nonqualified bonds are a portion of the outstanding bonds in an amount that, if the remaining bonds were issued on the date on which the failure to properly use the proceeds occurs, at least 95 percent of the net proceeds of the remaining bonds would be used to provide an exempt facility. If no proceeds have been spent to provide an exempt facility, all of the outstanding bonds are nonqualified bonds.

(2) *Allocation of nonqualified bonds*. Allocations of nonqualified bonds must be made on a *pro rata* basis, except that an issuer may treat any bonds of an issue as the nonqualified bonds so long as—

(i) The remaining weighted average maturity of the issue, determined as of the date on which the nonqualified bonds are redeemed or defeased (determination date), and excluding from the determination the nonqualified bonds redeemed or defeased by the issuer in accordance with this section, is not greater than

(ii) The remaining weighted average maturity of the issue, determined as of the determination date, but without regard to the redemption or defeasance of any bonds (including the nonqualified bonds) occurring on the determination date.

Robert E. Wenzel,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 18, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 21, 2003, 68 F.R. 43059)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Suspensions, Censures, Disbarments, and Resignations

Announcement 2003-50

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Arnold, John	Clovis, CA	Enrolled Agent	February 13, 2003 to August 12, 2003

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Kalajian, Thomas	Laguna Hills, CA	CPA	October 2, 2002
Messman, Carla	Outing, MN	Enrolled Agent	January 9, 2003

Consent Suspensions From Practice Before the Internal Revenue Service

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

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

Name	Address	Designation	Date of Suspension
Kemp, Bart	Sonoma, CA	Attorney	March 15, 2003 to November 15, 2003
Marks, Gary	Hewlett, NY	CPA	March 24, 2003 to March 23, 2004
Fehl, Kenneth	Palo Alto, CA	Attorney	April 1, 2003 to March 31, 2004
Cohen, Peter	Edison, NJ	CPA	April 3, 2003 to May 2, 2005
Kohn, Michael	St. Louis, MO	Attorney	Indefinite from April 30, 2003
Sogamoso, Carlos	Bellflower, CA	Enrolled Agent	Indefinite from May 1, 2003
Huston, James	Kingman, AZ	CPA	May 1, 2003 to April 30, 2006
Halleran, Edward	Carle Place, NY	Enrolled Agent	Indefinite from May 1, 2003

Name	Address	Designation	Date of Suspension
Marshall, E. Peter	Glens Falls, NY	CPA	May 1, 2003 to April 30, 2006
Bell, Rosanna	Irvington, NY	CPA	Indefinite from May 8, 2003
Kingsley, Steven	Weston, CT	CPA	Indefinite from May 15, 2003
Schawe, Rudolph	Brenham, TX	Enrolled Agent	May 22, 2003 to October 21, 2004
Scheve, Michael	Baltimore, MD	CPA	Indefinite from May 27, 2003
McKenzie, Dawna	Fort Smith, AR	Enrolled Agent	Indefinite from June 2, 2003
Suen, Ming	San Francisco, CA	Enrolled Agent	Indefinite from June 3, 2003
Reyes, Ruperto	Placentia, CA	Enrolled Agent	June 10, 2003 to December 9, 2005
Garmo, Georgis	W. Bloomfield, MI	CPA	Indefinite from June 10, 2003
Holmes, James L.	Burlington, NC	Enrolled Agent	Indefinite from June 18, 2003
Brooks, Sandra	San Diego, CA	Enrolled Agent	Indefinite from June 20, 2003
Malley, Wayne	Cupertino, CA	Enrolled Agent	Indefinite from June 27, 2003
Leininger, Barbara	Lutz, FL	Enrolled Agent	Indefinite from June 27, 2003

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

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

Name	Address	Designation	Date of Suspension
Radwick, Peter	Woodinville, WA	CPA	Indefinite from March 10, 2003
Jellinger, Richard	Anoka, MN	Attorney	Indefinite from March 10, 2003
Deen, Billy	Mansfield, TX	CPA	Indefinite from March 10, 2003
Dougherty Jr, William	Newport News, VA	Attorney	Indefinite from March 10, 2003
Abood, Norman	Oregon, OH	Attorney	Indefinite from March 10, 2003
Matis, Vendel	Redlands, CA	Attorney	Indefinite from March 31, 2003
Workman, Andrew	Panama City, FL	CPA	Indefinite from March 31, 2003
Bagwell, Jr., Noel	Cunningham, TN	Attorney	Indefinite from March 31, 2003
O'Brien, Brien	Sioux City, IA	Attorney	Indefinite from March 31, 2003
Boykoff, Franklin	Pleasantville, NY	Attorney	Indefinite from March 31, 2003
McKinnon, Marva	Statesville, NC	Attorney	Indefinite from March 31, 2003
Bailey, Scott K.	Eden Prairie, MN	Attorney	Indefinite from March 31, 2003

Name	Address	Designation	Date of Suspension
Kim, Kun	Atlanta, GA	CPA	Indefinite from March 31, 2003
Massari III, Domenic	Tampa, FL	Attorney	Indefinite from May 12, 2003
Haugabrook II, Tyrone	Valdosta, GA	Attorney	Indefinite from May 19, 2003
Wester, Joseph	Montgomery, AL	CPA	Indefinite from May 19, 2003
Smercina, David	Solon, OH	CPA	Indefinite from May 19, 2003
Pullings, Retna	Washington, DC	Attorney	Indefinite from May 19, 2003
Boyd, James	Mendota Heights, MN	Attorney	Indefinite from May 20, 2003
Spindler, Judith	Omaha, NE	Attorney	Indefinite from May 20, 2003
Wintroub, Edward	Omaha, NE	Attorney	Indefinite from May 20, 2003
Brinker, Peter	Omaha, NE	Attorney	Indefinite from May 21, 2003
Valdes, Alfredo	Old Greenwich, CT	CPA	Indefinite from May 21, 2003
Cruise, Michael	Lincoln, NE	Attorney	Indefinite from May 22, 2003
Schoppert, Thomas	Minot, ND	Attorney	Indefinite from June 2, 2003
White, Paul	Smithfield, NC	Enrolled Agent	Indefinite from June 2, 2003
Brier, Michael	Providence, RI	CPA	Indefinite from June 16, 2003

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Designation
Evans, Caroline	Tiverton, RI	May 7, 2003

Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Pargas, Carlos B.	Miami, FL	CPA	March 19, 2003
Malkasian, Gary	Sacramento, CA	CPA	March 27, 2003
Wilcox, Ronald E.	Mt. Carmel, IL	CPA	April 29, 2003
Wood, David T.	Shawneetown, IL	CPA	May 27, 2003

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.

Numerical Finding List[1]

Bulletins 2003–27 through 2003–33

Announcements:

2003-45, 2003-28 I.R.B. *73*
2003-46, 2003-30 I.R.B. *222*
2003-47, 2003-29 I.R.B. *124*
2003-48, 2003-28 I.R.B. *73*
2003-49, 2003-32 I.R.B. *339*
2003-50, 2003-30 I.R.B. *222*
2003-52, 2003-32 I.R.B. *345*
2003-53, 2003-32 I.R.B. *345*

Notices:

2003-38, 2003-27 I.R.B. *9*
2003-39, 2003-27 I.R.B. *10*
2003-40, 2003-27 I.R.B. *10*
2003-41, 2003-28 I.R.B. *49*
2003-42, 2003-28 I.R.B. *49*
2003-43, 2003-28 I.R.B. *50*
2003-44, 2003-28 I.R.B. *52*
2003-45, 2003-29 I.R.B. *86*
2003-46, 2003-28 I.R.B. *53*
2003-47, 2003-30 I.R.B. *132*
2003-48, 2003-30 I.R.B. *133*
2003-49, 2003-32 I.R.B. *294*
2003-50, 2003-32 I.R.B. *295*
2003-51, 2003-33 I.R.B. *361*
2003-52, 2003-32 I.R.B. *296*
2003-53, 2003-33 I.R.B. *362*
2003-54, 2003-33 I.R.B. *363*

Proposed Regulations:

REG-106736-00, 2003-28 I.R.B. *60*
REG-107618-02, 2003-27 I.R.B. *13*
REG-122917-02, 2003-27 I.R.B. *15*
REG-131997-02, 2003-33 I.R.B. *366*
REG-116914-03, 2003-32 I.R.B. *338*

Revenue Procedures:

2003-45, 2003-27 I.R.B. *11*
2003-46, 2003-28 I.R.B. *54*
2003-47, 2003-28 I.R.B. *55*
2003-48, 2003-29 I.R.B. *86*
2003-49, 2003-29 I.R.B. *89*
2003-50, 2003-29 I.R.B. *119*
2003-51, 2003-29 I.R.B. *121*
2003-52, 2003-30 I.R.B. *134*
2003-53, 2003-31 I.R.B. *230*
2003-54, 2003-31 I.R.B. *236*
2003-55, 2003-31 I.R.B. *242*
2003-56, 2003-31 I.R.B. *249*
2003-57, 2003-31 I.R.B. *257*
2003-58, 2003-31 I.R.B. *262*
2003-59, 2003-31 I.R.B. *268*

Revenue Procedures— Continued:

2003-60, 2003-31 I.R.B. *274*
2003-61, 2003-32 I.R.B. *296*
2003-62, 2003-32 I.R.B. *299*
2003-63, 2003-32 I.R.B. *304*
2003-64, 2003-32 I.R.B. *306*
2003-65, 2003-32 I.R.B. *336*
2003-66, 2003-33 I.R.B. *364*

Revenue Rulings:

2003-70, 2003-27 I.R.B. *3*
2003-71, 2003-27 I.R.B. *1*
2003-72, 2003-33 I.R.B. *346*
2003-73, 2003-28 I.R.B. *44*
2003-74, 2003-29 I.R.B. *77*
2003-75, 2003-29 I.R.B. *79*
2003-76, 2003-33 I.R.B. *355*
2003-77, 2003-29 I.R.B. *75*
2003-78, 2003-29 I.R.B. *76*
2003-79, 2003-29 I.R.B. *80*
2003-80, 2003-29 I.R.B. *83*
2003-81, 2003-30 I.R.B. *126*
2003-82, 2003-30 I.R.B. *125*
2003-83, 2003-30 I.R.B. *128*
2003-84, 2003-32 I.R.B. *289*
2003-85, 2003-32 I.R.B. *291*
2003-86, 2003-32 I.R.B. *290*
2003-87, 2003-29 I.R.B. *82*
2003-88, 2003-32 I.R.B. *292*
2003-90, 2003-33 I.R.B. *353*
2003-91, 2003-33 I.R.B. *347*
2003-92, 2003-33 I.R.B. *350*
2003-93, 2003-33 I.R.B. *346*
2003-94, 2003-33 I.R.B. *357*
2003-95, 2003-33 I.R.B. *358*

Treasury Decisions:

9061, 2003-27 I.R.B. *5*
9062, 2003-28 I.R.B. *46*
9067, 2003-32 I.R.B. *287*

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2003-1 through 2003-26 is in Internal Revenue Bulletin 2003-27, dated July 7, 2003.

Findings List of Current Actions on Previously Published Items[1]

Bulletins 2003–27 through 2003–33

Notices:

89-79
Modified and superseded by
Rev. Proc. 2003-47, 2003-28 I.R.B. *55*

89-94
Modified by
Notice 2003-50, 2003-32 I.R.B. *295*

2001-4
Section III.C. superseded for 2004 and subsequent calendar years by
Rev. Proc. 2003-64, 2003-32 I.R.B. *306*

2001–70
Amplified by
Notice 2003-45, 2003-29 I.R.B. *86*

2001–74
Amplified by
Notice 2003-45, 2003-29 I.R.B. *86*

2002-1
Amplified by
Notice 2003-49, 2003-32 I.R.B. *294*

Proposed Regulations:

EE-86-88 (LR-279-81)
Withdrawn by
REG-122917-02, 2003-27 I.R.B. *15*

Revenue Procedures:

66-50
Modified, amplified, and superseded by
Rev. Proc. 2003-62, 2003-32 I.R.B. *299*

77-12
Amplified, modified, and superseded by
Rev. Proc. 2003-51, 2003-29 I.R.B. *121*

81-40
Modified and superseded by
Rev. Proc. 2003-62, 2003-32 I.R.B. *299*

89-21
Superseded by
Rev. Proc. 2003-53, 2003-31 I.R.B. *230*

90-32
Section 4 superseded by
Rev. Proc. 2003-55, 2003-31 I.R.B. *242*
Section 5 superseded by
Rev. Proc. 2003-56, 2003-31 I.R.B. *249*
Section 6 superseded by
Rev. Proc. 2003-57, 2003-31 I.R.B. *257*
Section 7 superseded by
Rev. Proc. 2003-59, 2003-31 I.R.B. *268*

Revenue Procedures— Continued:

Section 8 superseded by
Rev. Proc. 2003-60, 2003-31 I.R.B. *274*

96-30
Modified and amplified by
Rev. Proc. 2003-48, 2003-29 I.R.B. *86*

2000-12
Modified by
Rev. Proc. 2003-64, 2003-32 I.R.B. *306*

2000–15
Superseded by
Rev. Proc. 2003-61, 2003-32 I.R.B. *296*

2002-9
Modified by
Rev. Proc. 2003-45, 2003-27 I.R.B. *11*
Amplified and modified by
Rev. Proc. 2003-50, 2003-29 I.R.B. *119*
Modified and amplified by
Rev. Proc. 2003-63, 2003-32 I.R.B. *304*
Rev. Rul. 2003-81, 2003-30 I.R.B. *126*

2002-33
Amplified and modified by
Rev. Proc. 2003-50, 2003-29 I.R.B. *119*

2002-34
Superseded by
Rev. Proc. 2003-52, 2003-30 I.R.B. *134*

2003-3
Modified by
Rev. Proc. 2003-48, 2003-29 I.R.B. *86*

2003-15
Modified and superseded by
Rev. Proc. 2003-49, 2003-29 I.R.B. *89*

Revenue Rulings:

79-410
Amplified by
Rev. Rul. 2003-90, 2003-33 I.R.B. *353*

81-225
Clarified and amplified by
Rev. Rul. 2003-92, 2003-33 I.R.B. *350*

[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2003-1 through 2003-26 is in Internal Revenue Bulletin 2003-27, dated July 7, 2003.

*U.S. Government Printing Office: 2003—496–919/60097