

## **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**

#### **Ct. D. 2079, page 978.**

**Tax assessment; partnership.** The Supreme Court holds that the proper assessment against the partnership suffices to extend the statute of limitations to collect the tax in a judicial proceeding from the general partners who are liable for the payment of the partnership's debts. **United States v. Galletti et al.**

#### **Rev. Rul. 2004-45, page 971.**

**Health Savings Account (HSA) – interaction with other health arrangements.** This ruling addresses the interaction between Health Savings Accounts (HSAs), health flexible spending arrangements (health FSAs), and health reimbursement arrangements (HRAs).

#### **Rev. Rul. 2004-52, page 973.**

**Credit card annual fees.** This ruling holds that credit card annual fees are not interest for federal income tax purposes. Moreover, the ruling holds that credit card annual fees are includible in the gross income by the card issuer when they become due and payable by cardholders under the terms of the credit card agreements.

#### **Notice 2004-39, page 982.**

This notice explains how the changes to section 1(h) of the Code made by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) apply to capital gain dividends paid (or accounted for as if paid) by regulated investment companies (RICs) and real estate investment trusts (REITs) in taxable years that end on or after May 6, 2003.

#### **Rev. Proc. 2004-31, page 986.**

**Changes in method of accounting for transfers to trusts under section 461(f).** This document provides procedures for taxpayers to change their method of accounting for deducting under section 461(f) of the Code amounts transferred to trusts in transactions described in Notice 2003-77, 2003-49 I.R.B. 1182.

#### **Rev. Proc. 2004-32, page 988.**

This document provides automatic consent procedures for taxpayers to change their method of accounting to a method that complies with Rev. Rul. 2004-52, in this Bulletin, or to the Ratable Inclusion Method for Credit Card Annual Fees described in this revenue procedure. Rev. Proc. 2002-9 modified and amplified.

#### **Rev. Proc. 2004-33, page 989.**

This procedure describes conditions under which the Commissioner will allow a taxpayer to treat its income from credit card late fees as interest income on a pool of credit card loans. This document also provides automatic consent procedures for a taxpayer to change its method of accounting for credit card late fee income to a method that treats these fees as interest that creates or increases the amount of OID on a pool of credit card loans to which the fees relate. Rev. Proc. 2002-9 modified and amplified.

### **EXEMPT ORGANIZATIONS**

#### **Rev. Rul. 2004-51, page 974.**

**Joint ventures.** This ruling illustrates the tax consequences for a section 501(c)(3) organization that enters into a joint venture with a for-profit organization as an insubstantial part of its activities.

**(Continued on the next page)**

Announcements of Disbarments and Suspensions begin on page 1001.  
Finding Lists begin on page ii.



**Announcement 2004–50, page 1005.**

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

**ADMINISTRATIVE****Rev. Rul. 2004–50, page 977.**

**Indian tribal government.** This ruling provides clarification with regard to an Indian tribal government's ability to qualify as an eligible shareholder under section 1361 of the Code. Specifically, the ruling explains that a federally recognized Indian tribal government does not qualify as a permissible S corporation shareholder under section 1361(b)(1)(B) because it is not treated as an individual subject to individual income taxes under section 1 of the Code. The ruling also explains that a federally recognized Indian Tribe cannot qualify as a permissible S corporation shareholder under section 1361(c)(6) because it is neither a section 501(c)(3) organization, nor a section 401(a) qualified plan, profit-sharing, or stock bonus plan organization.

**Rev. Proc. 2004–28, page 984.**

This procedure provides guidance to regulated investment companies (RICs) who must comply with the asset diversification rules of section 851(b)(3) of the Code. The procedure describes conditions under which a RIC may look through a repurchase agreement (repo) to government securities serving as the underlying collateral to treat itself as the owner of the government securities for purposes of these rules. The procedure is effective for repos held by a RIC on or after August 15, 2001.

**Rev. Proc. 2004–34, page 991.**

This procedure provides a method of accounting under which taxpayers using an accrual method of accounting may defer including all or part of certain advance payments in gross income until the year after the year the payment is received. Rev. Proc. 71–21 modified and superseded and Rev. Proc. 2002–9 modified and amplified.

**Announcement 2004–48, page 998.**

This announcement provides background information relating to Rev. Proc. 2004–34 in this Bulletin. Rev. Proc. 2004–34 provides a method of accounting under which taxpayers using an accrual method of accounting may defer including all or part of certain advance payments in gross income until the year after the year the payment is received.

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## Introduction

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

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

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

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

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

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

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

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

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

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

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

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

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

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

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

## Section 61.—Gross Income Defined

Rev. Rul. 2004-52 holds that credit card annual fees are not interest for federal income tax purposes. Moreover, the ruling holds that credit card annual fees are includible in the gross income by the card issuer when they become due and payable by cardholders under the terms of the credit card agreements. See Rev. Rul. 2004-52, page 973.

## Section 223.—Health Savings Accounts

**Health Savings Account (HSA) – interaction with other health arrangements.** This ruling addresses the interaction between Health Savings Accounts (HSAs), health flexible spending arrangements (health FSAs), and health reimbursement arrangements (HRAs).

### Rev. Rul. 2004-45

#### ISSUE

In the situations described below, may an individual make contributions to a Health Savings Account (HSA) under section 223 of the Internal Revenue Code if the individual is covered by a high deductible health plan (HDHP) and also covered by a health flexible spending arrangement (health FSA) or a health reimbursement arrangement (HRA)?

#### FACTS

Situation 1. An individual is covered by an HDHP (as defined under section 223(c)(2)(A)). The HDHP has an 80/20 percent coinsurance feature above the deductible. The individual is also covered by a health FSA under a section 125 cafeteria plan and an HRA that meets the requirements of Notice 2002-45, 2002-2 C.B. 93. The health FSA and HRA pay or reimburse all section 213(d) medical expenses that are not covered by the HDHP (such as co-payments, coinsurance, expenses not covered due to the deductible and other medical expenses not covered by the HDHP). The health FSA and HRA coordinate the payment of benefits under the ordering rules of Notice 2002-45. The

individual is not entitled to benefits under Medicare and may not be claimed as a dependent on another person's tax return.

Situation 2. Same facts as Situation 1, except that the health FSA and HRA are limited-purpose arrangements that pay or reimburse, pursuant to the written plan document, only vision and dental expenses (whether or not the minimum annual deductible of the HDHP has been satisfied). In addition, the health FSA and HRA pay or reimburse preventive care benefits as described in Notice 2004-23, 2004-15 I.R.B. 725.

Situation 3. Same facts as Situation 1, except that the individual is not covered by a health FSA. Under the employer's HRA, the individual elects, before the beginning of the HRA coverage period, to forgo the payment or reimbursement of medical expenses incurred during that coverage period. The decision to forgo the payment or reimbursement of medical expenses does not apply to permitted insurance, permitted coverage and preventive care ("excepted medical expenses"). See section 223(c)(1)(B) and Notice 2004-23. Medical expenses incurred during the suspended HRA coverage period (other than the excepted medical expenses if otherwise allowed to be paid or reimbursed by an HRA), cannot be paid or reimbursed by the HRA currently or later (*i.e.*, after the HRA suspension ends). However, the employer decides to continue to make employer contributions to the HRA during the suspension period and thus the maximum available amount under the HRA is not affected by the suspension but is available for the payment or reimbursement of the excepted medical expenses incurred during the suspension period as well as medical expenses incurred in later HRA coverage periods.

Situation 4. Same facts as Situation 1, except that the health FSA and HRA are post-deductible arrangements that only pay or reimburse medical expenses (including the individual's 20 percent coinsurance responsibility for expenses above the deductible) after the minimum annual deductible of the HDHP has been satisfied.

Situation 5. Same facts as Situation 1, except that the individual is not covered

by a health FSA. The employer's HRA is a retirement HRA that only reimburses those medical expenses incurred after the individual retires.

#### LAW AND ANALYSIS

Section 223(a) allows a deduction for contributions to an HSA for an "eligible individual" for any month during the taxable year. Section 223(c)(1)(A) provides that an "eligible individual" means, with respect to any month, any individual who is covered under an HDHP on the first day of such month and is not, while covered under an HDHP, "covered under any health plan which is not a high deductible health plan, and which provides coverage for any benefit which is covered under the high deductible health plan."

Section 223(b) provides a limit on amounts that can be contributed to an HSA. The maximum annual contribution limit for an eligible individual with self-only coverage is the amount required by section 223(b)(2)(A). The maximum annual contribution limit for an eligible individual with family coverage is the amount required by section 223(b)(2)(B).

Section 223(c)(2)(A) defines an HDHP as a health plan that satisfies certain requirements with respect to minimum annual deductibles and maximum annual out-of-pocket expenses. Generally, if substantially all of the coverage in a health plan that is intended to be an HDHP is provided through a health FSA or HRA, the health plan is not an HDHP.

In addition to coverage under an HDHP, section 223(c)(1)(B) provides that an eligible individual may have specifically enumerated coverage that is disregarded for purposes of the deductible. Coverage that may be disregarded includes "permitted insurance" and other specified coverage ("permitted coverage"). "Permitted insurance" is coverage under which substantially all of the coverage provided relates to liabilities incurred under workers' compensation laws, tort liabilities, liabilities relating to ownership or use of property, insurance for a specified disease or illness, and insurance that pays a fixed amount per day (or other period) of hospitalization.

“Permitted coverage” (whether through insurance or otherwise) is coverage for accidents, disability, dental care, vision care or long-term care. Section 223(c)(2)(C) also provides a safe harbor for the absence of a preventive care deductible. See Notice 2004–23.

The legislative history of section 223 explains these provisions by stating that “eligible individuals for HSAs are individuals who are covered by a high deductible health plan and no other health plan that is not a high deductible health plan.” The legislative history also explains that, “[a]n individual with other coverage in addition to a high deductible health plan is still eligible for an HSA if such other coverage is certain permitted insurance or permitted coverage.” H.R. Conf. Rep. No. 391, 108<sup>th</sup> Cong., 1st Sess. 841 (2003).

Section 125(a) states that no amount will be included in the gross income of a participant in a cafeteria plan solely because, under the plan, the participant may choose among the benefits of the plan. Section 125(d) defines a cafeteria plan as a written plan under which participants may choose among two or more benefits consisting of cash and qualified benefits.

Section 125(f) defines qualified benefits as any benefit not included in the gross income of the employee by reason of an express provision in the Code. Qualified benefits include employer-provided accident and health coverage under section 106, including health FSAs.

Notice 2002–45, 2002–2 C.B. 93, describes the tax treatment of HRAs. The notice explains that an HRA that receives tax-favored treatment is an arrangement that is paid for solely by the employer and not pursuant to a salary reduction election under section 125, reimburses the employee for medical care expenses incurred by the employee and by the employee’s spouse and dependents, and provides reimbursement up to a maximum dollar amount with any unused portion of that amount at the end of the coverage period carried forward to subsequent coverage periods.

Notice 2002–45, Part IV, states that if an employer provides an HRA in conjunction with another accident or health plan and that other plan is provided pursuant to a salary reduction election under a cafeteria plan, then all the facts and circumstances are considered in determining whether the salary reduction is attributable to the HRA.

An accident or health plan funded pursuant to salary reduction is not an HRA and is subject to the rules under section 125.

Under section 223, an eligible individual cannot be covered by a health plan that is not an HDHP unless that health plan provides permitted insurance, permitted coverage or preventive care. A health FSA and an HRA are health plans and constitute other coverage under section 223(c)(1)(A)(ii). Consequently, an individual who is covered by an HDHP and a health FSA or HRA that pays or reimburses section 213(d) medical expenses is generally not an eligible individual for the purpose of making contributions to an HSA. See Rev. Rul. 2004–38, 2004–15 I.R.B. 717, which holds that an individual who is covered by an HDHP that does not provide prescription drug coverage and a separate prescription drug plan or rider that provides benefits before the minimum annual deductible of the HDHP has been satisfied is not an eligible individual for HSA purposes.

However, an individual is an eligible individual for the purpose of making contributions to an HSA for periods the individual is covered under the following arrangements:

*Limited-Purpose Health FSA or HRA.* A limited-purpose health FSA that pays or reimburses benefits for “permitted coverage” (but not through insurance or for long-term care services) and a limited-purpose HRA that pays or reimburses benefits for “permitted insurance” (for a specific disease or illness or that provides a fixed amount per day (or other period) of hospitalization) or “permitted coverage” (but not for long-term care services). In addition, the limited-purpose health FSA or HRA may pay or reimburse preventive care benefits. The individual is an eligible individual for the purpose of making contributions to an HSA because these benefits may be provided whether or not the HDHP deductible has been satisfied.

*Suspended HRA.* A suspended HRA, pursuant to an election made before the beginning of the HRA coverage period, that does not pay or reimburse, at any time, any medical expense incurred during the suspension period except preventive care, permitted insurance and permitted coverage (if otherwise allowed to be paid or reimbursed by the HRA). The individual is an eligible individual for the pur-

pose of making contributions to an HSA. When the suspension period ends, the individual is no longer an eligible individual because the individual is again entitled to receive payment or reimbursement of section 213(d) medical expenses from the HRA. An individual who does not forgo the payment or reimbursement of medical expenses incurred during an HRA coverage period, is not an eligible individual for HSA purposes during that HRA coverage period.

If an HSA is funded through salary reduction under a cafeteria plan during the suspension period, the terms of the salary reduction election must indicate that the salary reduction is used only to pay for the HSA offered in conjunction with the HRA and not to pay for the HRA itself. Thus, the mere fact that an individual participates in an HSA funded pursuant to a salary reduction election does not necessarily result in attributing the salary reduction to the HRA.

*Post-Deductible Health FSA or HRA.* A post-deductible health FSA or HRA that does not pay or reimburse any medical expense incurred before the minimum annual deductible under section 223(c)(2)(A)(i) is satisfied. The individual is an eligible individual for the purpose of making contributions to the HSA. The deductible for the HRA or health FSA (“other coverage”) need not be the same as the deductible for the HDHP, but in no event may the HDHP or other coverage provide benefits before the minimum annual deductible under section 223(c)(2)(A)(i) is satisfied. Where the HDHP and the other coverage do not have identical deductibles, contributions to the HSA are limited to the lower of the deductibles. In addition, although the deductibles of the HDHP and the other coverage may be satisfied independently by separate expenses, no benefits may be paid before the minimum annual deductible under section 223(c)(2)(A)(i) has been satisfied.

*Retirement HRA.* A retirement HRA that pays or reimburses only those medical expenses incurred after retirement (and no expenses incurred before retirement). In this case, the individual is an eligible individual for the purpose of making contributions to the HSA before retirement but loses eligibility for coverage periods when the retirement HRA may pay or reimburse section 213(d) medical expenses. Thus, after retirement, the individual is

no longer an eligible individual for the purpose of the HSA.

In the arrangements described, the individual does not fail to be an eligible individual under section 223 and may contribute to an HSA. In addition, combinations of these arrangements which are consistent with these requirements would not disqualify an individual from being an eligible individual. For example, if an employer offers a combined post-deductible health FSA and a limited-purpose health FSA, this would not disqualify an otherwise eligible individual from contributing to an HSA.

An individual may not be reimbursed for the same medical expense by more than one plan or arrangement. However, if the individual has available an HSA, a health FSA and an HRA that pay or reimburse the same medical expense, the health FSA or the HRA may pay or reimburse the medical expense, subject to the ordering rules in Notice 2002-45, Part V, so long as the individual certifies to the employer that the expense has not been reimbursed and that the individual will not seek reimbursement under any other plan or arrangement covering that expense (including the HSA).

#### HOLDINGS

In Situation 1, the individual is covered by an HDHP and by a health FSA and HRA that pay or reimburse medical expenses incurred before the minimum annual deductible under section 223(c)(2)(A)(i) has been satisfied. The health FSA and HRA pay or reimburse medical expenses that are not limited to the exceptions for permitted insurance, permitted coverage or preventive care. As a result, the individual is not an eligible individual for the purpose of making contributions to an HSA. This result is the same if the individual is covered by a health FSA or HRA sponsored by the employer of the individual's spouse. See, Rev. Rul. 2004-38.

In Situation 2, the individual is covered by an HDHP and by a health FSA and HRA that pay or reimburse medical expenses incurred before the minimum annual deductible under section 223(c)(2)(A)(i) has been satisfied. However, the medical expenses paid or reimbursed by the health FSA and HRA include only vision and dental benefits (which are

permitted coverage) and preventive care. All of these benefits may be covered as a separate health plan, as a separate or optional rider, or as part of the HDHP and whether or not the minimum annual deductible under section 223(c)(2)(A)(i) has been satisfied. The individual is an eligible individual for the purpose of making contributions to an HSA.

In Situation 3, the individual elects to forgo the payment or reimbursement of medical expenses incurred during an HRA coverage period. The suspension of payments and reimbursements by the HRA does not apply to permitted insurance, permitted coverage and preventive care (if otherwise allowed to be paid or reimbursed by the HRA). The individual is an eligible individual for the purpose of making contributions to an HSA until the suspension period ends and the individual is again entitled to receive, from the HRA, payments or reimbursements of section 213(d) medical expenses incurred after the suspension period.

In Situation 4, the health FSA and HRA pay or reimburse medical expenses (including the 20 percent coinsurance not otherwise covered by the HDHP) only after the HDHP's minimum annual deductible has been satisfied. The individual is an eligible individual for the purpose of making contributions to an HSA.

In Situation 5, the HRA is a retirement HRA that only pays or reimburses medical expenses incurred after the individual retires. The individual is an eligible individual for the purpose of making contributions to an HSA before retirement because the HRA will pay or reimburse only medical expenses incurred after retirement.

#### Drafting Information

The principal author of this notice is Shoshanna Tanner of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Ms. Tanner at (202) 622-6080 (not a toll-free call).

## Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-2: Method of accounting for interest.

Rev. Rul. 2004-52 holds that credit card annual fees are not interest for federal income tax purposes. Moreover, the ruling holds that credit card annual fees are includible in the gross income by the card issuer when they become due and payable by card holders under the terms of the credit card agreements. See Rev. Rul. 2004-52, page 973.

Rev. Proc. 2004-32 provides automatic procedures for taxpayers to change their method of accounting to a method that complies with Rev. Rul. 2004-52, 2004-22 I.R.B. dated June 1, 2004, or to the Ratable Inclusion Method for Credit Card Annual fees described in this revenue procedure. See Rev. Proc. 2004-32, page 988.

Rev. Proc. 2004-33 provides automatic procedures for taxpayers to change their method of accounting for credit card late fee income to treat these fees as interest that creates or increases the amount of OID on a pool of credit card loans to which the fees relate. This revenue procedure also sets forth the conditions under which the Commissioner will not challenge a taxpayer's treatment of these fees as interest or as OID on a pool of credit card loans to which the fees relate. See Rev. Proc. 2004-33, page 989.

## Section 451.—General Rule for Taxable Year of Inclusion

Rev. Proc. 2004-32 provides automatic procedures for taxpayers to change their method of accounting to a method that complies with Rev. Rul. 2004-52, 2004-22 I.R.B. dated June 1, 2004, or to the Ratable Inclusion Method for Credit Card Annual fees described in this revenue procedure. See Rev. Proc. 2004-32, page 988.

26 CFR 1.451-1: Taxable year of inclusion.  
(Also: §§ 61, 446.)

**Credit card annual fees.** This ruling holds that credit card annual fees are not interest for federal income tax purposes. Moreover, the ruling holds that credit card annual fees are includible in the gross income by the card issuer when they become due and payable by cardholders under the terms of the credit card agreements.

## Rev. Rul. 2004-52

### ISSUES

(1) Are credit card annual fees interest for federal income tax purposes?

(2) When are credit card annual fees includible in gross income by the card issuer?

## FACTS

X, a taxpayer that uses an overall accrual method of accounting for federal income tax purposes, issues credit cards. Each card allows the cardholder to access a revolving line of credit to make purchases of goods and services and, if otherwise provided for under the applicable cardholder agreement, to obtain cash advances.

Credit card issuers, including X, charge certain cardholders an annual fee. These credit card issuers make various benefits and services available to their cardholders during the year, regardless of whether the cardholder actually utilizes them. Further, although they provide these benefits and services to cardholders, no part of the annual fee that is charged to any cardholder is for a specific benefit or service provided by a credit card issuer to that cardholder.

Each cardholder's credit card agreement sets forth the applicable terms and conditions under which X may charge that cardholder an annual fee. X charges some cardholders a nonrefundable annual fee. X charges other cardholders an annual fee that is refundable on a *pro rata* basis if the cardholder closes the account during the period covered by the fee.

Under the applicable cardholder agreement, no annual fee becomes due and payable until X posts an annual fee charge to the cardholder's credit card account. X reflects this posting in the cardholder's credit card statement. X generally posts the full amount of the annual fee in a single charge unless the terms of the agreement require X to post the annual fee charge in installments.

## LAW AND ANALYSIS

For federal income tax purposes, interest is an amount that is paid in compensation for the use or forbearance of money. *Deputy v. DuPont*, 308 U.S. 488 (1940), 1940-1 C.B. 118; *Old Colony Railroad Co. v. Commissioner*, 284 U.S. 552 (1932), 1932-1 C.B. 274. Neither the label used for the fee nor a taxpayer's treatment of the fee for financial or regulatory reporting purposes is determinative of the proper federal income tax charac-

terization of that fee. See *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 542-43 (1979), 1979-1 C.B. 167, 174-75; Rev. Rul. 72-315, 1972-1 C.B. 49.

The annual fee that credit card issuers, including X, charge any cardholder is not for any specific benefit provided by the credit card issuer to that cardholder. Rather, it is charged for all of the benefits and services that are available to the cardholder under the applicable cardholder agreement. Because cardholders pay annual fees to credit card issuers, including X, in return for all of the benefits and services available under the applicable credit card agreement, annual fees are not compensation for the use or forbearance of money. Thus, X's annual fee income is not interest income for federal income tax purposes.

Under § 451(a) of the Internal Revenue Code, the amount of any item of gross income is includible in gross income for the taxable year in which it is received by the taxpayer, unless that amount is to be properly accounted for in a different period under the method of accounting used by the taxpayer in computing taxable income.

Under § 1.451-1(a) of the Income Tax Regulations, income is includible in gross income by a taxpayer that uses an accrual method of accounting when all events have occurred that fix the taxpayer's right to receive that income and the amount of that income can be determined with reasonable accuracy. See also § 1.446-1(c)(1)(ii)(A). Generally, all the events that fix the right to receive income occur when either the required performance takes place, payment is due, or payment is made, whichever occurs first (the all events test). See Rev. Rul. 2003-10, 2003-1 C.B. 288; Rev. Rul. 80-308, 1980-2 C.B. 162.

X is required to include these annual fees in gross income under § 1.451-1(a) when the fee income becomes due and payable under its agreements, because X's right to the income is fixed at that point and the amount of the income can be determined with reasonable accuracy. Thus, the all events test is satisfied when X posts an annual fee charge to a cardholder's credit card account even if X later is required to refund a portion of a previously posted refundable annual fee charge because the cardholder closes the account during the period covered by that fee.

Notwithstanding the holding of this revenue ruling, Rev. Proc. 2004-32, 2004-22 I.R.B. 988, dated June 1, 2004, this Bulletin, allows card issuers to account for annual fee income using the Ratable Inclusion Method for Credit Card Annual Fees, which is described in section 4 of that revenue procedure. Rev. Proc. 2004-32 also provides automatic consent for a taxpayer described in this revenue ruling to change its method of accounting for annual fee income.

## HOLDINGS

(1) Credit card annual fees are not interest for federal income tax purposes.

(2) Credit card annual fees are includible in gross income by the card issuer when they become due and payable by cardholders under the terms of the credit card agreements.

## DRAFTING INFORMATION

The principal authors of this revenue ruling are Rebecca E. Asta, Alexa Dubert, and Tina Jannotta of the Office of Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact the principal authors at (202) 622-3930 (not a toll-free call).

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## Section 481.—Adjustments Required by Changes in Method of Accounting

Taxpayers changing a method of accounting for certain transfers to trusts to satisfy contested liabilities under section 461(f) may be required to take into account a positive adjustment under section 481(a) entirely in one year. See Rev. Proc. 2004-31, page 986.

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

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. (Also sections 511-513.)

**Joint ventures.** This ruling illustrates the tax consequences for a section 501(c)(3) organization that enters into a joint venture with a for-profit organization as an insubstantial part of its activities.

## Rev. Rul. 2004-51

### ISSUES

1. Whether, under the facts described below, an organization continues to qualify for exemption from federal income tax as an organization described in § 501(c)(3) of the Internal Revenue Code when it contributes a portion of its assets to and conducts a portion of its activities through a limited liability company (LLC) formed with a for-profit corporation.

2. Whether, under the same facts, the organization is subject to unrelated business income tax under § 511 on its distributive share of the LLC's income.

### FACTS

*M* is a university that has been recognized as exempt from federal income tax under § 501(a) as an organization described in § 501(c)(3). As a part of its educational programs, *M* offers summer seminars to enhance the skill level of elementary and secondary school teachers.

To expand the reach of its teacher training seminars, *M* forms a domestic LLC, *L*, with *O*, a company that specializes in conducting interactive video training programs. *L*'s Articles of Organization and Operating Agreement ("governing documents") provide that the sole purpose of *L* is to offer teacher training seminars at off-campus locations using interactive video technology. *M* and *O* each hold a 50 percent ownership interest in *L*, which is proportionate to the value of their respective capital contributions to *L*. The governing documents provide that all returns of capital, allocations and distributions shall be made in proportion to the members' respective ownership interests.

The governing documents provide that *L* will be managed by a governing board comprised of three directors chosen by *M* and three directors chosen by *O*. Under the governing documents, *L* will arrange and conduct all aspects of the video teacher training seminars, including advertising, enrolling participants, arranging for the necessary facilities, distributing the course materials and broadcasting the seminars to various locations. *L*'s teacher training seminars will cover the same content covered in the seminars *M* conducts on *M*'s campus. However, school teachers will participate through an interactive video

link at various locations rather than in person. The governing documents grant *M* the exclusive right to approve the curriculum, training materials, and instructors, and to determine the standards for successful completion of the seminars. The governing documents grant *O* the exclusive right to select the locations where participants can receive a video link to the seminars and to approve other personnel (such as camera operators) necessary to conduct the video teacher training seminars. All other actions require the mutual consent of *M* and *O*.

The governing documents require that the terms of all contracts and transactions entered into by *L* with *M*, *O* and any other parties be at arm's length and that all contract and transaction prices be at fair market value determined by reference to the prices for comparable goods or services. The governing documents limit *L*'s activities to conducting the teacher training seminars and also require that *L* not engage in any activities that would jeopardize *M*'s exemption under § 501(c)(3). *L* does in fact operate in accordance with the governing documents in all respects.

*M*'s participation in *L* will be an insubstantial part of *M*'s activities within the meaning of § 501(c)(3) and § 1.501(c)(3)-1(c)(1) of the Income Tax Regulations.

Because *L* does not elect under § 301.7701-3(c) of the Procedure and Administration Regulations to be classified as an association, *L* is classified as a partnership for federal tax purposes pursuant to § 301.7701-3(b).

### LAW

#### *Exemption under § 501(c)(3)*

Section 501(c)(3) provides, in part, for the exemption from federal income tax of corporations organized and operated exclusively for charitable, scientific, or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of the exempt purposes specified in § 501(c)(3).

Activities that do not further exempt purposes must be an insubstantial part of the organization's activities. In *Better Business Bureau of Washington, D.C. v. United States*, 326 U.S. 279, 283 (1945), the Supreme Court held that "the presence of a single . . . [non-exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

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

Section 1.501(c)(3)-1(d)(2) defines the term "charitable" as used in § 501(c)(3) as including the advancement of education.

Section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term "educational" as used in § 501(c)(3) relates to the instruction or training of the individual for the purpose of improving or developing his capabilities.

Section 1.501(c)(3)-1(d)(3)(ii) provides examples of educational organizations including a college that has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on and an organization that presents a course of instruction by means of correspondence or through the utilization of television or radio.

#### *Joint Ventures*

Rev. Rul. 98-15, 1998-1 C.B. 718, provides that for purposes of determining exemption under § 501(c)(3), the activities of a partnership, including an LLC treated as a partnership for federal tax purposes, are considered to be the activities of the partners. A § 501(c)(3) organization may form and participate in a partnership and meet the operational test if 1) participation in the partnership furthers a charitable purpose, and 2) the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose and only incidentally for the benefit of the for-profit partners.

*Redlands Surgical Services*, 113 T.C. 47, 92-93 (1999), *aff'd* 242 F.3d 904 (9th



Cir. 2001), provides that a nonprofit organization may form partnerships, or enter into contracts, with private parties to further its charitable purposes on mutually beneficial terms, “so long as the nonprofit organization does not thereby impermissibly serve private interests.” The Tax Court held that the operational standard is not satisfied merely by establishing “whatever charitable benefits [the partnership] may produce,” finding that the nonprofit partner lacked “formal or informal control sufficient to ensure furtherance of charitable purposes.” Affirming the Tax Court, the Ninth Circuit held that ceding “effective control” of partnership activities impermissibly serves private interests. 242 F.3d at 904.

*St. David's Health Care System v. United States*, 349 F.3d 232, 236–237 (5th Cir. 2003), held that the determination of whether a nonprofit organization that enters into a partnership operates exclusively for exempt purposes is not limited to “whether the partnership provides some (or even an extensive amount of) charitable services.” The nonprofit partner also must have the “capacity to ensure that the partnership’s operations further charitable purposes.” *Id.* at 243. “[T]he non-profit should lose its tax-exempt status if it cedes control to the for-profit entity.” *Id.* at 239.

#### *Tax on Unrelated Business Income*

Section 511(a), in part, provides for the imposition of tax on the unrelated business taxable income (as defined in § 512) of organizations described in § 501(c)(3).

Section 512(a)(1) defines “unrelated business taxable income” as the gross income derived by any organization from any unrelated trade or business (as defined in § 513) regularly carried on by it less the deductions allowed, both computed with the modifications provided in § 512(b).

Section 512(c) provides that, if a trade or business regularly carried on by a partnership of which an organization is a member is an unrelated trade or business with respect to the organization, in computing its unrelated business taxable income, the organization shall, subject to the exceptions, additions, and limitations contained in § 512(b), include its share (whether or not distributed) of the gross income of the partnership from the unrelated trade or business and its share of the partner-

ship deductions directly connected with the gross income.

Section 513(a) defines the term “unrelated trade or business” as any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501.

Section 1.513–1(d)(2) provides that a trade or business is “related” to an organization’s exempt purposes only if the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income). A trade or business is “substantially related” for purposes of § 513, only if the causal relationship is a substantial one. Thus, to be substantially related, the activity “must contribute importantly to the accomplishment of [exempt] purposes.” Section 1.513–1(d)(2). Section 513, therefore, focuses on “the manner in which the exempt organization operates its business” to determine whether it contributes importantly to the organization’s charitable or educational function. *United States v. American College of Physicians*, 475 U.S. 834, 849 (1986).

#### ANALYSIS

*L* is a partnership for federal tax purposes. Therefore, *L*’s activities are attributed to *M* for purposes of determining both whether *M* operates exclusively for educational purposes and therefore continues to qualify for exemption under § 501(c)(3) and whether *M* has engaged in an unrelated trade or business and therefore may be subject to the unrelated business income tax on its distributive share of *L*’s income.

The activities *M* is treated as conducting through *L* are not a substantial part of *M*’s activities within the meaning of § 501(c)(3) and § 1.501(c)(3)–1(c)(1). Therefore, based on all the facts and circumstances, *M*’s participation in *L*, taken alone, will not affect *M*’s continued qualification for exemption as an organization described in § 501(c)(3).

Although *M* continues to qualify as an exempt organization described in

§ 501(c)(3), *M* may be subject to unrelated business income tax under § 511 if *L* conducts a trade or business that is not substantially related to the exercise or performance of *M*’s exempt purposes or functions.

The facts establish that *M*’s activities conducted through *L* constitute a trade or business that is substantially related to the exercise and performance of *M*’s exempt purposes and functions. Even though *L* arranges and conducts all aspects of the teacher training seminars, *M* alone approves the curriculum, training materials and instructors, and determines the standards for successfully completing the seminars. All contracts and transactions entered into by *L* are at arm’s length and for fair market value, *M*’s and *O*’s ownership interests in *L* are proportional to their respective capital contributions, and all returns of capital, allocations and distributions by *L* are proportional to *M*’s and *O*’s ownership interests. The fact that *O* selects the locations and approves the other personnel necessary to conduct the seminars does not affect whether the seminars are substantially related to *M*’s educational purposes. Moreover, the teacher training seminars *L* conducts using interactive video technology cover the same content as the seminars *M* conducts on *M*’s campus. Finally, *L*’s activities have expanded the reach of *M*’s teacher training seminars, for example, to individuals who otherwise could not be accommodated at, or conveniently travel to, *M*’s campus. Therefore, the manner in which *L* conducts the teacher training seminars contributes importantly to the accomplishment of *M*’s educational purposes, and the activities of *L* are substantially related to *M*’s educational purposes. Section 1.513–1(d)(2). Accordingly, based on all the facts and circumstances, *M* is not subject to unrelated business income tax under § 511 on its distributive share of *L*’s income.

#### HOLDINGS

1. *M* continues to qualify for exemption under § 501(c)(3) when it contributes a portion of its assets to and conducts a portion of its activities through *L*.

2. *M* is not subject to unrelated business income tax under § 511 on its distributive share of *L*’s income.

The principal author of this revenue ruling is Virginia G. Richardson of Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, contact Virginia G. Richardson at (202) 283-8938 (not a toll-free call).

## Section 511.—Imposition of Tax on Unrelated Business Income of Charitable, etc., Organizations

Unrelated business income tax consequences for a section 501(c)(3) organization that enters into a joint venture with a for-profit organization as an insubstantial part of its activities. See Rev. Rul. 2004-51, page 974.

## Section 512.—Unrelated Business Taxable Income

Unrelated business income tax consequences for a section 501(c)(3) organization that enters into a joint venture with a for-profit organization as an insubstantial part of its activities. See Rev. Rul. 2004-51, page 974.

## Section 513.—Unrelated Trade or Business

Unrelated business income tax consequences for a section 501(c)(3) organization that enters into a joint venture with a for-profit organization as an insubstantial part of its activities. See Rev. Rul. 2004-51, page 974.

## Section 1272.—Current Inclusion in Income of Original Issue Discount

Rev. Proc. 2004-33 provides automatic procedures for taxpayers to change their method of accounting for credit card late fee income to treat these fees as interest that creates or increases the amount of OID on a pool of credit card loans to which the fees relate. This revenue procedure also sets forth the conditions under which the Commissioner will not challenge a taxpayer's treatment of these fees as interest or as OID on a pool of credit card loans to which the fees relate. See Rev. Proc. 2004-33, page 989.

## Section 1361.—S Corporation Defined

*26 CFR 1.1361(b): Small business corporation defined.*  
(Also: §§ 401, 501, 1362, 7701, 7871, 305.7871-1.)

**Indian tribal government.** This ruling provides clarification with regard to an Indian tribal government's ability to qualify as an eligible shareholder under section 1361 of the Code. Specifically, the ruling explains that a federally recognized Indian tribal government does not qualify as a permissible S corporation shareholder under section 1361(b)(1)(B) because it is not treated as an individual subject to individual income taxes under section 1 of the Code. The ruling also explains that a federally recognized Indian Tribe cannot qualify as a permissible S corporation shareholder under section 1361(c)(6) because it is neither a section 501(c)(3) organization, nor a section 401(a) qualified plan, profit-sharing, or stock bonus plan organization.

## Rev. Rul. 2004-50

### ISSUE

Is a federally recognized Indian tribal government, as described in § 7701(a)(40)(A) of the Internal Revenue Code, an eligible S corporation shareholder under § 1361?

### FACTS

X is a federally recognized Indian tribal government (Indian tribal government) and a shareholder in *Corporation*, a domestic entity, formed in accordance with the laws of *State*. *Corporation* wants to make an election to be an S corporation.

### LAW AND ANALYSIS

Section 1361(a) provides that for purposes of this title, the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1361(b)(1) provides that for purposes of this subchapter, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) have

as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(6) provides that for purposes of subsection (b)(1)(B), an organization which is (A) described in §§ 401(a) or 501(c)(3), and (B) exempt from taxation under § 501(a), may be a shareholder in an S corporation.

Section 401(a) provides the definition of a qualified pension, profit-sharing, and stock bonus plans that qualifies under § 1361(b) as an eligible S corporation shareholder.

Section 501(a) provides that an organization described in subsection (c) or (d) or § 401(a) shall be exempt from taxation under this subtitle unless that exemption is denied under § 502 or § 503.

Section 501(c)(3) describes corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literacy, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in section (h)), and which does not participate in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Section 7701(a)(40)(A) states that the term "Indian tribal government" refers to the governing body of any tribe, band, community, village, or group of Indians, or (if applicable) Alaska Natives, which is determined by the Secretary of the Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions.

Section 7871(a) and § 305.7871-1 of the Income Tax Regulations provide that Indian tribal governments will be treated as states for certain enumerated federal tax purposes.

Section 7871(d) states that, for purposes of § 7871(a), a subdivision of an Indian tribal government shall be treated as a political subdivision of a state if (and only if) the Secretary of the Treasury determines (after consultation with the Secretary of the Interior) that the subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.

Rev. Proc. 2002-64, 2002-2 C.B. 717, provides the most recent list of federally recognized tribal governments. In the situation described in this ruling, *X* is a federally recognized Indian tribal government.

Generally, federal income tax statutes do not tax Indian tribes. See Rev. Rul. 67-284, 1967-2 C.B. 55. An Indian tribe is not subject to federal income tax as an individual under § 1 or as a corporation under § 11. However, colleges and universities formed by Indian tribes are subject to § 511(a)(2)(B) (relating to the taxation of colleges and universities which are agencies or instrumentalities of governments or their political subdivisions) pursuant to § 7871(a)(5). Indian tribes also are subject to certain excise taxes.

Rev. Rul. 60-384, 1960-2 C.B. 172, provides circumstances under which a governmental agency is prohibited from qualifying as a § 501(c)(3) organization. A state or municipality itself will not qualify as an organization described in § 501(c)(3) since its purposes are clearly not exclusively those described in § 501(c)(3). Where a particular branch or department under whose jurisdiction the activity in question is being coordinated is an integral part of a state or municipal government, the provisions of § 501(c)(3) would also not be applicable.

Based on the above law and published guidance, *X*, an Indian tribal government, is not subject to federal income tax as an individual under § 1. Because an Indian tribal government is not subject to tax as an individual for § 1 purposes, it is not considered an individual under § 1361(b)(1)(B).

In addition, *X*, an Indian tribal government, does not qualify under the § 1362(c)(6) exception for certain exempt organizations described in § 501(c)(3) or § 401(a). *X* is not a § 401(a) organization because it is not a qualified pension, profit-sharing, or stock bonus plan. Furthermore, *X* is not a § 501(c)(3) organization because it is a government and

its purposes are not exclusively those described in § 501(c)(3). Consequently, *X* is not an eligible S corporation shareholder, and *Corporation* cannot make an election to be an S corporation.

#### HOLDING

A federally recognized Indian tribal government is not an eligible S corporation shareholder for purposes of § 1361.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is Laura C. Nash of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Ms. Nash at (202) 622-3050 (not a toll-free call).

### Section 6501.—Limitations on Assessment and Collection

#### Ct. D. 2079

#### SUPREME COURT OF THE UNITED STATES

No. 02-1389

UNITED STATES v. GALLETTI ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

March 23, 2004

Syllabus

“[T]he amount of any tax imposed [by the Internal Revenue Code] shall be assessed within three years after the return was filed.” 26 U.S.C. Sec. 6501(a). If a tax is properly so assessed, the statute of limitations for collecting it is extended by 10 years from the assessment date. Sec. 6502(a). Respondents were general partners of a partnership (hereinafter *Partnership*) that failed to pay significant federal employment taxes from 1992 to 1995. The Internal Revenue Service (IRS) timely assessed the *Partnership*, but the taxes were never paid. Respondents later filed for Chapter 13 bankruptcy protection, and the

IRS then filed proof of claims against them for the *Partnership*'s unpaid employment taxes. Respondents objected, arguing that the timely assessment of the *Partnership* did not extend the 3-year limitations period against the general partners, who had not been separately assessed within that period. The Bankruptcy Court and the District Court agreed and sustained respondents' objections. The Ninth Circuit affirmed, holding that since respondents are “taxpayers” under Sec. 7701, which defines “taxpayer” to mean “any person subject to any internal revenue tax,” they are also “taxpayers” under Secs. 6203 and 6501. As such, the court held that the assessment against the *Partnership* extended the limitations period only with respect to the *Partnership*.

*Held:* The proper tax assessment against the *Partnership* suffices to extend the statute of limitations to collect the tax in a judicial proceeding from the general partners who are liable for the payment of the *Partnership*'s debts. Pp. 4-9.

(a) Respondents argue that a valid assessment triggering the 10-year increase in the limitations period must name them individually, as they are primarily liable for the tax debt. They claim, first, that they are the relevant taxpayers under Sec. 6203, which requires the assessment to be made by “recording the liability of the taxpayer.” Although the Ninth Circuit correctly concluded that an individual partner can be a “taxpayer,” Sec. 6203 speaks of the taxpayer's “liability,” which indicates that the relevant taxpayer must be determined. Here, the liability arose from the *Partnership*'s failure to comply with Sec. 3402(a)(1)'s requirement that an “employer [paying] wages” deduct and withhold employment taxes. And Sec. 3403 makes clear that the “employer” that fails to withhold and submit the requisite employment taxes is the “liable” taxpayer. In this case, the *Partnership* is the “employer.” Second, respondents claim that they are primarily liable for the tax debt because California law makes them jointly and severally liable for the *Partnership*'s debts. However, to be primarily liable for this debt, respondents must show that they are the “employer.” And, under California law, a partnership and its general partners are separate entities. Thus respondents cannot argue that, for all intents and purposes, imposing a tax directly on

the Partnership is equivalent to imposing a tax directly on the general partners, but must instead prove that the tax liability was imposed both on the Partnership and on respondents as separate “employers.” That respondents are jointly and severally liable for the Partnership’s debts is irrelevant to this determination. Pp. 4–7.

(b) The Code does not require the Government to make separate assessments of a single tax debt against persons or entities secondarily liable for that debt in order for Sec. 6502’s extended limitations period to apply to judicial collection actions against those persons or entities. It is clear that “assessment” refers to little more than the calculation or recording of a tax liability, see, e.g., Sec. 6201, and that it is *the tax* that is assessed, not the taxpayer, see, e.g., Sec. 6501. The limitations period resulting from a proper assessment governs the time extension for enforcing the tax liability. *United States v. Updike*, 281 U.S. 489, 495. Once a tax has been properly assessed, nothing in the Code requires the IRS to duplicate its efforts by separately assessing the same tax against individuals or entities who are not the actual taxpayers but are, by reason of state law, liable for the taxpayer’s debt. The assessment’s consequences—the extension of the limitations period for collecting the debt—attach to the debt without reference to the special circumstances of the secondarily liable parties. Here, the tax was properly assessed against the Partnership, thereby extending the limitations period for collecting the debt. The United States now timely seeks to collect that debt in judicial proceedings against respondents. Pp. 7–9.

314 F.3d 336 reversed and remanded.

THOMAS, J., delivered the opinion for a unanimous Court.

**SUPREME COURT OF THE  
UNITED STATES**

No. 02-1389

UNITED STATES, PETITIONER *v.*  
ABEL COSMO GALLETTI ET AL.

ON WRIT OF CERTIORARI TO THE  
UNITED STATES COURT  
OF APPEALS FOR THE NINTH  
CIRCUIT

March 23, 2004

JUSTICE THOMAS delivered the opinion of the Court.

Section 6501(a) of the Internal Revenue Code states that, except as otherwise provided, “the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed . . . and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.” 26 U.S.C. Sec. 6501(a). If a tax is properly assessed within three years, however, the statute of limitations for the collection of the tax is extended by 10 years from the date of assessment. Sec. 6502(a). We must decide in this case whether, in order for the United States to avail itself of the 10-year increase in the statute of limitations for collection of a tax debt, it must assess the taxes not only against a partnership that is directly liable for the debt, but also against each individual partner who might be jointly and severally liable for the debts of the partnership. Under California law a partnership maintains a separate identity from its general partners, and the partners are only secondarily liable for the tax debts of the partnership, as they are for any debt of the partnership. Because, in this case, the only relevant “taxpayer” for purposes of Secs. 6501–6502 is the partnership, we hold that the proper assessment of the tax against the partnership suffices to extend the statute of limitations for collection of the tax from the general partners who are liable for the payment of the partnership’s debts. The Government’s timely assessment of the tax against the partnership was sufficient to extend the statute of limitations to collect the tax in a judicial proceeding, whether from the partnership itself or from those liable for its debts.

I

Respondents, Abel Cosmo Galletti, Sarah Galletti, Francesco Briguglio, and Angela Briguglio, were general partners of Marina Cabrillo Company (Partnership). From 1992 to 1995, the Partnership failed to pay significant federal employment tax liabilities that it had incurred. Although the Internal Revenue Service (IRS) timely assessed those taxes against the Partnership in 1994, 1995, and 1996, the Partnership never satisfied the debt.

Respondents Abel and Sarah Galletti and respondents Francesco and Angela

Briguglio filed joint petitions for relief under Chapter 13 of the Bankruptcy Code on October 20, 1999, and February 4, 2000, respectively. In the Gallettis’ proceedings, the IRS filed a proof of claim in the amount of \$395,179.89 for unpaid employment taxes assessed between January 1994 and July 1995 against the Partnership. In the Briguglios’ proceedings, the IRS filed a proof of claim in the amount of \$427,402.74. The proof of claim included secured claims totaling \$403,264.06 for unpaid employment taxes assessed between January 1994 and November 1996 against the Partnership.

Respondents objected to the claims on the ground that they were not proven against the estates. Respondents did not dispute that under California law they are jointly and severally liable for the debts of the Partnership. Nor did they dispute that the IRS had properly assessed the taxes against the Partnership within the 3-year statute of limitations, thereby extending the limitations period for collection of the taxes by 10 years. Rather, respondents argued that the timely assessment of the Partnership extended the statute of limitations only against the Partnership. To extend the 3-year statute of limitations against the general partners, respondents argued, the IRS had to separately assess the general partners within the 3-year limitations period. Because it did not, and because the 3-year limitations period had expired, respondents argued that the IRS could no longer collect the debt from them. The Bankruptcy Court and the District Court agreed and sustained respondents’ objections to the claims.

The Court of Appeals for the Ninth Circuit affirmed. The Government argued that the Code does not require that the individual partners be assessed within the 3-year period prescribed by Sec. 6501 and that the IRS made a valid assessment of the taxpayer here because the Partnership is the only relevant “taxpayer.” The Court of Appeals held that since respondents are “taxpayers” under Sec. 7701(a)(14), which defines “taxpayer” to mean “any person subject to any internal revenue tax,” they are also “taxpayers” under Secs. 6203 and 6501. As such, the Court of Appeals held that “[t]he assessment against the Partnership extended the statute of limitations only with respect to the Partnership.” 314 F.3d 336, 340 (2002).

The Government argued in the alternative that because respondents conceded that they were liable for the Partnership's employment tax debts as a matter of California law, the Government had a right to payment, which suffices to prove a valid claim in bankruptcy. See 11 U.S.C. Sec. 101(5)(A) (defining "claim" as including a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured"). The Court of Appeals rejected this argument because, under California law, a creditor must obtain a judgment against a partner before holding that partner liable for the partnership's debt. Cal. Corp. Code Ann. Sec. 16307(c) (Supp. 2004). At the time the United States filed its proof of claim, it had not obtained a separate judgment against respondents, and the time for obtaining a judgment under the Internal Revenue Code against respondents had expired.

We granted certiorari, 539 U.S. \_\_\_\_\_ (2003), and now reverse.

## II

Section 6501(a) of the Internal Revenue Code provides that "the amount of any tax imposed [by the Code] shall be assessed within 3 years after the return was filed." 26 U.S.C. Sec. 6501(a). "The assessment shall be made by recording the liability of the taxpayer in the office of the Secretary [of the Treasury] in accordance with rules or regulations prescribed by the Secretary." Sec. 6203. Within 60 days of the assessment, the Secretary is required to "give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof." Sec. 6303(a). If the tax is properly assessed within 3 years, the limitations period for collection of the tax is extended by 10 years from the date of the assessment. Sec. 6502.

The dispute in this case centers on whether the United States can collect the Partnership's unpaid employment taxes from respondents in a judicial proceeding occurring more than three years after the tax return was filed but within the 10-year extension to the 3-year limitations period that attached when the tax was timely assessed against the Partnership.<sup>1</sup> Respondents insist that a valid assessment (that is, one that would trigger the 10-year increase in the statute of limitations) must name them individually. This is so, according to respondents, because they are primarily liable for the tax debt, both because they are "the [relevant] taxpayer[s]" under Sec. 6203 and because they are jointly and severally liable for the tax debts of the partnership.<sup>2</sup> We reject both arguments in turn.

## A

Respondents argue, and the Court of Appeals agreed, that each partner is primarily liable for the debt and must be individually assessed because each partner is a separate "taxpayer" under 26 U.S.C. Sec. 6203. The statutory definition of "taxpayer" includes "any person subject to any internal revenue tax," and "person" includes both "an individual" and a "partnership," Secs. 7701(a)(14), (a)(1). The Court of Appeals observed that although the Partnership is a "taxpayer," each individual partner is also a separate "taxpayer." As such, the Court of Appeals interpreted Sec. 6203's requirement that the Secretary of the Treasury record "the liability of the taxpayer" to require a separate assessment against each of the general partners.

Although the Court of Appeals correctly concluded that an individual partner can be a "taxpayer," the inquiry does not end there. Section 6203 speaks of "*the liability of the taxpayer*" (emphasis added), which indicates that the relevant taxpayer must be determined. The liability in this case arose from the Partnership's failure to

comply with Sec. 3402(a)(1) of the Code, which requires "every employer making payment of wages" to deduct and withhold employment taxes. Moreover, "[t]he employer shall be liable for the payment of the tax required to be deducted and withheld." Sec. 3403. When an employer fails to withhold and submit the requisite amount of employment taxes, Sec. 3403 makes clear that the liable taxpayer is the employer. In this case, the "employer" was the Partnership.<sup>3</sup>

## B

Respondents also argue that they are primarily liable for the Partnership's tax debt because, under California law, general partners are jointly and severally liable for the debts of their partnership, Cal. Corp. Code Ann. Sec. 16306 (Supp. 2004). Brief for Respondents 8–16. As our prior discussion demonstrates, however, respondents cannot show that they are primarily liable for the payment of the Partnership's employment taxes unless they can show that they are the "employer." However, under California's partnership principles, a partnership and its general partners are separate entities. See Cal. Corp. Code Ann. Sec. 16201 (Supp. 2004). Thus respondents cannot argue that, for all intents and purposes, imposing a tax directly on the Partnership is equivalent to imposing a tax directly on the general partners. Respondents must instead prove that the tax liability was imposed both on the Partnership and respondents as separate "employers." The fact that respondents are jointly and severally liable for the debts of the Partnership is irrelevant to this determination.

## III

We now turn to the question whether the Government must make separate assessments of a single tax debt against persons or entities secondarily liable for that debt

<sup>1</sup> Because the Government is attempting to enforce the Partnership's tax liabilities against respondents in a judicial proceeding, we do not address whether an assessment only against the Partnership is sufficient for the IRS to commence administrative collection of the Partnership's tax debts by lien or levy against respondents' property.

We also decline to address whether an assessment against the partnership suffices to trigger liability against the partners for interest and penalties without separate notice and demand to them.

<sup>2</sup> Respondents argue that even if we were to hold that the partners are secondarily liable, the IRS would still be barred from collecting the taxes. Respondents contend that if partners are not "taxpayers" under Sec. 6203, then their liability arises only under state law, and the state 3-year statute of limitations therefore applies. Brief for Respondents 30–34. Respondents have forfeited this argument by failing to raise it in the courts below. Indeed, the closest respondents have come to arguing that the state limitations period applies was in the Court of Appeals, when respondents argued that "under California law, any collections suit filed against a partner to collect a partnership debt is subject to the statute limitation provision which applies to the underlying debt of the partnership." Brief for Respondents in Nos. 01–55953, 01–55954 (CA9), p. 14. This argument, of course, is contrary to respondents' position in this Court.

<sup>3</sup> Our decision is consistent with this Court's holding in *United States v. Williams*, 514 U.S. 527, 532–536 (1995), where we interpreted "taxpayer" under 26 U.S.C. Sec. 6511 more broadly. Here, it is clear that we must interpret "the taxpayer" under Sec. 6203 with reference to the underlying liability.

in order for Sec. 6502's extended statute of limitations to apply to those persons or entities.<sup>4</sup> We hold that the Code contains no such requirement. Respondents' argument that they must be separately assessed turns on a mistaken understanding of the function and nature of an assessment as identical to the initiation of a formal collection action against any person or entity who might be liable for payment of a debt. In its numerous uses throughout the Code, it is clear that the term "assessment" refers to little more than the calculation or recording of a tax liability. See, e.g., 26 U.S.C. Sec. 6201 (assessment authority); Sec. 6203 (method of assessment); Sec. 6204 (supplemental assessments); 26 CFR Sec. 601.103 (2003). See also Black's Law Dictionary 111 (7th ed. 1999) (defining "assessment" as the "[d]etermination of the [tax] rate or amount of something, such as a tax or damages"). "The Federal tax system is basically one of self-assessment," whereby each taxpayer computes the tax due and then files the appropriate form of return along with the requisite payment. 26 CFR Sec. 601.103(a) (2003). In most cases, the Secretary accepts the self-assessment and simply records the liability of the taxpayer. Where the taxpayer fails to file the form of return or miscalculates the tax due, as in this case, the Secretary can assess "all taxes (including interest, additional amounts, additions to the tax, and assessable penalties)," 26 U.S.C.

Sec. 6201(a), by "recording the liability of the taxpayer in the office of the Secretary," Sec. 6203. In other words, where the Secretary rejects the self-assessment of the taxpayer or discovers that the taxpayer has failed to file a return, the Secretary calculates the proper amount of liability and records it in the Government's books.

To be sure, the assessment of a tax triggers certain consequences. After the amount of liability has been established and recorded, the IRS can employ administrative enforcement methods to collect the tax. Secs. 6321–6327, 6331–6334. The assessment of a tax liability also extends the period during which the Government can collect the tax. But the fact that the act of assessment has consequences does not change the function of the assessment: to calculate and record a tax liability.

Under a proper understanding of the function and nature of an assessment, it is clear that it is *the tax* that is assessed, not the taxpayer. See Sec. 6501(a) ("the amount of any tax . . . shall be assessed"); Sec. 6502(a) ("[w]here the assessment of any tax"). And in *United States v. Updike*, 281 U.S. 489 (1930), the Court, interpreting a predecessor to Sec. 6502, held that the limitations period resulting from a proper assessment governs "the extent of time for the enforcement of the tax liability," *id.*, at 495. In other words, the Court held that the statute of limitations attached to the debt as a whole.

The basis of the liability in *Updike* was a tax imposed on the corporation, and the Court held that the same limitations period applied in a suit to collect the tax from the corporation as in a suit to collect the tax from the derivatively liable transferee. *Id.*, at 494–496. See also *United States v. Wright*, 57 F.3d 561, 563 (CA7 1995) (holding that, based on *Updike*'s principle of "all-for-one, one-for-all," the statute of limitations governs the debt as a whole).

Once a tax has been properly assessed, nothing in the Code requires the IRS to duplicate its efforts by separately assessing the same tax against individuals or entities who are not the actual taxpayers but are, by reason of state law, liable for payment of the taxpayer's debt. The consequences of the assessment—in this case the extension of the statute of limitations for collection of the debt—attach to the tax debt without reference to the special circumstances of the secondarily liable parties.

In this case, the tax was properly assessed against the Partnership, thereby extending the statute of limitations for collection of the debt. The United States now timely seeks to collect that debt in judicial proceedings against respondents.<sup>5</sup> We therefore reverse the judgment of the Court of Appeals and remand the case for further proceedings consistent with this opinion.

*It is so ordered.*

<sup>4</sup> We use the term "secondary liability" to mean liability that is derived from the original or primary liability.

<sup>5</sup> The Court of Appeals also held that the claims were barred by California partnership law, which requires a creditor first to obtain a judgment against a partnership before holding the partners liable for the partnership's debt. 314 F.3d 336, 344 (CA9 2002). When respondents filed for bankruptcy, an automatic stay barred the Government from bringing suit outside the Bankruptcy Court to enforce respondents' secondary liability. 11 U.S.C. Sec. 362(a)(1). Respondents do not dispute, however, that the adjudication of a disputed claim satisfies California's requirement that there be a "judgment against a partner." Cal. Corp. Code Ann. Sec. 16307(c) (Supp. 2004) Moreover, a claim is allowable in bankruptcy "whether or not such right is reduced to judgment." 11 U.S.C. Sec. 101(5)(A).

# Part III. Administrative, Procedural, and Miscellaneous

## Capital Gain Dividends of RICs and REITs

### Notice 2004-39

#### SECTION 1. PURPOSE

This notice provides guidance to regulated investment companies (“RICs”), real estate investment trusts (“REITs”), and their shareholders in applying § 1(h) of the Internal Revenue Code to capital gain dividends of RICs and REITs. The notice explains how the changes to § 1(h) made by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the “JGTRRA”), Pub. L. No. 108-27, 117 Stat. 752, apply to RIC and REIT capital gain dividends paid (or accounted for as if paid) in taxable years that end on or after May 6, 2003.

#### SECTION 2. BACKGROUND

For individuals, estates, and trusts, § 1(h) imposes differing rates of tax on various transactions depending on the types of transactions giving rise to net capital gains. For transactions taken into account during taxable years ending before May 6, 2003, a taxpayer’s long-term capital gains and losses generally are separated into three tax-rate groups: a 20-percent group, a 25-percent group, and a 28-percent group. See Notice 97-59, 1997-2 C.B. 309. For certain taxpayers, transactions in the 20-percent group may be taxed at a 10-percent rate, or at an 8-percent rate if the gain is qualified 5-year gain under § 1(h)(9) (as in effect before the enactment of the JGTRRA).

For transactions taken into account during taxable years ending on or after May 6, 2003, and beginning before January 1, 2009, the JGTRRA reduced the 20-percent rate to 15 percent, reduced the 10-percent rate to 5 percent (0 percent for taxable years beginning after 2007), and repealed the rules dealing with qualified 5-year gain. For a taxable year that includes May 6, 2003, the reduction in rates and the repeal of the rules dealing with qualified 5-year gain apply to gain or loss properly taken into account for the portion of the taxable year on or after May 6, 2003. Because this effective date generally occurs sometime during a taxpayer’s

taxable year, the amount of capital gain that benefits from the reduced 15-percent (or 5-percent) rate is generally the lesser of the net capital gain for the entire taxable year or the net capital gain determined using only gain and loss properly taken into account for the portion of the taxable year on or after May 6, 2003. JGTRRA § 301(c)(1)–(2) (“the JGTRRA transition rule”). In applying the JGTRRA transition rule with respect to a pass-through entity, the determination of when gains and losses are properly taken into account is made at the entity level. *Id.* § 301(c)(4). See the last paragraph of Section 3 of this notice for the application of this rule.

The Secretary has authority to issue regulations concerning the application of § 1(h) to sales and exchanges by (and of interests in) pass-through entities, including RICs and REITs. § 1(h)(9).

To the extent that a RIC or a REIT has net capital gain for a taxable year, it may designate as capital gain dividends the dividends that it pays during the year, the dividends that § 855 or 858 deems it to pay during the year, or deficiency dividends under § 860 that it pays for that year. In general, a capital gain dividend is treated by the shareholders that receive it as a gain from the sale or exchange of a capital asset held for more than one year.

Notice 97-64, 1997-2 C.B. 323, describes regulations that will be issued under § 1(h) concerning the application of § 1(h) to capital gain dividends of RICs and REITs, effective for taxable years ending on or after May 7, 1997. As described in Notice 97-64, the regulations will allow a RIC or REIT to make additional designations of capital gain dividends to reflect the differing tax-rate groups under § 1(h) and will provide limitations on the amounts that can be designated in the differing tax-rate groups. In calculating those limitations, the regulations will provide for a deferral adjustment or bifurcation adjustment in certain situations. In addition, the regulations will provide special rules for distributions of § 1202 gain.

Moreover, when those regulations are issued, they will reflect changes to § 1(h) since the publication of Notice 97-64. (For example, the Tax and Trade Relief Extension Act of 1998, Pub. L. No.

105-277, 112 Stat. 2681-886, ended the relevance of holding a capital asset for more than 18 months.)

This Notice 2004-39 describes how the reduction in rates made by the JGTRRA and the JGTRRA transition rule (for taxable years that include May 6, 2003), apply to capital gain dividends of RICs and REITs. Future guidance may be issued to clarify certain of the rules originally described in Notice 97-64 and to make other modifications to take into account industry experience with the rules. That guidance generally will apply on a prospective basis.

#### SECTION 3. APPLICATION OF § 1(h) TO RIC AND REIT CAPITAL GAIN DIVIDENDS

For taxable years ending on or after May 6, 2003, the rules described in Notice 97-64 continue to apply to capital gain dividends of RICs and REITs, with appropriate modifications to take into account the changes that have been made to § 1(h) since that notice was published. Thus, if a RIC or REIT designates a dividend as a capital gain dividend, the RIC or REIT may make an additional designation of the dividend as a 15%-rate gain distribution, subject to the limitations described in section 5 of Notice 97-64, including the limitation that the additional designation of a class of capital gain dividend not exceed the maximum distributable amount in that class.

In general, a RIC or REIT determines the maximum distributable amounts that may be designated in each class of capital gains dividends by performing the computation required by § 1(h) as if the RIC or REIT were an individual whose ordinary income is subject to a marginal tax rate of at least 28 percent. The maximum distributable gain in each class of capital gain dividends is equal to the amount that, in the computation under § 1(h), is multiplied by the corresponding rate gain percentage. The computation under § 1(h), however, is modified in the following ways:

- The RIC or REIT disregards qualified dividend income. That is, net capital gain is not increased by qualified dividend income, and qualified dividend

income is disregarded in determining the amount of gain properly taken into account for the portion of a taxable year on or after May 6, 2003. (Under § 854(b) or § 857(c), qualified dividend income received by the RIC or REIT may contribute to a separate designation of other RIC or REIT dividends.)

- The RIC or REIT makes the deferral adjustment or bifurcation adjustment described in section 6 of Notice 97-64.
- The computation takes into account, if applicable, the JGTRRA transition rule for taxable years that contain May 6, 2003. The JGTRRA transition rule, however, interacts with the deferral adjustment in a way that differs from the interaction between that adjustment and the transition rule for the 1997 reductions in capital gains rates. That is, for purposes of the JGTRRA transition rule, the deferral adjustment is applied in determining whether a gain or loss is taken into account before May 6, 2003, or after May 5, 2003. For example, if a RIC sells shares of stock before May 6, 2003, but the sale is treated under § 852(b)(3)(C) and § 1.852-11(e) as arising after that date, the sale is taken into account on the

later date for purposes of the JGTRRA transition rule. This application of the deferral adjustment differs from the special rule in section 6 of Notice 97-64 for transactions occurring during 1997.

The JGTRRA transition rule applies at both the RIC/REIT level and at the shareholder level. That is, the rule applies at the RIC/REIT level to taxable years of the RIC or REIT that contain May 6, 2003, to govern how capital gain dividends may be designated, and it applies to taxable years of RIC/REIT shareholders that contain May 6, 2003, to govern the application of § 1(h) to the shareholder for that taxable year. Thus, if a RIC or REIT pays a capital gain dividend during 2004 that it properly designates as a 20%-rate gain distribution and the dividend is received by a fiscal year trust in a year of the trust that includes May 6, 2003, the dividend is treated by the trust as gain that is properly taken into account for the portion of the taxable year before May 6, 2003. On the other hand, if that same capital gain dividend is received during 2004 by an individual shareholder, or a trust, whose taxable year is the calendar year, the dividend is subject to tax at a rate no higher than 15 percent, because the JGTRRA transition rule applies only to shareholder taxable years that include May 6, 2003.

In taxable years beginning on or after May 6, 2003, some taxpayers may receive a RIC or REIT distribution amount that is designated as a 20%-rate gain distribution and that includes a portion constituting 5-year gain. As a result of the repeal of the separate rules for 5-year gains, the 5-year gain portion of that 20%-rate gain distribution is not subject to the prior-law 8-percent rate for 5-year gain. These taxpayers, however, will not be disadvantaged by the rate changes. The 5-year gain portion will be treated the same as any other 20%-rate gain distribution that is received in a taxable year beginning on or after May 6, 2003, and therefore will be taxed at a rate no higher than 15 percent (5 percent for certain taxpayers). Any taxpayer that would have been eligible in a taxable year to pay tax at the 8-percent rate for some or all 5-year gain had the prior rates remained in effect will be eligible under the new rules to pay tax on that amount of 5-year gain at the 5-percent rate.

#### SECTION 4. EXAMPLES

(1) *Example 1.* RIC X's taxable year ends on April 30. X has only the following capital gains and losses for the periods indicated, all of which are from sales of stock held for less than five years:

	GAIN	LOSS	NET
<b>5/1 to 5/5/2003</b>			
Long-term capital gain or loss	100x	0	100x
Short-term capital gain or loss	100x	0	100x
<b>5/6 to 10/31/2003</b>			
Long-term capital gain or loss	0	0	0
Short-term capital gain or loss	0	(90x)	(90x)
<b>11/1 to 4/30/2004</b>			
Long-term capital gain or loss	110x	0	110x
Short-term capital gain or loss	0	0	0

X does not make a deferral adjustment because X does not have a post-October net capital loss or net long-term capital loss for its taxable year ending April 30, 2004. X must make a bifurcation adjustment, however, because it has a pre-November net capital gain, it has a taxable year ending in April, and it does not make a deferral adjustment. Because X must apply both the bifurcation adjustment and the JGTRRA transition rule, for the pre-November and post-October portions of this taxable year X must make separate determinations of the maximum amounts that may be designated as 20%-rate gain and 15%-rate gain. The

sum of these amounts determines the various maximum amounts that can be designated in the different classes of gain for the entire year.

For the pre-November period, the JGTRRA transition rule applies because the period includes May 6, 2003. Thus, X determines a net capital gain amount using only gain and loss properly taken into account for the portion of the taxable year that is on or after May 6, 2003 (and, because the determination is for the pre-November period, on or before October 31, 2003). The amount so determined is \$0. X's net capital gain for the entire pre-November period is \$100x.

Thus, for the pre-November period, X's maximum designation of 20%-rate gain is \$100x and its maximum designation of 15%-rate gain is \$0. (X also has a net short-term gain of \$10x in the pre-November period, which results in a dividend that is not specially designated and is treated by shareholders as ordinary income.)

For the post-October period, the JGTRRA transition rule does not apply because that period does not include May 6, 2003. Because X has \$110x of net capital gain for that period, X's maximum designation of 15%-rate gain is \$110x.



For the taxable year ending April 30, 2004, therefore, X may designate up to \$210x of capital gain dividends, of which up to \$110x may be designated as

15%-rate gain distributions and up to \$100x may be designated as 20%-rate gain distributions.

(2) *Example 2.* RIC Y's taxable year ends on April 30. Y has only the following capital gains and losses for the periods indicated, all of which are from sales of stock held for less than five years:

	GAIN	LOSS	NET
<b>5/1 to 5/5/2003</b>			
Long-term capital gain or loss	90x	0	90x
Short-term capital gain or loss	0	0	0
<b>5/6 to 10/31/2003</b>			
Long-term capital gain or loss	0	(90x)	(90x)
Short-term capital gain or loss	0	0	0
<b>11/1 to 4/30/2004</b>			
Long-term capital gain or loss	100x	0	100x
Short-term capital gain or loss	0	0	0

Y does not make a deferral adjustment because it does not have a post-October net capital loss or net long-term capital loss for its taxable year ending April 30, 2004. Y does not make a bifurcation adjustment because it does not have a net capital gain for the pre-November portion of its taxable year ending April 30, 2004. Because Y's taxable year ending April 30, 2004, includes May 6, 2003, the JGTRRA transition rule applies in determining Y's maximum designations of capital gain for that taxable year.

Y's net capital gain for the entire year is \$100x. Y's net capital gain determined using only gain and loss properly taken into account for the portion of the taxable year on or after May 6, 2003, however, is \$10x. For this taxable year, Y may designate up to \$100x of capital gain dividends, of which up to \$10x may be designated as 15%-rate gain distributions and up to \$90x may be designated as 20%-rate gain distributions.

Assume that Y pays a capital gain dividend on December 1, 2004, and that, under § 855(a), Y treats the dividend as having been paid during its taxable year ending April 30, 2004, but that, under § 855(b), Y's shareholders treat the dividend as having been received in their taxable years that contain December 1, 2004. Assume also that shareholder A of Y is an individual, estate, or trust whose taxable year is the calendar year and that, on December 1, 2004, A receives from Y a dividend of \$10x, of which \$1x is designated as a 15%-rate gain distribution and \$9x is designated as a 20%-rate gain distribution. Because A's 2004 taxable year does not include May 6, 2003, neither the JGTRRA transition rule nor JGTRRA § 301(c)(4) applies to A for that taxable year. Thus, the \$10x capital gain dividend received by A in 2004 is subject to a tax rate no higher than 15 percent.

#### DRAFTING INFORMATION

The principal author of this notice is Sonja Kotlica of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Ms. Kotlica at (202) 622-3960 (not a toll-free call).

26 CFR 601.201: Rulings and determination letters. (Also Part I, §§ 851, 852; 1.851-2.)

## Rev. Proc. 2004-28

### SECTION 1. PURPOSE

This revenue procedure describes conditions under which a taxpayer that has invested in a repurchase agreement (repo) may treat its position in the repo as a Government security for purposes of qualifying as a regulated investment company (RIC) under the asset diversification test of section 851(b)(3) of the Internal Revenue Code.

### SECTION 2. BACKGROUND

.01 A repo is a written agreement that provides for a "sale" and "repurchase" of a security or securities (the "underlying securities," or the "collateral". The purchaser agrees to purchase the underlying securities at a specific price and the seller, or "counterparty," agrees to repurchase the same securities on a specific date for a specified price, plus an additional amount that reflects the time value of the purchaser's investment from the date of purchase of the underlying securities to the date of their repurchase by the seller.

.02 RICs purchase securities in repo transactions as a convenient means to invest idle cash at competitive rates on a secured basis, generally for short periods of time. See Securities and Exchange Commission (SEC) Release No. IC-25058, 66 FR 36156, 36156-57 (July 11, 2001):

While a repurchase agreement has legal characteristics of both a sale and a secured transaction, economically it functions as a loan from the fund to the counterparty, in which the securities purchased by the fund serve as collateral for the loan and are placed in the possession or under the control of the fund's custodian during the term of the agreement. . . .

A fund investing in a properly structured repurchase agreement looks primarily to the value and liquidity of the collateral rather than the credit of the counterparty for satisfaction of the repurchase agreement.

*Id.* at 36157 (footnote omitted).

.03 Section 851(b) provides that certain requirements must be satisfied for a domestic corporation to be taxed as a RIC under subchapter M, part I. Section 851(b)(3) imposes certain asset diversification requirements with respect to a RIC's total assets that must be satisfied as of the close of each quarter of the RIC's taxable year.

.04 Section 851(b)(3)(A) requires that at least 50 percent of the value of a corporation's total assets be represented by cash and cash items (including receivables), Government securities, securities of other RICs, and other securities generally limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the RIC and to not more than 10 percent of the outstanding voting securities of such issuer.

.05 Section 851(b)(3)(B) provides that not more than 25 percent of the RIC's total assets may be invested in the securities (other than Government securities and the securities of other RICs) of any one issuer, or of two or more issuers that the RIC controls and that are determined, under regulations, to be engaged in the same or similar trades or businesses or related trades or businesses.

.06 Section 5(b)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.* (1940 Act) defines a "diversified company" as a management company that has at least 75 percent of its assets invested in cash and cash items (including receivables), Government securities, securities of other investment companies, and other securities that, for the purpose of this calculation, are limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the management company and to not more than 10 percent of the outstanding voting securities of the issuer. The remaining 25 percent of the management company's assets may be invested in any manner.

.07 Effective August 15, 2001, the SEC adopted Rule 5b-3, which is intended to adapt the 1940 Act to the economic realities of repos and to reflect recent developments in bankruptcy law protecting parties to repos. SEC Release No. IC-25058. Subject to certain conditions, Rule 5b-3 permits a fund to "look through" the counterparty to the collateral in determining whether the fund is in compliance with the investment criteria for diversified funds set forth in section 5(b)(1) of the 1940 Act and with certain other securities laws.

.08 The following definition is set forth in Rule 5b-3:

(1) *Collateralized Fully* in the case of a repurchase agreement means that:

(i) The value of the securities collateralizing the repurchase agreement (reduced by the transaction costs (including loss of interest) that the investment company reasonably could expect to incur if the seller defaults) is, and during the entire term of the repurchase agreement remains, at least equal to the Resale Price provided for in the agreement;

(ii) The investment company has perfected its security interest in the collateral;

(iii) The collateral is maintained in an account of the investment company with its custodian or a third party that qualifies as a custodian under the [1940] Act;

(iv) The collateral consists entirely of:

(A) Cash items;

(B) Government securities;

(C) Securities that at the time the repurchase agreement is entered into are rated in the highest rating category by the requisite nationally recognized statistical rating organizations [as defined in Rule 5b-3(c)(5)]; or

(D) Unrated Securities that are of comparable quality to securities that are rated in the highest rating category by the requisite nationally recognized statistical rating organizations, as determined by the investment company's board of directors or its delegate; and

(v) Upon an Event of Insolvency with respect to the seller, the repurchase agreement would qualify under a provision of applicable insolvency law providing an exclusion from any automatic stay of creditors' rights against the seller.

Rule 5b-3(c)(1).

.09 The "Collateralized Fully" definition plays a critical role in the application of the 1940 Act diversification rules to repos:

(a) *Repurchase Agreements.* For purposes of [the 1940 Act investment criteria for diversified investment companies and prohibition on registered investment companies from acquiring an interest in a broker-dealer, underwriter, or investment advisor], the acquisition of a repurchase agreement may be deemed to be an acquisition of the underlying securities, provided the obligation of the seller to repurchase the securities from the investment company is Collateralized Fully.

Rule 5b-3(a).

The effect of this rule is that, for purposes of the definition of a diversified investment company in section 5 of the 1940 Act, if a repo is Collateralized Fully, a fund may (but need not) treat an investment in the repo as an investment in the underlying security or securities.

.10 Section 851(c)(5) provides that, for purposes of section 851(b)(3), all terms not specifically defined in section 851(c) shall have the same meaning as when used in the 1940 Act, as amended. The term "Government security" is not specifically defined in section 851(c).

.11 Section 2(a)(16) of the 1940 Act defines the term "Government security" for purposes of the 1940 Act without specific reference to funds investing in repos for which Government securities serve as collateral.

.12 The RIC diversification rules of subchapter M are substantially similar in structure and purpose to those of section 5(b)(1) of the 1940 Act. Both sets of rules impose numerical limitations on the percentages and types of assets that may be held by an investment company. Both sets of rules are intended to protect the investor from the risks of loss and of illiquidity inherent in the concentration of assets in the securities of a single or a small number of issuers. *See* H.R. Rep. No. 2020, 86<sup>th</sup> Cong., 2<sup>d</sup> Sess. 820-26. In view of the commonality of structure and purpose of both sets of rules and in view of the need for RICS simultaneously to comply with both, the RIC diversification provisions of the Code and those of the 1940 Act should be interpreted consistently.

### SECTION 3. SCOPE

This revenue procedure applies to repos that, within the meaning of Rule 5b-3(c)(1), are Collateralized Fully with securities that qualify as Government securities for purposes of section 851(b)(3).

### SECTION 4. PROCEDURE

If a taxpayer has invested in a repo to which this revenue procedure applies, the taxpayer may treat its position in that repo as a Government security for purposes of section 851(b)(3) even if the taxpayer is not treated as the owner of the underlying securities for federal tax purposes.

### SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for repos held by a RIC on or after August 15, 2001.

## DRAFTING INFORMATION

The principal author of this revenue procedure is Susan Thompson Baker of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact her at (202) 622-3940 (not a toll-free call).

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*26 CFR 601.204: Changes in accounting periods and methods of accounting.*  
(Also Part I, §§ 461, 481; 1.461-2.)

## Rev. Proc. 2004-31

### SECTION 1. PURPOSE

This revenue procedure provides procedures for taxpayers to change their method of accounting for deducting under § 461(f) of the Internal Revenue Code amounts transferred to trusts in transactions described in Notice 2003-77, 2003-49 I.R.B. 1182.

### SECTION 2. BACKGROUND

.01 On November 19, 2003, the Internal Revenue Service and Treasury Department filed with the Federal Register proposed and temporary regulations under § 461(f). T.D. 9095, 2003-49 I.R.B. 1175 [68 F.R. 65634]; REG-136890-02, 2003-49 I.R.B. 1191 [68 F.R. 65645]. These regulations clarify that the transfer of a taxpayer's note or promise to provide property or services in the future is not a transfer for the satisfaction of a contested liability under § 461(f). The regulations also provide that a transfer of a taxpayer's stock or the stock or note of a related party is not a transfer for the satisfaction of a contested liability under § 461(f). The regulations further provide that, in general, economic performance does not occur when a taxpayer transfers money or other property to a trust, escrow account, or court to provide for the satisfaction of a contested workers compensation, tort, or other payment liability. Rather, economic performance occurs when payment is made to the claimant.

.02 Notice 2003-77, 2003-49 I.R.B. 1182, identifies 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, transactions in which taxpayers established trusts purported to qualify under § 461(f) that are the same as or substantially similar to the following transactions:

(1) Transactions in which a taxpayer transfers money or other property in taxable years beginning after December 31, 1953, and ending after August 16, 1954, and retains certain powers over the money or other property transferred;

(2) Transactions in which a taxpayer transfers any indebtedness of the taxpayer or any promise by the taxpayer to provide services or property in the future in taxable years beginning after December 31, 1953, and ending after August 16, 1954;

(3) Transactions in which a taxpayer using an accrual method of accounting transfers money or other property after July 18, 1984, to provide for the satisfaction of a workers compensation or tort liability (unless the trust is the person to which the liability is owed, or payment to the trust discharges the taxpayer's liability to the claimant);

(4) Transactions in which a taxpayer using an accrual method of accounting transfers money or other property in taxable years beginning after December 31, 1991, to provide for the satisfaction of a liability for which payment is economic performance under § 1.461-4(g) (unless the trust is the person to which the liability is owed, or payment to the trust discharges the taxpayer's liability to the claimant), other than a liability for workers compensation or tort; and

(5) Transactions in which a taxpayer transfers stock issued by the taxpayer, or indebtedness or stock issued by a party related to the taxpayer (as defined in § 267(b)), on or after November 19, 2003.

.03 Section 1.6011-4(a) provides that every taxpayer that has participated (as described in § 1.6011-4(c)(3)) in a reportable transaction and that is required to file a tax return must attach a disclosure statement to its return. A reportable transaction includes any transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by published guidance as a listed transaction. Section 1.6011-4(b)(2). Generally, a listed transaction is not treated as a reportable transaction if the transaction

affected the taxpayer's Federal income tax liability as reported on any tax return filed on or before February 28, 2000. Section 1.6011-4T(b)(2) as published in T.D. 8877, 2000-1 C.B. 747, in 65 Fed. Reg. 11205. See also § 1.6011-4(h).

.04 Sections 446(e) and 1.446-1(e) provide that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(i) provides that, to obtain the Commissioner's consent to an accounting method change, a taxpayer must file a Form 3115, *Application for Change in Accounting Method*, during the taxable year in which the taxpayer desires to make the proposed change. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e).

.05 Rev. Proc. 97-27, 1997-1 C.B. 680, (as modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432), provides procedures for obtaining the consent of the Commissioner to change a method of accounting for federal income tax purposes. In general, under these procedures a taxpayer must file a Form 3115 during the year of change and may not request or make a retroactive change in method of accounting unless specifically authorized by the Commissioner. Rev. Proc. 97-27, sections 5.01, 2.04. In addition, under these procedures a taxpayer generally takes into account a positive § 481(a) adjustment resulting from the change in method of accounting ratably over four taxable years and receives audit protection for taxable years prior to the year of change. Rev. Proc. 97-27, sections 5.02(3)(a), 9.01. However, section 8.01 of Rev. Proc. 97-27 states that the Service reserves the right to decline to process a Form 3115 "in situations in which it would not be in the best interest of sound tax administration to permit the requested change. In this regard, the Service will consider whether the change in method of accounting would clearly and directly frustrate compliance efforts of the Service in administering the income tax laws."

.06 Rev. Rul. 90-38, 1990-1 C.B. 57, provides that, if a taxpayer uses an erroneous method of accounting for two or more consecutive taxable years, the taxpayer has adopted a method of accounting. The ruling further provides that a taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing an amended return.

.07 A change from deducting an asserted liability in the taxable year of transfer of money or other property to a trust described in Notice 2003-77 to deducting the liability in the taxable year of payment to the claimant is a change in method of accounting. The Service has determined that it is not in the best interest of sound tax administration to permit a prospective change in method of accounting for such deductions in transactions that are required to be disclosed as listed transactions under § 1.6011-4. In addition, in the interest of sound tax administration, the Service has determined that the terms and conditions set forth in Rev. Proc. 97-27 should be modified for changes in methods of accounting for such deductions in transactions that are not required to be disclosed as listed transactions under § 1.6011-4.

### SECTION 3. SCOPE

This revenue procedure applies to taxpayers that desire to change a method of accounting for transactions described in section 2.02 of this revenue procedure.

### SECTION 4. APPLICATION

.01 *Change in method of accounting for transactions described in Notice 2003-77 that are required to be disclosed as listed transactions under § 1.6011-4.* The Service will not process applications for changes in method of accounting filed for transactions within the scope of this revenue procedure that are required to be disclosed under § 1.6011-4. Taxpayers may change their method of accounting for these transactions by filing an amended return in accordance with section 4.04 of this revenue procedure.

.02 *Change in method of accounting for transactions described in Notice 2003-77 that are not required to be disclosed as listed transactions under § 1.6011-4.*

Taxpayers that desire to change a method of accounting for transactions within the scope of this revenue procedure that are not required to be disclosed under § 1.6011-4 may change their method of accounting for these transactions by filing an amended return in accordance with section 4.04 of this revenue procedure or may request a change in method of accounting in accordance with the advance consent procedures of Rev. Proc. 97-27 with the following modifications:

(1) In lieu of the four year spread period for positive § 481(a) adjustments provided in section 5.02(3)(a) of Rev. Proc. 97-27, the taxpayer must take into account the entire amount of a positive § 481(a) adjustment in the taxable year of change; and

(2) The taxpayer must describe each transaction, explain in the Form 3115 why the transaction is not required to be disclosed under § 1.6011-4, and state the amount of § 481(a) adjustment for that transaction.

.03 *Change in method of accounting by taxpayers that have engaged in multiple transactions described in Notice 2003-77, some of which are required to be disclosed as listed transactions under § 1.6011-4.* A taxpayer changing its method of accounting for multiple transactions within the scope of this revenue procedure, some of which are required to be disclosed under § 1.6011-4 and some of which are not required to be disclosed under § 1.6011-4:

(1) May change its method of accounting for transactions that are not required to be disclosed under § 1.6011-4 in accordance with section 4.02 of this revenue procedure, but must take into account in computing the § 481(a) adjustment only amounts attributable to those transactions; and

(2) Must file amended returns in accordance with sections 4.01 and 4.04 of this revenue procedure to change its method of accounting for all transactions required to be disclosed under § 1.6011-4 prior to filing the Form 3115 for transactions not required to be disclosed.

.04 *Change in method of accounting by filing amended return.*

(1) In accordance with § 1.446-1(e)(3)(ii) and Rev. Rul. 90-38, consent is hereby granted for any taxpayer that has engaged in a transaction within the scope of this revenue procedure to file

amended returns to retroactively change an impermissible method of accounting for amounts transferred to trusts purported to qualify under § 461(f) to a method that complies with § 461(f) and the regulations thereunder. This consent is granted only if the taxpayer files such amended returns for the first taxable year in which the taxpayer used the impermissible method of accounting for these transactions (or if the period of limitations has expired for such taxable year, for the first taxable year for which the period of limitations has not expired) and for each subsequent taxable year in which the taxpayer's use of the impermissible method of accounting for these transactions reduced the taxpayer's taxable income. If the period of limitations has expired for the first taxable year in which a taxpayer used the impermissible method of accounting for these transactions and the taxpayer files amended returns pursuant to this consent, the amended return for the first taxable year for which the period of limitations has not expired must include the entire amount of the § 481(a) adjustment attributable to the change in accounting method.

(2) A taxpayer that complies with section 4.04(1) of this revenue procedure also may file amended returns for any taxable years in which the taxpayer's use of the impermissible method of accounting for these transactions increased its taxable income.

(3) Taxpayers filing amended returns under this revenue procedure must write "FILED UNDER REVENUE PROCEDURE 2004-31" at the top of the amended return. Taxpayers also must comply with the requirements of § 1.6011-4 including, but not limited to, attaching to the amended return any disclosure statements that may be required in accordance with § 1.6011-4(a) and (e).

### SECTION 5. EFFECTIVE DATE

This revenue procedure is effective on May 6, 2004.

### DRAFTING INFORMATION

The principal author of this revenue procedure is Norma Rotunno of the Office of the Associate Chief Counsel (Income Tax & Accounting). For further

information regarding this notice, contact Ms. Rotunno at (202) 622-7900 (not a toll-free number).

26 CFR 601.204: Changes in accounting periods and in methods of accounting.  
(Also: §§ 446, 451.)

## Rev. Proc. 2004-32

### SECTION 1. PURPOSE

This revenue procedure allows credit card issuers described in Rev. Rul. 2004-52, 2004-22 I.R.B. 973, dated June 1, 2004, this Bulletin, to account for annual fee income using the Ratable Inclusion Method for Credit Card Annual Fees, which is set forth in section 4 of this revenue procedure. The procedure also provides automatic consent procedures for a credit card issuer within the scope of this revenue procedure to change its method of accounting for annual fee income.

### SECTION 2. BACKGROUND

.01 Rev. Rul. 2004-52 describes certain taxpayers that issue credit cards. Each card allows the cardholder to access a revolving line of credit to make purchases of goods and services and, if otherwise provided by the applicable cardholder agreement, to obtain cash advances. These taxpayers may charge cardholders a credit card annual fee. Rev. Rul. 2004-52 holds that credit card annual fees are not interest for federal income tax purposes and that they are includible in income when the all events test under § 451 of the Internal Revenue Code is satisfied. Under the facts of Rev. Rul. 2004-52, the all events test is satisfied when the credit card annual fee becomes due and payable under the taxpayer's cardholder agreements.

.02 Any change in a taxpayer's treatment of income from credit card annual fees, including a change to conform the taxpayer's method to either Rev. Rul. 2004-52 or to the Ratable Inclusion Method for Credit Card Annual Fees, which is permitted by section 4 of this revenue procedure, is a change in method of accounting to which the provisions of §§ 446 and 481 apply.

.03 Under § 446(e) and § 1.446-1(e)(2)(i) of the Income Tax Regulations,

a taxpayer generally must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the terms and conditions necessary to obtain consent to change a method of accounting. Rev. Proc. 2002-9, 2002-1 C.B. 327 (as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432), provides procedures by which a taxpayer may obtain automatic consent to change to the methods of accounting described in the Appendix of Rev. Proc. 2002-9. Section 5.03 of Rev. Proc. 2002-9 provides that, unless otherwise provided, a taxpayer making a change in method of accounting under the revenue procedure must take into account a § 481(a) adjustment in the manner provided in section 5.04 of Rev. Proc. 2002-9.

### SECTION 3. SCOPE

This revenue procedure applies to a taxpayer that uses an overall accrual method of accounting for federal income tax purposes and that issues credit cards to, and receives annual fees from, cardholders under agreements that allow each cardholder to use a credit card to access a revolving line of credit to make purchases of goods and services and, if so authorized, to obtain cash advances.

### SECTION 4. RATABLE INCLUSION METHOD FOR CREDIT CARD ANNUAL FEES

.01 *Permission to use the Ratable Inclusion Method for Credit Card Annual Fees.* The Commissioner in an exercise of his discretion under § 446 permits taxpayers within the scope of this revenue procedure to account for their income from credit card annual fees using the Ratable Inclusion Method for Credit Card Annual Fees, which is described in this section 4.

.02 *Description of method.* Under the Ratable Inclusion Method for Credit Card Annual Fees, a credit card annual fee is recognized in income ratably over the period covered by the fee.

.03 *Special rules.* A taxpayer's use of the Ratable Inclusion Method for Credit Card Annual Fees does not clearly reflect its credit card annual fee income (and thus the Commissioner does not permit its use) unless the taxpayer also complies with the rules in section 4.03(1) and 4.03(2) of this revenue procedure.

(1) *Closed accounts.* If a credit card is cancelled or if a cardholder account is otherwise closed during a taxable year, any remaining unrecognized portion of the credit card annual fee that is allocable to the account must be recognized in income in that year, unless the remaining portion is refunded.

(2) *Fees billed in installments.* If a credit card annual fee is due and payable in installments, each installment must be recognized ratably over the period to which the installment relates.

.04 *Aggregation of fees.* Taxpayers may account for income from credit card annual fees in an aggregate manner. A taxpayer that accounts for annual fees in an aggregate manner must establish that its recognition of credit card annual fee income satisfies the rules in sections 4.02 and 4.03 of this revenue procedure.

### SECTION 5. CHANGE IN METHOD OF ACCOUNTING

A taxpayer within the scope of this revenue procedure that wants to change its method of accounting for income from credit card annual fees, either to a method that satisfies the all events test in accordance with Rev. Rul. 2004-52 or to the Ratable Inclusion Method for Credit Card Annual Fees that is described in section 4 of this revenue procedure, must follow the provisions of Rev. Proc. 2002-9 (or its successor), with the following modifications:

.01 The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply to a taxpayer that wants to make the change for either its first or second taxable year ending on or after December 31, 2003; and

.02 The taxpayer must prepare and file a Form 3115 in accordance with section 6 of Rev. Proc. 2002-9 and must enter the designated number for the automatic change in method in Line 1a of Form 3115.

(1) The designated number for the automatic accounting method change to in-

clude credit card annual fees in income as required by Rev. Rul. 2004-52 is "80".

(2) The designated number for the automatic accounting method change to the Ratable Inclusion Method for Credit Card Annual Fees is "81".

## SECTION 6. AUDIT PROTECTION

If a taxpayer within the scope of this revenue procedure currently uses the method described in section 4 of this revenue procedure, the method of accounting for the taxpayer's credit card annual fees will not be raised as an issue by the Service in a taxable year that ends before December 31, 2003. Also, if a taxpayer currently uses the method described in section 4 of this revenue procedure, and its use of that method is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002-9) in examination, before an appeals office, or before the U.S. Tax Court for any taxable year that ends before December 31, 2003, that issue will not be further pursued by the Service.

## SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include this automatic change in the APPENDIX.

## SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2003.

## DRAFTING INFORMATION

The principal authors of this revenue procedure are Rebecca E. Asta, Alexa Dubert and Tina Jannotta of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact the principal authors at (202) 622-3930 (not a toll-free call).

26 CFR 601.204: *Changes in accounting periods and in methods of accounting.*  
(Also: §§ 446, 1272.)

# Rev. Proc. 2004-33

## SECTION 1. PURPOSE

This revenue procedure describes conditions under which the Commissioner will allow a taxpayer to treat its income from credit card late fees as interest income on a pool of credit card loans. This revenue procedure also provides the exclusive procedure by which a taxpayer within the scope of this revenue procedure may obtain the Commissioner's consent to change its method of accounting for income from credit card late fees to a method that treats these fees as interest that creates or increases the amount of original issue discount (OID) on the pool of credit card loans to which the fees relate.

## SECTION 2. BACKGROUND

.01 Certain taxpayers issue credit cards that allow a cardholder to access a revolving line of credit to purchase goods and services. Some of these taxpayers may also issue credit cards that allow a cardholder to obtain cash advances.

.02 The terms and conditions that govern the cardholder's use of the credit card are provided in a credit card agreement. Under many credit card agreements, the cardholder is charged a fee when the cardholder is delinquent with respect to a payment due (late fee).

.03 For federal income tax purposes, interest is an amount that is paid in compensation for the use or forbearance of money. *Deputy v. DuPont*, 308 U.S. 488 (1940), 1940-1 C.B. 118; *Old Colony Railroad Co. v. Commissioner*, 284 U.S. 552 (1932), 1932-1 C.B. 274. Whether a fee is an interest charge for federal income tax purposes is determined by reference to all of the relevant facts and circumstances surrounding the imposition of the charge. Neither the label used for the charge (for example, a "finance charge") nor a taxpayer's treatment of the item for financial or regulatory reporting purposes is determinative of the proper federal income tax characterization of the fee. *See* Rev. Rul. 72-315, 1972-1 C.B. 49; *see also Thor Power Tool Co. v. Commissioner*, 439

U.S. 522, 542-43 (1979), 1979-1 C.B. 167.

.04 Rev. Rul. 74-187, 1974-1 C.B. 48, holds that late fees on utility bills are interest absent evidence that the late payment charge assessed by the public utility is for a specific service performed in connection with the customer's account. Even if a charge is a one-time charge or is imposed as a flat sum in addition to a stated periodic interest rate, that charge may still be interest for federal income tax purposes. *See* Rev. Rul. 77-417, 1977-2 C.B. 60, and Rev. Rul. 72-2, 1972-1 C.B. 19.

.05 Under § 1273(a)(1) of the Internal Revenue Code, OID is the excess of the stated redemption price at maturity (SRPM) of a debt instrument over the issue price of that instrument. Under § 1273(a)(2), the SRPM of a debt instrument is the amount fixed by the last modification of the purchase agreement and includes interest and other amounts payable at that time, other than qualified stated interest (QSI). Under § 1.1273-1(b) of the Income Tax Regulations, the SRPM is the sum of all payments provided by the debt instrument other than QSI. Under § 1.1273-1(c), QSI is stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) or that will be constructively received under § 451 at least annually at a single fixed rate.

.06 Section 1004 of the Taxpayer Relief Act of 1997, which is effective for taxable years beginning after August 5, 1997, extended the rules of § 1272(a)(6) to any pool of debt instruments the yield on which may be affected by reason of prepayments. *See* H.R. Conf. Rep. No. 220, 105<sup>th</sup> Cong., 1<sup>st</sup> Sess. 522 (1997). Section 1272(a)(6) provides rules for determining the daily portions of OID if principal is subject to acceleration.

.07 Any change in the taxpayer's treatment of income from credit card late fees that affects when those fees are recognized in income is a change in method of accounting to which the provisions of §§ 446 and 481 apply. Under § 1.446-1(e)(2)(i), a taxpayer generally must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the

terms and conditions necessary to obtain consent to change a method of accounting.

.08 Rev. Proc. 2002-9, 2002-1 C.B. 327 (as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432), provides procedures by which taxpayers may obtain automatic consent to change to the methods of accounting described in the Appendix of Rev. Proc. 2002-9. Section 5.03 of Rev. Proc. 2002-9 provides that, unless otherwise provided, a taxpayer making a change in method of accounting under the revenue procedure must take into account a section 481(a) adjustment in the manner provided in section 5.04 of Rev. Proc. 2002-9.

### SECTION 3. SCOPE

This revenue procedure applies to a taxpayer if—

.01 The taxpayer issues credit cards allowing cardholders to access a revolving line of credit established by the taxpayer; and

.02 None of the cardholders' credit card transactions with the taxpayer is treated by the taxpayer for federal income tax purposes as creating either debt that is given in consideration for the sale or exchange of property (within the meaning of §1274) or debt that is deferred payment for property (within the meaning of § 483).

### SECTION 4. APPLICATION

.01 Subject to subsection .02 of this section 4, if a taxpayer is within the scope of this revenue procedure, the Commissioner will not challenge either the taxpayer's treatment of credit card late fees as interest or the taxpayer's treatment of this interest as being part of SRPM and thus as creating or increasing OID on a pool of credit card loans to which these fees relate.

.02 Subsection .01 of section 4 of this revenue procedure applies only if the taxpayer follows all of the requirements of section 5 of this revenue procedure and, if the taxpayer is changing its method of accounting, all of the requirements of section 6 of this revenue procedure.

### SECTION 5. REQUIREMENTS

A taxpayer must be able to demonstrate the following:

.01 The amount of any credit card late fee charged to each cardholder by the taxpayer is separately stated on the cardholder's account when the late fee is imposed; and

.02 Under the applicable credit card agreement governing each cardholder's use of the credit card, no amount identified as a credit card late fee is charged for property or for specific services performed by the taxpayer for the benefit of the cardholder.

### SECTION 6. CHANGE IN METHOD OF ACCOUNTING

If a taxpayer within the scope of this revenue procedure wants to change its method of accounting for income from credit card late fees and if, under the method to which the taxpayer is changing, these fees are treated as interest that creates or increases the amount of OID on a pool of credit card loans to which these fees relate, the taxpayer must follow the provisions of Rev. Proc. 2002-9 (or its successor), with the following modifications:

.01 The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply to a taxpayer that wants to make the change for either its first or second taxable year ending on or after December 31, 2003; and

.02 The taxpayer must prepare and file a Form 3115 in accordance with section 6 of Rev. Proc. 2002-9 and enter the designated number ("82") for this automatic change in method in Line 1a of Form 3115.

### SECTION 7. AUDIT PROTECTION

.01 If a taxpayer within the scope of this revenue procedure currently uses a method of accounting that treats credit card late fees as interest that creates or increases the amount of OID on a pool of credit card loans to which these fees relate, the issue of whether the taxpayer is properly treating its credit card late fees as OID on a pool of credit card loans will not be raised by the Commissioner in a taxable year that ends before December 31, 2003.

.02 If a taxpayer within the scope of this revenue procedure currently uses a method of accounting that treats credit card late fees as interest that creates or increases the amount of OID on a pool of credit card loans to which these fees relate and its use of that method is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002-9) in examination, before an appeals office, or before the U.S. Tax Court for any taxable year that ends before December 31, 2003, that issue will not be further pursued by the Service.

.03 Neither the audit protection provided in connection with a change in a taxpayer's method of accounting for credit card late fees that is properly made under section 6 of this revenue procedure, nor the audit protection provided under sections 7.01 and 7.02 of this revenue procedure, is a determination by the Commissioner that the taxpayer is properly accounting for any OID income on that pool of credit card loans. Thus, for example, the Service is not precluded from pursuing the issue of whether a taxpayer is properly accounting for its OID income (including any OID attributable to late fees) on its pool of credit card loans in accordance with § 1272(a)(6).

### SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include this automatic change in the APPENDIX.

### SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2003.

### DRAFTING INFORMATION

The principal authors of this revenue procedure are Rebecca E. Asta, Alexa Dubert and Tina Jannotta of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact the principal authors at (202) 622-3930 (not a toll-free call).

## Rev. Proc. 2004-34

### SECTION 1. PURPOSE

This revenue procedure allows taxpayers a limited deferral beyond the taxable year of receipt for certain advance payments. Qualifying taxpayers generally may defer to the next succeeding taxable year the inclusion in gross income for federal income tax purposes of advance payments (as defined in section 4 of this revenue procedure) to the extent the advance payments are not recognized in revenues (or, in certain cases, are not earned) in the taxable year of receipt. Except as provided in section 5.02(2) of this revenue procedure for certain short taxable years, this revenue procedure does not permit deferral to a taxable year later than the next succeeding taxable year. This revenue procedure neither restricts a taxpayer's ability to use the methods provided in § 1.451-5 of the Income Tax Regulations regarding advance payments for goods nor limits the period of deferral available under § 1.451-5.

This revenue procedure also provides the exclusive administrative procedures under which a taxpayer within the scope of this revenue procedure may obtain consent to change to a method of accounting provided in section 5 of this revenue procedure.

### SECTION 2. BACKGROUND AND CHANGES

.01 In general, § 451 of the Internal Revenue Code provides that the amount of any item of gross income is included in gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, the amount is to be properly accounted for as of a different period. Section 1.451-1(a) provides that, under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive the income and the amount can be determined with reasonable accuracy. All the events that fix the right to receive income generally occur when

(1) the payment is earned through performance, (2) payment is due to the taxpayer, or (3) payment is received by the taxpayer, whichever happens earliest. See Rev. Rul. 84-31, 1984-1 C.B. 127.

.02 Section 1.451-5 generally allows accrual method taxpayers to defer the inclusion in gross income for federal income tax purposes of advance payments for goods until the taxable year in which they are properly accruable under the taxpayer's method of accounting for federal income tax purposes if that method results in the advance payments being included in gross income no later than when the advance payments are recognized in revenues under the taxpayer's method of accounting for financial reporting purposes.

.03 Rev. Proc. 71-21, 1971-2 C.B. 549, was published to implement an administrative decision of the Commissioner in the exercise of his discretion under § 446 to allow accrual method taxpayers in certain specified and limited circumstances to defer the inclusion in gross income for federal income tax purposes of payments received (or amounts due and payable) in one taxable year for services to be performed by the end of the next succeeding taxable year. Rev. Proc. 71-21 was designed to reconcile the federal income tax and financial accounting treatment of payments received for services to be performed by the end of the next succeeding taxable year without permitting extended deferral of the inclusion of those payments in gross income for federal income tax purposes.

.04 Considerable controversy exists about the scope of Rev. Proc. 71-21. In particular, advance payments for non-services (and often, for combinations of services and non-services) do not qualify for deferral under Rev. Proc. 71-21, and taxpayers and the Internal Revenue Service frequently disagree about whether advance payments are, in fact, for "services." In addition to the issue of defining "services" for purposes of Rev. Proc. 71-21, questions also arise about whether advance payments received under a series of agreements, or under a renewable agreement, are within the scope of Rev. Proc. 71-21. In the interest of reducing the controversy surrounding these issues, the Service has determined that it is appropriate to expand the scope of Rev. Proc.

71-21 to include advance payments for certain non-services and combinations of services and non-services. Additionally, the Service has determined that it is appropriate to expand the scope of Rev. Proc. 71-21 to include advance payments received in connection with an agreement or series of agreements with a term or terms extending beyond the end of the next succeeding taxable year. The Service has determined, however, that for taxpayers deferring recognition of income under this revenue procedure it is appropriate to retain the limited one-year deferral of Rev. Proc. 71-21 (except as provided in section 5.02(2) of this revenue procedure for certain short taxable years).

### SECTION 3. SCOPE

This revenue procedure applies to taxpayers using or changing to an overall accrual method of accounting that receive advance payments as defined in section 4 of this revenue procedure.

### SECTION 4. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure —

.01 *Advance Payment*. Except as provided in section 4.02 of this revenue procedure, a payment received by a taxpayer is an "advance payment" if —

(1) including the payment in gross income for the taxable year of receipt is a permissible method of accounting for federal income tax purposes (without regard to this revenue procedure);

(2) the payment is recognized by the taxpayer (in whole or in part) in revenues in its applicable financial statement (as defined in section 4.06 of this revenue procedure) for a subsequent taxable year (or, for taxpayers without an applicable financial statement as defined in section 4.06 of this revenue procedure, the payment is earned by the taxpayer (in whole or in part) in a subsequent taxable year); and

(3) the payment is for —

(a) services;

(b) the sale of goods (other than for the sale of goods for which the taxpayer uses a method of deferral provided in § 1.451-5(b)(1)(ii));

(c) the use (including by license or lease) of intellectual property as defined in section 4.03 of this revenue procedure;



(d) the occupancy or use of property if the occupancy or use is ancillary to the provision of services (for example, advance payments for the use of rooms or other quarters in a hotel, booth space at a trade show, campsite space at a mobile home park, and recreational or banquet facilities, or other uses of property, so long as the use is ancillary to the provision of services to the property user);

(e) the sale, lease, or license of computer software;

(f) guaranty or warranty contracts ancillary to an item or items described in subparagraph (a), (b), (c), (d), or (e) of this section 4.01(3);

(g) subscriptions (other than subscriptions for which an election under § 455 is in effect), whether or not provided in a tangible or intangible format;

(h) memberships in an organization (other than memberships for which an election under § 456 is in effect); or

(i) any combination of items described in subparagraphs (a) through (h) of this section 4.01(3).

**.02 Exclusions From Advance Payment.** The term “advance payment” does not include —

(1) rent (except for amounts paid with respect to an item or items described in subparagraph (c), (d), or (e) of section 4.01(3));

(2) insurance premiums, to the extent the recognition of those premiums is governed by Subchapter L;

(3) payments with respect to financial instruments (for example, debt instruments, deposits, letters of credit, notional principal contracts, options, forward contracts, futures contracts, foreign currency contracts, credit card agreements, financial derivatives, etc.), including purported prepayments of interest;

(4) payments with respect to service warranty contracts for which the taxpayer uses the accounting method provided in Rev. Proc. 97-38, 1997-2 C.B. 479;

(5) payments with respect to warranty and guaranty contracts under which a third party is the primary obligor;

(6) payments subject to § 871(a), 881, 1441, or 1442; and

(7) payments in property to which § 83 applies.

**.03 Intellectual Property.** The term “intellectual property” includes copyrights, patents, trademarks, service marks, trade

names, and similar intangible property rights (such as franchise rights and arena naming rights).

**.04 Received.** Income is “received” by the taxpayer if it is actually or constructively received, or if it is due and payable to the taxpayer.

**.05 Next Succeeding Taxable Year.** The term “next succeeding taxable year” means the taxable year immediately following the taxable year in which the advance payment is received by the taxpayer.

**.06 Applicable Financial Statement.** The taxpayer’s applicable financial statement is the taxpayer’s financial statement listed in paragraphs (1) through (3) of this section 4.06 that has the highest priority (including within paragraph (2)). A taxpayer that does not have a financial statement described in paragraphs (1) through (3) of this section 4.06 does not have an applicable financial statement for purposes of this revenue procedure. The financial statements are, in descending priority —

(1) a financial statement required to be filed with the Securities and Exchange Commission (“SEC”) (the 10-K or the Annual Statement to Shareholders);

(2) a certified audited financial statement that is accompanied by the report of an independent CPA (or in the case of a foreign corporation, by the report of a similarly qualified independent professional), that is used for —

(a) credit purposes,

(b) reporting to shareholders, or

(c) any other substantial non-tax purpose; or

(3) a financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agencies (other than the SEC or the Internal Revenue Service).

## SECTION 5. PERMISSIBLE METHODS OF ACCOUNTING FOR ADVANCE PAYMENTS

**.01 Full Inclusion Method.** A taxpayer within the scope of this revenue procedure that includes the full amount of advance payments in gross income for federal income tax purposes in the taxable year of receipt is using a proper method of accounting under § 1.451-1, regardless of whether the taxpayer recognizes the full

amount of advance payments in revenues for that taxable year for financial reporting purposes and regardless of whether the taxpayer earns the full amount of advance payments in that taxable year.

**.02 Deferral Method.**

(1) In general.

(a) A taxpayer within the scope of this revenue procedure that chooses to use the Deferral Method described in this section 5.02 is using a proper method of accounting under § 1.451-1. Under the Deferral Method, for federal income tax purposes the taxpayer must —

(i) include the advance payment in gross income for the taxable year of receipt (and, if applicable, in gross income for a short taxable year described in section 5.02(2) of this revenue procedure) to the extent provided in section 5.02(3) of this revenue procedure, and

(ii) except as provided in section 5.02(2) of this revenue procedure, include the remaining amount of the advance payment in gross income for the next succeeding taxable year.

(b) Except as provided in section 5.02(3)(b) of this revenue procedure, a taxpayer using the Deferral Method must be able to determine —

(i) the extent to which advance payments are recognized in revenues in its applicable financial statement (as defined in section 4.06 of this revenue procedure) in the taxable year of receipt (and a short taxable year described in section 5.02(2) of this revenue procedure, if applicable), or

(ii) if the taxpayer does not have an applicable financial statement (as defined in section 4.06 of this revenue procedure), the extent to which advance payments are earned (as described in section 5.02(3)(b) of this revenue procedure), in the taxable year of receipt (and a short taxable year described in section 5.02(2) of this revenue procedure, if applicable).

(2) *Short taxable years.* If the next succeeding taxable year is a taxable year (other than a taxable year in which the taxpayer dies or ceases to exist in a transaction other than a transaction to which § 381(a) applies) of 92 days or less, a taxpayer using the Deferral Method must include the portion of the advance payment not included in the taxable year of receipt in gross income for the short taxable year to the extent provided in section 5.02(3) of

this revenue procedure. Any amount of the advance payment not included in the taxable year of receipt and the short taxable year must be reported in gross income for the taxable year immediately following the short taxable year.

(3) *Inclusion of advance payments in gross income.*

(a) Except as provided in paragraph (b) of this section 5.02(3), a taxpayer using the Deferral Method must —

(i) include the advance payment in gross income for the taxable year of receipt (and, if applicable, in gross income for a short taxable year described in section 5.02(2) of this revenue procedure) to the extent recognized in revenues in its applicable financial statement (as defined in section 4.06 of this revenue procedure) for that taxable year, and

(ii) include the remaining amount of the advance payment in gross income in accordance with section 5.02(1)(a)(ii) of this revenue procedure.

(b) If the taxpayer does not have an applicable financial statement (as defined in section 4.06 of this revenue procedure), or if the taxpayer is unable to determine, as required by section 5.02(1)(b)(i) of this revenue procedure, the extent to which advance payments are recognized in revenues in its applicable financial statements for the taxable year of receipt (and a short taxable year described in section 5.02(2) of this revenue procedure, if applicable), a taxpayer using the Deferral Method must include the advance payment in gross income for the taxable year of receipt (and, if applicable, in gross income for a short taxable year described in section 5.02(2)) to the extent earned in that taxable year and include the remaining amount of the advance payment in gross income in accordance with section 5.02(1)(a)(ii) of this revenue procedure. The determination of whether an amount is earned in a taxable year must be made without regard to whether the taxpayer may be required to refund the advance payment upon the occurrence of a condition subsequent. If the taxpayer is unable to determine the extent to which a payment (such as a payment for contingent goods or services) is earned in the taxable year of receipt (and, if applicable, in a short taxable year described in section 5.02(2)), the taxpayer may determine that amount —

(i) on a statistical basis if adequate data are available to the taxpayer;

(ii) on a straight line ratable basis over the term of the agreement if the taxpayer receives advance payments under a fixed term agreement and if it is not unreasonable to anticipate at the end of the taxable year of receipt that the advance payment will be earned ratably over the term of the agreement; or

(iii) by the use of any other basis that in the opinion of the Commissioner results in a clear reflection of income.

(4) *Allocable payments.*

(a) *General rule.* A taxpayer that receives a payment that is partially attributable to an item or items described in section 4.01(3) of this revenue procedure may use the Deferral Method for the portion of the payment allocable to such item or items and, with respect to the remaining portion of the payment, may use any proper method of accounting (including the Deferral Method if the remaining portion of the advance payment is for an item or items described in section 4.01(3) of this revenue procedure with a different deferral period (based on the taxpayer's applicable financial statement or the earning of the payment, as applicable)), provided that the taxpayer's method for determining the portion of the payment allocable to such item or items is based on objective criteria.

(b) *Advance payments under section 4.01(3)(i).* An advance payment under section 4.01(3)(i) that is wholly attributable to two or more items described in subparagraphs (a) through (h) of section 4.01(3) of this revenue procedure that have the same deferral period (based on the taxpayer's applicable financial statement or the earning of the payment, as applicable) is not an allocable payment under section 5.02(4)(a) of this revenue procedure.

(c) *Allocation deemed to be based on objective criteria.* A taxpayer's allocation method with respect to an allocable payment described in section 5.02(4)(a) of this revenue procedure will be deemed to be based on objective criteria if the allocation method is based on payments the taxpayer regularly receives for an item or items it regularly sells or provides separately.

(5) *Acceleration of advance payments.* Notwithstanding section 5.02(1) of this revenue procedure, a taxpayer using the

Deferral Method must include in gross income for the taxable year of receipt (or, if applicable, for a short taxable year described in section 5.02(2) of this revenue procedure) all advance payments not previously included in gross income —

(a) if, in that taxable year, the taxpayer either dies or ceases to exist in a transaction other than a transaction to which § 381(a) applies, or

(b) if, and to the extent that, in that taxable year, the taxpayer's obligation with respect to the advance payments is satisfied or otherwise ends other than in —

(i) a transaction to which § 381(a) applies, or

(ii) a § 351(a) transfer in which (a) substantially all assets of the trade or business (including advance payments) are transferred, (b) the transferee adopts or uses the Deferral Method in the year of transfer, and (c) the transferee and the transferor are members of an affiliated group of corporations that file a consolidated return, pursuant to §§ 1504–1564.

.03 *Examples.* In each example below, the taxpayer uses an accrual method of accounting for federal income tax purposes and files its returns on a calendar year basis. Except as stated otherwise, the taxpayer in each example has an applicable financial statement as defined in section 4.06 of this revenue procedure.

*Example 1.* On November 1, 2004, A, in the business of giving dancing lessons, receives an advance payment for a 1-year contract commencing on that date and providing for up to 48 individual, 1-hour lessons. A provides eight lessons in 2004 and another 35 lessons in 2005. In its applicable financial statement, A recognizes  $\frac{1}{6}$  of the payment in revenues for 2004, and  $\frac{5}{6}$  of the payment in revenues for 2005. A uses the Deferral Method. For federal income tax purposes, A must include  $\frac{1}{6}$  of the payment in gross income for 2004, and the remaining  $\frac{5}{6}$  of the payment in gross income for 2005.

*Example 2.* Assume the same facts as in *Example 1*, except that the advance payment is received for a 2-year contract under which up to 96 lessons are provided. A provides eight lessons in 2004, 48 lessons in 2005, and 40 lessons in 2006. In its applicable financial statement, A recognizes  $\frac{1}{12}$  of the payment in revenues for 2004,  $\frac{6}{12}$  of the payment in revenues for 2005, and  $\frac{5}{12}$  of the payment in gross revenues for 2006. For federal income tax purposes, A must include  $\frac{1}{12}$  of the payment in gross income for 2004, and the remaining  $\frac{11}{12}$  of the payment in gross income for 2005.

*Example 3.* On June 1, 2004, B, a landscape architecture firm, receives an advance payment for goods and services that, under the terms of the agreement, must be provided by December 2005. On December 31, 2004, B estimates that  $\frac{3}{4}$  of the work under the agreement has been completed. In its applicable fi-

financial statement, *B* recognizes  $\frac{3}{4}$  of the payment in revenues for 2004 and  $\frac{1}{4}$  of the payment in revenues for 2005. *B* uses the Deferral Method. For federal income tax purposes, *B* must include  $\frac{3}{4}$  of the payment in gross income for 2004, and the remaining  $\frac{1}{4}$  of the payment in gross income for 2005, regardless of whether *B* completes the job in 2005.

*Example 4.* On July 1, 2004, *C*, in the business of selling and repairing television sets, receives an advance payment for a 2-year contract under which *C* agrees to repair or replace, or authorizes a representative to repair or replace, certain parts in the customer's television set if those parts fail to function properly. In its applicable financial statement, *C* recognizes  $\frac{1}{4}$  of the payment in revenues for 2004,  $\frac{1}{2}$  of the payment in revenues for 2005, and  $\frac{1}{4}$  of the payment in revenues for 2006. *C* uses the Deferral Method. For federal income tax purposes, *C* must include  $\frac{1}{4}$  of the payment in gross income for 2004 and the remaining  $\frac{3}{4}$  of the payment in gross income for 2005.

*Example 5.* On December 2, 2004, *D*, in the business of selling and repairing television sets, sells for \$200 a television set with a 90-day warranty on parts and labor (for which *D*, rather than the manufacturer, is the obligor). *D* regularly sells televisions sets without the warranty for \$188. In its applicable financial statement, *D* allocates \$188 of the sales price to the television set and \$12 to the 90-day warranty, recognizes  $\frac{1}{3}$  of the amount allocable to the warranty (\$4) in revenues for 2004, and recognizes the remaining  $\frac{2}{3}$  of the amount allocable to the warranty (\$8) in revenues for 2005. *D* uses the Deferral Method. For federal income tax purposes, *D* must include the \$4 allocable to the warranty in gross income for 2004 and the remaining \$8 allocable to the warranty in gross income for 2005.

*Example 6.* *E*, in the business of photographic processing, receives advance payments for mailers and certificates that oblige *E* to process photographic film, prints, or other photographic materials returned in the mailer or with the certificate. *E* tracks each of the mailers and certificates with unique identifying numbers. On July 20, 2004, *E* receives payments for 2 mailers. One of the mailers is submitted and processed on September 1, 2004, and the other is submitted and processed on February 1, 2006. In its applicable financial statement, *E* recognizes the payment for the September 1, 2004, processing in revenues for 2004 and the payment for the February 1, 2006, processing in revenues for 2006. *E* uses the Deferral Method. For federal income tax purposes, *E* must include the payment for the September 1, 2004, processing in gross income for 2004 and the payment for the February 1, 2006, processing in gross income for 2005.

*Example 7.* *F*, a hair styling salon, receives advance payments for gift cards that may later be redeemed at the salon for hair styling services or hair care products at the face value of the gift card. The gift cards look like standard credit cards, and each gift card has a magnetic strip that, in connection with *F*'s computer system, identifies the available balance. The gift cards may not be redeemed for cash, and have no expiration date. In its applicable financial statement, *F* recognizes advance payments for gift cards in revenues when redeemed. *F* is not able to determine the extent to which advance payments are recognized in revenues in its applicable financial statement for

the taxable year of receipt and therefore does not meet the requirement of section 5.02(1)(b)(i) of this revenue procedure. Further, *F* does not determine under a basis described in section 5.02(3)(b) of this revenue procedure the extent to which payments are earned for the taxable year of receipt. Therefore, *F* may not use the Deferral Method for these advance payments.

*Example 8.* Assume the same facts as in *Example 7*, except that the gift cards have an expiration date 12 months from the date of sale, *F* does not accept expired gift cards, and *F* recognizes unredeemed gift cards in revenues in its applicable financial statement for the taxable year in which the cards expire. Because *F* tracks the sale date and the expiration date of the gift cards for purposes of its applicable financial statement, *F* is able to determine the extent to which advance payments are recognized in revenues for the taxable year of receipt. Therefore, *F* meets the requirement of section 5.02(1)(b)(i) of this revenue procedure and may use the Deferral Method for these advance payments.

*Example 9.* *G*, a video arcade operator, receives payments in 2004 for game tokens that are used by customers to play the video games offered by *G*. The tokens cannot be redeemed for cash. The tokens are imprinted with the name of the video arcade, but they are not individually marked for identification. For purposes of its applicable financial statement, *G* completed a study that determined that for payments received for tokens in the current year, *x* percent of tokens are expected to be used in the current year, *y* percent of tokens are expected to be used in the next year, and *z* percent of tokens are expected to never be used. Based on the study, in its applicable financial statement *G* recognizes in revenues for 2004 *x* percent (tokens expected to be used in 2004) and *z* percent (tokens expected never to be used) of the payments received in 2004 for tokens; *G* recognizes in revenues for 2005 the remaining *y* percent of the payments received in 2004 for tokens. *G* uses the Deferral Method. Using the study, *G* determines the extent to which advance payments are recognized in revenues in its applicable financial statement for the taxable year of receipt and therefore meets the requirement of section 5.02(1)(b)(i) of this revenue procedure. Under section 5.02(3)(a) of this revenue procedure, *G* must include advance payments in gross income in accordance with its applicable financial statement in the taxable year of receipt, provided that any portion of the payment not included in income in the taxable year of receipt is included in gross income for the next succeeding taxable year. Thus, for federal income tax purposes, *G* must include *x* percent and *z* percent of the advance payments in gross income for 2004, and *y* percent of the advance payments in gross income for 2005.

*Example 10.* Assume the same facts as in *Example 9*, except that *G* does not have an applicable financial statement (as defined in section 4.06 of this revenue procedure). *G* completed a study on a statistical basis, based on adequate data available to *G*, and concluded that for payments received in the current year, *x* percent of tokens are expected to be used in the current year, *y* percent of tokens are expected to be used in the next year, and the remaining *z* percent of tokens are expected to never be used. Based on the study, *G* treats as earned for 2004 *x* percent (for tokens expected to be used in that year) as well as *z* percent (for tokens that are expected to never be

used). *G* uses the Deferral Method. Using the study, *G* determines the extent to which advance payments are earned in the taxable year of receipt and therefore meets the requirement of section 5.02(1)(b)(ii) of this revenue procedure. Because *G* does not have an applicable financial statement, *G* may determine the extent to which a payment is earned in the taxable year of receipt on a statistical basis under section 5.02(3)(b)(i) of this revenue procedure, provided that any portion that is not included in the taxable year of receipt is included in the next succeeding taxable year. Thus, for federal income tax purposes, *G* must include *x* percent and *z* percent of the advance payments in gross income for 2004, and *y* percent of the advance payments in gross income for 2005.

*Example 11.* *H* is in the business of compiling and providing business information for a particular industry in an online format accessible over the internet. On September 1, 2004, *H* receives an advance payment from a subscriber for 1 year of access to its online database, beginning on that date. In its applicable financial statement, *H* recognizes  $\frac{1}{3}$  of the payment in revenues for 2004 and the remaining  $\frac{2}{3}$  in revenues for 2005. *H* uses the Deferral Method. For federal income tax purposes, *H* must include  $\frac{1}{3}$  of the payment in gross income for 2004 and the remaining  $\frac{2}{3}$  of the payment in gross income for 2005.

*Example 12.* On December 1, 2004, *I*, in the business of operating a chain of "shopping club" retail stores, receives advance payments for membership fees. Upon payment of the fee, a member is allowed access for a 1-year period to *I*'s stores, which offer discounted merchandise and services. In its applicable financial statement, *I* recognizes  $\frac{1}{12}$  of the payment in revenues for 2004 and  $\frac{11}{12}$  of the payment in revenues for 2005. *I* uses the Deferral Method. For federal income tax purposes, *I* must include  $\frac{1}{12}$  of the payment in gross income for 2004, and the remaining  $\frac{11}{12}$  of the payment in gross income for 2005.

*Example 13.* In 2004, *J*, in the business of operating tours, receives payments from customers for a 10-day cruise that will take place in April 2005. Under the agreement, *J* charts a cruise ship, hires a crew and a tour guide, and arranges for entertainment and shore trips for the customers. In its applicable financial statement, *J* recognizes the payments in revenues for 2005. *J* uses the Deferral Method. For federal income tax purposes, *J* must include the payments in gross income for 2005.

*Example 14.* On November 1, 2004, *K*, a travel agent, receives payment from a customer for an airline flight that will take place in April 2005. *K* purchases and delivers the airline ticket to the customer on November 14, 2004. *K* retains a portion of the customer's payment (the excess of the customer's payment over the cost of the airline ticket) as its commission. Because *K* is not required to provide any services after the ticket is delivered to the customer, *K* earns its commission when the airline ticket is delivered. The customer may cancel the flight and receive a refund from *K* only to the extent the airline itself provides refunds. *K* does not have an applicable financial statement (as defined in section 4.06 of this revenue procedure), but, in its unaudited financial statements, *K* recognizes its commission in revenues for 2005. The commission is not an advance payment as defined in section 4.01 of this revenue procedure because the payment is not earned by *K*, in whole or

in part, in a subsequent taxable year. Thus, *K* may not use the Deferral Method for this payment.

*Example 15.* *L*, a professional sports franchise, is a member of a sports league that enters into contracts with television networks for the right to broadcast games to be played between teams in the league. The money received by the sports league under the contracts is divided equally among the member teams. The league entered into a 3-year broadcasting contract beginning October 1, 2004. *L* receives three equal installment payments on October 1 of each contract year, beginning in 2004. In its applicable financial statement, *L* recognizes  $1/4$  of the first installment payment in revenues for 2004 and  $3/4$  in revenues for 2005; *L* recognizes  $1/4$  of the second installment in revenues for 2005 and  $3/4$  in revenues for 2006; *L* recognizes  $1/4$  of the third installment in revenues for 2006 and  $3/4$  in revenues for 2007. *L* uses the Deferral Method. Under section 4 of this revenue procedure, each installment payment constitutes an "advance payment." For federal income tax purposes, *L* must include  $1/4$  of the first installment payment in gross income for 2004 and  $3/4$  in gross income for 2005;  $1/4$  of the second installment in gross income for 2005 and  $3/4$  in gross income for 2006; and  $1/4$  of the third installment in gross income for 2006 and  $3/4$  in gross income for 2007.

*Example 16.* *M* is in the business of negotiating, placing, and servicing insurance coverage and administering claims for insurance companies. On December 1, 2004, *M* enters into a contract with an insurance company to provide property and casualty claims administration services for a 4-year period beginning January 1, 2005. Pursuant to the contract, the insurance company makes four equal annual payments to *M*; each payment relates to a year of service and is made during the month prior to the service year (for example, *M* is paid on December 1, 2004, for the service year beginning January 1, 2005). In its applicable financial statement, *M* recognizes the first payment in revenues for 2005; the second payment in revenues for 2006; the third payment in revenues for 2007; and the fourth payment in revenues for 2008. *M* uses the Deferral Method. Under section 4 of this revenue procedure, each annual payment constitutes an "advance payment." For federal income tax purposes, *M* must include the first payment in gross income for 2005; the second payment in gross income for 2006; the third payment in gross income for 2007; and the fourth payment in gross income for 2008.

*Example 17.* *N* is a cable internet service provider that enters into contracts with subscribers to provide internet services for a monthly fee (paid prior to the service month). For those subscribers who do not own a compatible modem, *N* provides a rental cable modem for an additional monthly charge (also paid prior to the service month). Pursuant to the contract, *N* will replace or repair the cable modem if it proves defective during the contract period. In December 2004, *N* receives payments from subscribers for January 2005 internet service and cable modem use. In its applicable financial statement, *N* recognizes the entire amount of these payments in revenues for 2005. *N* uses the Deferral Method. Because a subscriber's use of a cable modem is ancillary to the provision of internet services by *N*, and because the cable modem warranty is ancillary to the use of the cable modem, the payments are advance payments within the meaning of section 4.01(3)(i) of this revenue procedure.

Further, because the deferral period for each item is the same in *N*'s applicable financial statement, *N* is not required to allocate the advance payments (see section 5.02(4)(b) of this revenue procedure). For federal income tax purposes, *N* must include the advance payments in gross income for 2005.

*Example 18.* On January 1, 2005, *O* enters into, and receives advance payments pursuant to, a 5-year license agreement for its computer software. Under the contract, the licensee pays *O* both the first-year (2005) license fee and the fifth-year (2009) license fee upon commencement of the agreement. The fees for the second, third, and fourth years are payable on January 1 of each license year. In its applicable financial statement, *O* recognizes the fees in revenues for the respective license year. *O* uses the Deferral Method. For federal income tax purposes, *O* must include the first-year license fee in gross income for 2005, the second-year and the fifth-year license fee in gross income for 2006, the third-year license fee in gross income for 2007, and the fourth-year license fee in gross income for 2008.

*Example 19.* On July 1, 2004, *P*, in the business of selling and licensing computer software (off the shelf, fully customized, and semi-customized) and providing customer support, receives an advance payment for a 2-year "software maintenance contract" under which *P* will provide software updates if it develops an update within the contract period, as well as online and telephone customer support. In its applicable financial statement, *P* recognizes  $1/4$  of the payment in revenues for 2004,  $1/2$  in revenues for 2005, and the remaining  $1/4$  in revenues for 2006, regardless of when *P* provides updates or customer support. *P* uses the Deferral Method. For federal income tax purposes, *P* must include  $1/4$  of the payment in gross income for 2004 and  $3/4$  in gross income for 2005.

*Example 20.* Assume the same facts as in *Example 19*, except that *P* changes its taxable period to a fiscal year ending March 31 so that *P* has a short taxable year beginning January 1, 2005, and ending March 31, 2005. In its applicable financial statement, *P* recognizes  $1/4$  of the payment in revenues for the taxable year ending December 31, 2004;  $1/8$  in revenues for the short taxable year ending March 31, 2005;  $1/2$  in revenues for the taxable year ending March 31, 2006; and  $1/8$  in revenues for the taxable year ending March 31, 2007. Because the taxable year ending March 31, 2005, is 92 days or less, section 5.02(2) of this revenue procedure applies. For federal income tax purposes, *P* must include  $1/4$  of the payment in gross income for the taxable year ending December 31, 2004,  $1/8$  in gross income for the short taxable year ending March 31, 2005, and the remaining  $5/8$  in gross income for the taxable year ending March 31, 2006.

*Example 21.* Assume the same facts as in *Example 19*, except that *P* ceases to exist on December 1, 2004, in a transaction other than a transaction to which § 381(a) applies. For federal income tax purposes, *P* must include the entire advance payment in gross income for 2004.

*Example 22.* On July 1, 2004, *Q*, in the business of selling and licensing computer software (off the shelf, fully customized, and semi-customized) and providing customer support, receives an advance payment of \$100 for a 2-year software license agreement that includes a 1-year "software maintenance contract" under which *Q* will provide software up-

dates if it develops an update within the contract period, as well as online and telephone customer support. In its applicable financial statement, *Q* allocates \$20 of the payment to the maintenance contract and \$80 to the license agreement, based on objective criteria. With respect to the \$20 allocable to the maintenance contract, *Q* recognizes  $1/2$  (\$10) in revenues for 2004 and the remaining  $1/2$  (\$10) in revenues for 2005 regardless of when *Q* provides updates or customer support. With respect to the \$80 allocable to the license agreement, *Q* recognizes  $1/4$  (\$20) in revenues for 2004,  $1/2$  (\$40) in revenues for 2005, and the remaining  $1/4$  (\$20) in revenues for 2006. *Q* uses the Deferral Method. For federal income tax purposes, *Q* must include \$30 in gross income for 2004 (\$10 allocable to the maintenance contract and \$20 allocable to the license agreement) and the remaining \$70 in gross income for 2005.

## SECTION 6. EFFECTIVE DATE

.01 *In General.* Except as provided in section 6.02 of this revenue procedure, this revenue procedure is effective for taxable years ending on or after May 6, 2004.

.02 *Automatic Change for 2003.* For a change in accounting method under section 8.02 or 8.04(1) of this revenue procedure, this revenue procedure is effective for taxable years ending on or after December 31, 2003. See section 8.06 of this revenue procedure for applicable transition rules.

## SECTION 7. AUDIT PROTECTION

If a taxpayer uses the Deferral Method described in section 5.02 of this revenue procedure for advance payments (as defined in section 4 of this revenue procedure), the taxpayer's use of the Deferral Method will not be raised as an issue by the Service in a taxable year that ends before May 6, 2004. *But see* sections 9 and 10 of Rev. Proc. 2002-9, 2002-1 C.B. 327 (as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432); section 11 of Rev. Proc. 97-27, 1997-1 C.B. 680 (as modified and amplified by Rev. Proc. 2002-19, as amplified and clarified by Rev. Proc. 2002-54). If the taxpayer uses the Deferral Method described in section 5.02 of this revenue procedure, and the treatment of advance payments (as defined in section 4 of this revenue procedure) under the Deferral Method is an issue under consideration (within the meaning of sec-

tion 3.09 of Rev. Proc. 2002-9) in examination, in appeals, or before the U.S. Tax Court in a taxable year that ends before May 6, 2004, that issue will not be further pursued by the Service.

## SECTION 8. CHANGE IN METHOD OF ACCOUNTING

.01 *In General.* A change in a taxpayer's treatment of advance payments to either of the methods described in section 5 of this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481, and the regulations thereunder, apply. A taxpayer may adopt any permissible method of accounting for advance payments for the first taxable year in which the taxpayer receives advance payments. A taxpayer that seeks to change its method of accounting for advance payments must use Form 3115, *Application for Change in Accounting Method*, and complete all applicable parts thereof. See § 1.446-1(e).

.02 *Automatic Change.* Except with respect to a change in method to which section 8.03 or 8.04(2) of this revenue procedure applies, a taxpayer within the scope of this revenue procedure that wants to change to one of the methods of accounting provided in section 5 of this revenue procedure must follow the automatic change in method of accounting provisions in Rev. Proc. 2002-9 (or its successor) with the following modifications —

(1) The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply to a taxpayer that wants to change its method for its first or second taxable year ending on or after December 31, 2003, provided the taxpayer's method of accounting for advance payments is not an issue under consideration for taxable years under examination, within the meaning of section 3.09 of Rev. Proc. 2002-9, at the time the copy of the Form 3115 is filed with the national office;

(2) For purposes of Line 1a of Form 3115, the designated automatic accounting method change number for the changes in accounting method provided in section 5A of the Appendix of Rev. Proc. 2002-9, as added by this revenue procedure, are 83 for changes to the Full Inclusion Method and 84 for changes to the Deferral Method; and

(3) In lieu of providing the information and documentation required by line 1 of Schedule B to Form 3115, a taxpayer changing to the Deferral Method under this section must —

(a) state whether the taxpayer uses an applicable financial statement (as defined in section 4.06 of this revenue procedure) and, if so, identify the type;

(b) describe the basis used for deferral (*i.e.*, the method the taxpayer uses in its applicable financial statement or how the taxpayer determines amounts earned, as applicable); and

(c) if the taxpayer makes an allocation to which section 5.02(4)(c) of this revenue procedure applies, include a statement that the allocation method is based on payments the taxpayer regularly receives for an item or items it regularly provides separately.

### .03 *Advance Consent Change.*

(1) A taxpayer within the scope of this revenue procedure that wants to use the Deferral Method for allocable payments described in section 5.02(4)(a) of this revenue procedure (other than allocable payments described in section 5.02(4)(c) of this revenue procedure) or for payments for which a method under section 5.02(3)(b)(i) or (iii) of this revenue procedure applies must follow the change in method of accounting provisions in Rev. Proc. 97-27.

(2) In lieu of providing the information and documentation required by line 1 of Schedule B to Form 3115, a taxpayer changing to the Deferral Method under this section 8.03 must —

(a) state whether the taxpayer uses an applicable financial statement (as defined in section 4.06 of this revenue procedure) and, if so, identify the type;

(b) describe the basis used for deferral (*i.e.*, the method the taxpayer uses in its applicable financial statement or how the taxpayer determines amounts earned, as applicable);

(c) provide a redacted copy of representative actual contracts or representative sample contracts relating to the advance payments and indicate the particular parts of the contract(s) that are relevant to the requested change;

(d) if the taxpayer makes an allocation to which section 5.02(4)(a) of this revenue procedure applies, include a representation that the claimed allocation is

based on objective criteria and a description of the criteria used for the allocation;

(e) if the taxpayer has advance payments to which the method under section 5.02(3)(b)(i) applies, describe the statistical basis used to determine when the advance payments are earned and describe the data and methodology used to develop the statistical basis; and

(f) if the taxpayer has advance payments to which the method under section 5.02(3)(b)(iii) applies, provide an explanation of how the basis used for deferral results in a clear reflection of income.

### .04 *Changes to an Overall Accrual Method and the Deferral Method.*

#### (1) *Automatic change.*

(a) *In general.* This section 8.04(1) applies to a taxpayer that qualifies under section 8.02 of this revenue procedure to change automatically to the Deferral Method and that either —

(i) qualifies under Rev. Proc. 2002-9 to change automatically to an overall accrual method or to an overall accrual method in conjunction with the recurring item exception of § 461(h)(3) (*see* section 5.01(1)(a)(i) or (ii) of the Appendix of Rev. Proc. 2002-9), or

(ii) is required to change to an overall accrual method under § 448 for the first taxable year it is subject to § 448 ("first § 448 year") and otherwise would be required to make the change under the provisions of § 1.448-1(h)(3).

(b) *Application.* A taxpayer described in section 8.04(1)(a) of this revenue procedure must follow the automatic change in method of accounting provisions in Rev. Proc. 2002-9 (or its successor) (including all the requirements of section 5.01 of the Appendix of Rev. Proc. 2002-9), with the following modifications —

(i) The taxpayer must file a single Form 3115 for both changes;

(ii) The taxpayer must include both change number 30 and change number 84 on Line 1a of Form 3115;

(iii) The taxpayer must complete all parts of Form 3115 that are applicable to both the change to an overall accrual method and the change to the Deferral Method (*see* section 8.02(3) of this revenue procedure);

(iv) For changes under section 8.04(1)(a)(i) of this revenue procedure, the taxpayer must complete Schedule A (com-

putation of the § 481(a) adjustment) of Form 3115, including line 1b (income received or reported before it was earned), and must take the net § 481(a) adjustment into account as provided in section 5.04 of Rev. Proc. 2002–9 or section 2.02 of Rev. Proc. 2002–19, as applicable; and

(v) For changes under section 8.04(1)(a)(ii) of this revenue procedure, the taxpayer must complete Schedule A (computation of the § 481(a) adjustment) of Form 3115, including line 1b (income received or reported before it was earned), and must take the net § 481(a) adjustment into account as provided in § 1.448–1(g)(2)(i), (g)(2)(ii), or (g)(3), as applicable.

(2) *Advance consent change.*

(a) *In general.* A taxpayer within the scope of this revenue procedure that wants to change to the Deferral Method under section 8.03 of this revenue procedure, and also wants to change to an overall accrual method or to an overall accrual method in conjunction with the recurring item exception, must request to make both changes by filing one Form 3115, and the taxpayer must follow the change in method of accounting provisions in Rev. Proc. 97–27. Only one user fee is required for these changes. See section 5.01(3) of the Appendix of Rev. Proc. 2002–9. The taxpayer must complete all parts of Form 3115 that are applicable to both the change to an overall accrual method and the change to the Deferral Method (see section 8.03(2) of this revenue procedure).

(b) *First § 448 year and Deferral Method change.* A taxpayer within the scope of this revenue procedure that wants to change to the Deferral Method under section 8.03 of this revenue procedure and is required to change to an overall accrual method under § 448 for its first § 448 year must make the change under the provisions of § 1.448–1(h)(3). Only one user fee is required for these changes and the taxpayer must complete all parts of Form 3115 that are applicable to both the change to an overall accrual method and the change to the Deferral Method (see section 8.03(2) of this revenue procedure).

.05 *Previously Filed Forms 3115.* If a taxpayer within the scope of this revenue procedure that qualifies to change its method automatically under section 8.02 or 8.04(1) of this revenue procedure filed a Form 3115 with the national office for a taxable year ending on or after December 31, 2003, and the Form 3115 is pending with the national office on May 6, 2004, the taxpayer must notify the national office in writing prior to July 6, 2004, if the taxpayer wants to withdraw its Form 3115 to make the change under section 8.02 or 8.04(1) of this revenue procedure. If the taxpayer notifies the national office within the time provided in this section 8.05, the taxpayer's Form 3115, and any user fee that was submitted with the Form 3115, will be returned to the taxpayer. A taxpayer whose Form 3115 is returned under this section 8.05 may file a new Form 3115 under the provisions prescribed in section 8.02 or 8.04(1) of this revenue procedure. If the taxpayer does not notify the national office within the time provided in this section 8.05, the national office will continue to process the taxpayer's Form 3115 in accordance with the administrative procedures under which it was originally filed, using existing authority (such as Rev. Proc. 71–21 or § 1.451–5, as applicable). With regard to changes under section 8.04(1) of this revenue procedure, this section 8.05 does not waive the generally applicable scope provisions and other requirements in section 5.01 of the Appendix of Rev. Proc. 2002–9.

.06 *Automatic Change Transition Rule.* A taxpayer within the scope of this revenue procedure that qualifies to change its method automatically under section 8.02 or 8.04(1) of this revenue procedure may change to the Full Inclusion Method, the Deferral Method, or an overall accrual method and the Deferral Method, as applicable, for taxable years ending on or after December 31, 2003. If a taxpayer has timely filed its federal income tax return for its first taxable year ending on or after December 31, 2003, and has not attached a Form 3115 to change its method of accounting for that taxable

year to a method provided in this revenue procedure, the taxpayer, as provided in section 6.02(3)(b)(i) of Rev. Proc. 2002–9, is granted an automatic extension of 6 months from the due date of its federal income tax return for the year of change (excluding extensions) to obtain the automatic consent provided by this revenue procedure, provided the taxpayer attaches Form 3115 to an amended return for the year of change and otherwise complies with section 6.02(3)(b)(i) of Rev. Proc. 2002–9.

## SECTION 9. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 71–21 is modified and superseded. Rev. Proc. 2002–9 is modified and amplified to include in section 5 of the Appendix the automatic change provided in section 8.04(1) of this revenue procedure, and to include in section 5A of the Appendix the automatic change provided in section 8.02 of this revenue procedure. The Deferral Method provided in this revenue procedure is available to qualifying taxpayers notwithstanding revenue rulings, revenue procedures, notices, or announcements published by the Service that may provide different rules for when advance payments must be included in gross income. See, e.g., Rev. Rul. 70–445, 1970–2 C.B. 101; Rev. Rul. 68–44, 1968–1 C.B. 191; Rev. Rul. 65–141, 1965–1 C.B. 210; and Rev. Rul. 60–85, 1960–1 C.B. 181.

## SECTION 10. DRAFTING INFORMATION

The principal author of this revenue procedure is Edwin B. Cleverdon of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Cleverdon at (202) 622–7900 (not a toll-free call).

# Part IV. Items of General Interest

## Issuance of Advance Payment Revenue Procedure

### Announcement 2004-48

#### PURPOSE

The Internal Revenue Service has issued Rev. Proc. 2004-34, page 991 of this Bulletin, which finalizes, with modifications, the revenue procedure proposed in Notice 2002-79, 2002-2 C.B. 964 (the proposed revenue procedure). The purpose of this announcement is to discuss some of the most significant issues raised in connection with finalizing the revenue procedure.

#### BACKGROUND

Notice 2002-79 proposed a revenue procedure to modify and supersede Rev. Proc. 71-21, 1971-2 C.B. 549. The proposed revenue procedure provided a limited deferral beyond the taxable year of receipt for certain advance payments for services, certain non-services, and combinations of services and certain non-services. Notice 2002-79 requested comments on the proposed revenue procedure and on the following specific issues:

- whether the proposed revenue procedure should take into account the cost of goods sold in deferring advance payments from the sale of goods;
- whether a taxpayer should be permitted to allocate advance payments between the deferral provisions in § 1.451-5 of the Income Tax Regulations and the proposed revenue procedure;
- whether advance payments should be accelerated as a result of non-taxable transfers, such as transfers under § 351 or § 721 of the Internal Revenue Code, and the treatment of short tax years resulting from § 381(a) transactions; and
- whether the use of statistical methodologies for tracing advance payments should be permitted if the taxpayer is unable to determine the extent to which particular advance payments received

in a given taxable year are actually included in gross receipts for financial reporting purposes in that year.

The Service received comments on these and several other issues. The most significant comments, along with certain other changes to the proposed revenue procedure, are discussed below.

#### CHANGES TO THE PROPOSED REVENUE PROCEDURE AND OTHER ISSUES

##### *Allocations*

Notice 2002-79 requested comments on allocations of advance payments between the Deferral Method in the proposed revenue procedure and § 1.451-5. Commentators suggested various approaches to resolve allocation issues involving § 1.451-5, including providing deferral rules identical to those provided in the regulations (making the regulations redundant), or making the revenue procedure and regulations mutually exclusive. Commentators also suggested that clarifying the types of services that are integral to a sale of goods for which advance payments may be deferred under § 1.451-5 would eliminate confusion about whether an allocation is necessary.

The Service does not believe it is appropriate to conform the deferral provisions of the revenue procedure to the regulations. Instead, the Service continues to believe it is appropriate to retain for purposes of the revenue procedure the one-year limited deferral rather than to use the longer deferral period allowable under the regulations. In addition, the Service does not believe that the revenue procedure and the regulations should be mutually exclusive. One of the purposes of the revenue procedure is to reduce controversy by allowing a taxpayer to use the revenue procedure without requiring the taxpayer to determine whether the payment qualifies for deferral under the regulations.

The Service recognizes that a taxpayer may receive an advance payment that is partially attributable to an item eligible for the Deferral Method under the revenue procedure and partially attributable to another item, such as: (1) an item that is not eligible for the Deferral Method; (2)

an item that is eligible for the Deferral Method, but on a different deferral schedule; or (3) an item that is eligible for deferral under § 1.451-5. In some of these situations, a taxpayer may be able to determine objectively the portion of the advance payment that is eligible for the Deferral Method. In these cases, the Service believes it is appropriate to allow a taxpayer to allocate an advance payment and to apply the Deferral Method to part of the payment and another method of accounting to the rest of the payment. The final revenue procedure, therefore, allows a taxpayer to make allocations if the taxpayer uses objective criteria for the allocation.

A taxpayer that wants to allocate advance payments generally must use the advance consent procedures for a change of accounting method set forth in Rev. Proc. 97-27, 1997-1 C.B. 680, as modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432. However, the final revenue procedure includes a safe harbor allocation for which the taxpayer may use the automatic change of accounting method procedures in Rev. Proc. 2002-9, 2002-1 C.B. 327, as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, and amplified, clarified, and modified by Rev. Proc. 2002-54. Under the safe harbor, if a taxpayer bases the allocation on payments the taxpayer regularly receives for an item or items it regularly provides separately, the allocation will be deemed to be based on objective criteria.

##### *Treatment Of Short Taxable Years*

The proposed revenue procedure retained the requirement under Rev. Proc. 71-21 that advance payments be included in gross income by the end of the "next succeeding taxable year" following the taxable year of receipt. Notice 2002-79 requested comments concerning the application of this rule when the next succeeding taxable year is a short taxable year resulting from a § 381 transaction. Commentators suggested various remedies including disregarding short taxable years or providing a minimum fixed deferral period to approximate the limited

one-year deferral that would be allowed under the revenue procedure.

The Service agrees that an additional taxable year of deferral should be permitted in the case of certain short taxable years. Therefore, the final revenue procedure provides that, when the next succeeding taxable year is a short taxable year (other than a taxable year in which the taxpayer dies or ceases to exist in a transaction other than a transaction to which § 381(a) applies) of 92 days or less, a taxpayer using the deferral method must include in gross income for the short taxable year the portion of the advance payment recognized for financial reporting purposes (or earned, if applicable) in the short taxable year. Any remaining amount must be included in gross income for the taxable year immediately following the short taxable year.

#### *Acceleration Of Income*

The proposed revenue procedure retained the requirement in Rev. Proc. 71-21 regarding the acceleration of inclusion in gross income if the taxpayer dies or ceases to exist (other than in a transaction to which § 381(a) applies) or if the taxpayer's obligation related to the advance payment otherwise ends. The notice requested comments on whether acceleration should be required with respect to certain non-taxable transfers. Several commentators suggested a "step-into-the-shoes" treatment for the transferee, which the Service believes would create significant complexity. Another commentator suggested an exception similar to the exception provided in the method change procedures for § 481(a) adjustments for transfers under § 351 within a consolidated group.

The final revenue procedure incorporates a limited exception for § 351 transfers. A taxpayer will not be required to include the advance payment in gross income if, in a § 351 transaction, (1) substantially all assets of the trade or business (including advance payments) are transferred, (2) the transferee adopts or uses the Deferral Method in the procedure in the year of transfer, and (3) the transferee and the transferor are members of an affiliated group of corporations that file a consolidated return pursuant to §§ 1504 - 1564.

#### *Definition Of "Applicable Financial Statement"*

The deferral permitted under the proposed revenue procedure was based on the amount deferred under the taxpayer's method of financial reporting. Commentators expressed concern that, without specific guidelines, taxpayers would adopt financial reporting methods that would maximize deferrals but that might not accurately reflect the true nature of the taxpayer's financial condition. Some commentators recommended adopting a standard based on generally accepted accounting principles (GAAP), and other commentators expressed concern that taxpayers without financial reports would be excluded from using the Deferral Method.

The final revenue procedure adopts an "applicable financial statement" standard similar to that set forth in § 1.56-1(c) regarding the types, and priority, of financial statements. Under the revenue procedure, a taxpayer's applicable financial statement is the first listed of the following:

- Financial statement required to be filed with Securities and Exchange Commission ("SEC") (the 10-K or the Annual Statement to Shareholders);
- Certified audited financial statement used for (in this priority) credit purposes, reporting to shareholders, or other substantial non-tax purposes; and
- Financial statement provided to a government regulator other than the SEC or the Internal Revenue Service.

Thus, for example, a taxpayer that both files a 10-K with the SEC and provides financial statements to a government regulator would be required to use the 10-K as the applicable financial statement under the revenue procedure. For those taxpayers that do not have an applicable financial statement described above, the final revenue procedure provides deferral methodologies based on when the advance payments is earned through performance.

#### *Statistical Sampling*

Because the deferral method in the proposed revenue procedure was based exclusively on the taxpayer's financial reporting method, the proposed revenue procedure

did not provide an independent method for using a statistical or other basis for determining when an advance payment is earned through performance. Section 3.06 of Rev. Proc. 71-21 provided a rule for using a statistical basis, if adequate data are available to the taxpayer, for determining when services are performed with respect to contingent service agreements. Some commentators were concerned that a similar provision was not included in the proposed revenue procedure.

Because some taxpayers do not have an applicable financial statement as previously described, and because some taxpayers are unable to trace the recognition of individual advance payments in their applicable financial statements, section 5.02(3)(b) of the final revenue procedure was added to allow these taxpayers to use certain other methods, including a statistical basis (if adequate data are available to the taxpayer), to include advance payments in gross income. If a taxpayer seeks to use a statistical basis or other methodology (other than a straight line ratable basis) to determine the amount deferred, the taxpayer must use the advance consent procedures for a change of accounting method set forth in Rev. Proc. 97-27.

#### *Items Not Eligible For Deferral As Advance Payments*

##### *Credit Card Fees*

The proposed revenue procedure excluded credit card fees from the definition of advance payments. Several commentators requested that credit card fees (including annual fees) be included within the document's scope. The final revenue procedure continues to exclude payments with respect to credit card agreements because the Service has addressed credit card fees in separate guidance. See Rev. Rul. 2004-52, page 973 of this Bulletin, Rev. Proc. 2004-32, page 988 of this Bulletin, and Rev. Proc. 2004-33, page 989 of this Bulletin.

##### *Insurance Premiums*

The proposed revenue procedure excluded "insurance premiums" from the definition of "advance payments" to avoid conflicts with accounting rules applicable to insurance companies. After further consideration, the Service determined that



a more focused definition would be appropriate. Therefore, the final revenue procedure excludes “insurance premiums, to the extent the recognition of those premiums is governed by Subchapter L.” This language is intended to exclude insurance companies as well as other entities that recognize income from insurance activities under the subchapter L accounting regime, but not taxpayers that are ineligible for the subchapter L regime (for example, taxpayers that issue insurance contracts but are not insurance companies within the meaning of § 816(a) or § 1.801-3(a)).

#### Advance Rentals

In conjunction with the final revenue procedure, the Service and Treasury are amending the regulations at § 1.61-8(b) to allow the Service to provide for the deferral of advance rentals. These amendments will be effective retroactively to the date the regulations were proposed in the Federal Register (December 18, 2002). The final revenue procedure applies to advance payments for the use of computer software and intellectual property, which may otherwise be considered advance rentals. Some commentators requested that the revenue procedure be expanded to include advance rentals for tangible property. The Service has not adopted this suggestion. The Service continues to believe that advance rentals for tangible property should be included in gross income when received unless § 467 requires otherwise.

#### Other Excluded Items

The proposed revenue procedure included payments for warranties in the list of items that may be eligible to be deferred as advance payments. Commentators stated that there could be confusion whether a warranty would be excluded as insurance. In addition to the clarifications made with respect to insurance as discussed above, the Service determined that it was appropriate to exclude warranties and guaranty contracts under which a third party is the primary obligor.

The proposed revenue procedure did not exclude payments in property to which § 83 applies or payments subject to the withholding rules in § 871, 881, 1441, or 1442. Upon further consideration, the Service has determined that because of the

specific statutory and regulatory income treatment for transactions under § 83, it is appropriate to exclude payments in property to which § 83 applies from the deferral provisions of the revenue procedure. Additionally, the final revenue procedure excludes payments subject to the specific withholding rules in § 871, 881, 1441, or 1442 from the deferral provisions.

#### Method Change Issues

The proposed revenue procedure provided that taxpayers would use the automatic change in accounting method procedures in Rev. Proc. 2002-9 to change to either the Deferral Method or the Full Inclusion Method. The Service believes that certain changes permitted under the final revenue procedure raise issues that warrant closer scrutiny by the Service. Therefore, the Service has determined that a taxpayer that wants to change to an accounting method that involves allocations of payments between the Deferral Method in the revenue procedure and some other method generally must follow the advance consent procedures in Rev. Proc. 97-27, rather than the automatic method change procedures. Similarly, a taxpayer that wants to use the Deferral Method, but either does not have an applicable financial statement or does not trace individual advance payments for purposes of its applicable financial statements, must follow the advance consent procedures of Rev. Proc. 97-27 if it wants to defer advance payments on a basis other a straight line ratable basis. The final revenue procedure also provides automatic method change procedures for certain changes to an overall accrual method of accounting combined with a change to the Deferral Method.

#### Record Keeping

Section 8 of the proposed revenue procedure set forth record keeping rules for taxpayers using an accounting method provided by the revenue procedure. However, because that section did not add to the general record keeping rules applicable to all taxpayers, it was determined that the provision is unnecessary. Thus, although the final revenue procedure does not include this provision, the record keeping rules in § 6001 and the regulations thereunder continue to apply to taxpayers that use

a method of accounting provided by the final revenue procedure.

#### COGS

The proposed revenue procedure did not provide a special rule for cost of goods sold (COGS), but requested comments on whether the revenue procedure should take into account COGS in deferring advance payments from the sale of goods.

Some commentators suggested that the Service does not have the authority to treat advance payments for the sale of goods as income when received, on the theory that the Code and regulations do not allow a tax on gross receipts, and that the Service should *require* taxpayers to defer advance payments for the sale of inventoriable goods.

The revenue procedure does not adopt this recommendation. The long-standing position of the Service has been that advance payments are income when received, unless the taxpayer *elects* to defer under an exception to that general rule. The final revenue procedure is designed to simplify the various issues that have arisen under Rev. Proc. 71-21. After careful consideration, the Service has determined that a special COGS rule is inconsistent with that simplification. Taxpayers that receive advance payments for goods and qualify to use the deferral method in § 1.451-5 may use that method, including the rule for COGS included in the regulation. Taxpayers that use the deferral method provided in the final revenue procedure must use the general rules under § 461 and the regulations thereunder for determining when a liability (including COGS) is incurred.

#### Effective Date

The revenue procedure is effective for taxable years ending on or after May 6, 2004. However, a transition rule allows taxpayers who are eligible to use the automatic change provisions to adopt or change to a method provided in the revenue procedure for taxable years ending on or after December 31, 2003.

#### DRAFTING INFORMATION

The principal author of this announcement is Edwin B. Cleverdon of the Office of Associate Chief Counsel (Income

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

## Announcement 2004-49

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

person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin

their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

## Consent Disbarments From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid institution or conclusion of a proceeding for his or her disbarment or suspension from practice be-

fore the Internal Revenue Service, may offer his or her consent to disbarment from such practice. The Director, Office of Professional Responsibility, in his discretion, may disbar an attorney, certified public ac-

countant, enrolled agent, or enrolled actuary in accordance with the consent offered.

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

Name	Address	Designation	Date of Disbarment
Ranes III, Wesse C.	Annapolis, MD	CPA	Indefinite from May 1, 2004

## 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 con-

clusion 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 ac-

tuary in accordance with the consent of-  
ferred.

The following individuals have been  
placed under consent suspension from

practice before the Internal Revenue Ser-  
vice:

Name	Address	Designation	Date of Suspension
Montgomery, Goldie L.	Lancaster, CA	Enrolled Agent	Indefinite from February 1, 2004
Frost, Charles L.	San Antonio, TX	Enrolled Agent	Indefinite from February 1, 2004
Briggs, John W.	Sayville, NY	Enrolled Agent	February 10, 2004 from August 8, 2004
Lahman, Gary M.	Ft. Collins, CO	Enrolled Agent	Indefinite from February 12, 2004
Stanny, Gertrude M.	South Lyon, MI	Enrolled Agent	Indefinite from March 1, 2004
Millar, Mark	Tall Timbers, MD	Enrolled Agent	Indefinite from March 1, 2004
Murray, Maureen E.	Naugatuck, CT	Enrolled Agent	Indefinite from March 1, 2004
Keith, James S.	Imperial Beach, CA	Enrolled Agent	March 2, 2004 from June 30, 2004
Zelek, Linda S.	Moultonboro, NH	CPA	Indefinite from March 4, 2004
Gilpin, Charles H.	San Leandro, CA	Enrolled Agent	Indefinite from March 5, 2004
Smith, Sean M.	Silver Spring, MD	Enrolled Agent	Indefinite from March 15, 2004
Morelini, Wayne C.	Modesto, CA	Enrolled Agent	Indefinite from March 15, 2004
Bower, Jay	Redmond, OR	Enrolled Agent	Indefinite from March 16, 2004
Lynn, Celia M.	Locust Grove, VA	Enrolled Agent	Indefinite from April 1, 2004

Name	Address	Designation	Date of Suspension
Swantz Jr., H. E.	San Diego, CA	Enrolled Agent	Indefinite from April 6, 2004
Hart, David A.	Lake Zurich, IL	Enrolled Agent	Indefinite from April 8, 2004
Lau, Dennis K.M.	Honolulu, HI	Enrolled Agent	Indefinite from April 20, 2004
Lentz, Carole	Mastic, NY	Enrolled Agent	Indefinite from April 23, 2004
Goble, Dennis R.	Valparaiso, IN	CPA	Indefinite from April 26, 2004
Rivera, Eduardo M.	Torrence, CA	Attorney	May 1, 2004 to October 29, 2006
Grant, Elaine C.	Woodway, WA	Enrolled Agent	May 1, 2004 to October 31, 2004
Bell, Don	Grand Junction, CO	Enrolled Agent	Indefinite from May 1, 2004
Cohick, Jeffrey S.	Newville, PA	Enrolled Agent	May 1, 2004 from October 30, 2004

## 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
Candelario, Alexander	Cabins, WV	CPA	Indefinite from February 1, 2004
Riener, Richard	St. Paul, MN	Attorney	Indefinite from March 1, 2004

Name	Address	Designation	Date of Suspension
Dunkle, Clark	Carlisle, PA	CPA	Indefinite from March 15, 2004
Bailey, Donald D.	Tucson, AZ	CPA	Indefinite from March 18, 2004
Hill, Donald R.	Clinchco, VA	CPA	Indefinite from April 1, 2004
Bergeson, Nancy	Inver Grove Hghts, MN	CPA	Indefinite from April 14, 2004
Reese, Kenneth J.	Nebraska City, NE	CPA	Indefinite from April 15, 2004
Coates, Marsden S.	Baltimore, MD	Attorney	Indefinite from April 15, 2004
Schaefer, Robert J.	Moorhead, MN	Attorney	Indefinite from April 20, 2004
Mills, Stuart B.	Pender, NE	Attorney	Indefinite from May 1, 2004
Harris-Smith, Bridgette	Silver Spring, MD	Attorney	Indefinite from May 3, 2004
Janousek, Donald R.	Omaha, NE	Attorney	Indefinite from May 3, 2004
Williams, Gary W.	Diamond Bar, CA	CPA	Indefinite from May 3, 2004
Demaio, Louis J.	Bel Air, MD	Attorney	Indefinite from May 3, 2004
Miller, Frederick C.	Cedar Hill, TX	CPA	Indefinite from May 15, 2004

## 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
Friedman, Milton G.	Ft. Lauderdale, FL	CPA	December 30, 2003
Stevens, William E.	Omaha, NE	CPA	February 13, 2004
Turner, Mark A.	Cincinnati, OH	CPA	February 25, 2004
Rath, Dorris A.	Bradenton, FL	Enrolled Agent	March 9, 2004
Damiano, Lisa	South Windsor, CT	Enrolled Agent	March 9, 2004
Silbiger, Arnold R.	Baltimore, MD	Attorney	March 11, 2004
Farwell, Nancy K.	Citrus Heights, CA	Enrolled Agent	April 5, 2004
Dembrowski, Karen E.	Encino, CA	CPA	April 13, 2004

## Foundations Status of Certain Organizations

### Announcement 2004-50

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

*Former Public Charities.* The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

129th Rescue Member Foundation,  
Moffett Field, CA  
A D Player Endowment Fund, Inc.,  
Houston, TX  
Abraham Lincoln Institute, Joppa, IL  
Abraham Lincoln National Cemetery  
Support Committee, Joliet, IL  
Achondroplasia Information Source,  
Hubbard, TX  
Advokids, Inc., Baltimore, MD  
African Repertory Troupe, Inc.,  
Mattapan, MA  
Africatown Community Mobilization  
Project, Inc., Mobile, AL

Afrikan Historical Preservation Society,  
Inc., Brooklyn, NY  
Agape Complete Services Parent Teacher  
Hotline, Donaldsonville, LA  
Agape Eleos Ministries International  
Foundation, Pleasanton, CA  
Agape Foundation, Mountain View, CA  
Agape in Action, Inc., Scottsdale, AZ  
Agape Life Institute, Austin, TX  
Agatha Foundation, Los Angeles, CA  
AHA Regional Cancer Research  
Treatment Center, Jourdanton, TX  
Alabama Chapter of the National  
Organization of Professional Black,  
Anniston, AL  
Alabama Fire and Life Safety Education  
Association, Birmingham, AL  
Alabama Lyric Theatre, Mobile, AL  
Alcore Community Development  
Corporation, Elizabeth, NJ  
Alicias Animal Haven, Encino, CA  
All Children's Assistance Fund,  
Santa Ana, CA  
Allasso Ministries, Inc., West Bend, WI  
Alliance to Revitalize Today's Society  
Project, Greeley, CO  
Alpha-Omega Sports Ministries,  
Ridgefield, WA  
Alyans Atizay Ayisyn, Inc., Miami, FL  
American Asian Pacific Health  
Care Organization Corporation,  
Westminster, CA  
American Institute of Film and New  
Media, Los Angeles, CA  
American Lifecare, Inc.,  
Palm Beach Gardens, FL  
American Research Center for Asia and  
the Pacific, Bethesda, MD  
American Student Athlete Association,  
Chicago, IL  
Angels in Heaven & Earth Foundation,  
Winnetka, CA

Angleton Pal, Angleton, TX  
Animal Foundation of East Tennessee,  
Powell, TN  
Annie Davis Foundation, Inc.,  
Memphis, TN  
Anointed Creations and Word Wellness  
Ministries, Fort Worth, TX  
Antioch Youth Center, Macon, GA  
Apex Soccer Club, Inc.,  
Thousand Oaks, CA  
Arizona Fragile X Foundation,  
Glendale, AZ  
Arlington High School Choir Booster  
Club, Arlington, TX  
Art & Industrial Womens Club of Barstow,  
Barstow, CA  
Artes Alba, Inc., Miami Shores, FL  
Artichoke Dance Company, Inc.,  
New York, NY  
Artists Advancement Crusade,  
Chicago, IL  
Asdew Residential Facility,  
Los Angeles, CA  
Association of Chinese Schools  
in Southeastern United States,  
Huntsville, AL  
Atlantic Society for the Arts, Inc.,  
Great Neck, NY  
Attingham Trust for the Study of Country  
Houses and Collections, England  
Avalon Home and School Association,  
Avalon, NJ  
Back to the Workplace, Inc.,  
High Ridge, MO  
Bao Phat Thanh Corporation,  
Westminster, CA  
Baptist Life Communities, Inc.,  
Cincinnati, OH  
Bark Banks Animal Rescue Kennel,  
Lexington, NC  
Beacon Senior Housing Corp.,  
Glendale, CA

Bedford Initiative, Inc., Boston, MA  
 Bellamy Outreach, Inc., Columbia, SC  
 Berkeley Center for the Study of Best Practice, Berkeley, CA  
 Bertram J. Zelden Foundation, Inc., Old Greenwich, CT  
 Bethesda Living Centers of Colorado Springs, Colorado Springs, CO  
 Bethesda Living Centers of Grand Junction, Colorado Springs, CO  
 Bethesda Living Centers of Kearney, Colorado Springs, CO  
 Bethesda Living Centers of Omaha, Colorado Springs, CO  
 Betty Shabazz National Black Wholistic Retreat Center, Boston, MA  
 B I B L E, Detroit, MI  
 Bini Association of Northern California, Oakland, CA  
 BJBS Enterprises, Inc., Tarsana, CA  
 Black Cultural Council of Odessa, Odessa, TX  
 Blackfeet Original Allotment Heirs Association, Browning, MT  
 Blair Mountain Historical Organization, Blair, WV  
 Blaze Premier Soccer Club, Inc., Boise, ID  
 Blue Hill Area Community Center, Blue Hill, ME  
 Blue Water Ministries, Los Angeles, CA  
 Bluelicks Pantry, Falmouth, KY  
 Boca Grande Soccer Club, Boca Grande, FL  
 Boys & Girls Club of the Omaha Nation, Inc., Macy, NE  
 Brevard Crisis Pregnancy Center and Shelter, Inc., Merritt Island, FL  
 Bridge Over Trouble Water, Inc., Morven, NC  
 Bright Dreams International, Dallas, TX  
 Bristol Heritage Collection, Nashville, TN  
 Broad Creek Conservancy, Inc., Ft. Washington, MD  
 Brothers & Sisters of Tribe, Phoenix, AZ  
 Brothers for Change, Inc., Madison, WI  
 Butler County Humane Society, Greenville, AL  
 Cafeteria Workers Local 634 Scholarship Tr. Fund, Philadelphia, PA  
 Caleb Missionary Relief Services, Decatur, GA  
 California Sacrifice, Ceres, CA  
 Call to Service, Big Lake, MN  
 Camerata Chamber Winds of Coppell, Coppell, TX  
 C A P Adult Family Homes Corporation, Cleveland, OH  
 Capital Area Diamond Star Motor Club, Inc., Centreville, VA  
 Cardiology Associates Foundation, New York, NY  
 Carlton-Hickman Foundation, Inc., Detroit, MI  
 Carrick Band Boosters Association, Inc., Pittsburgh, PA  
 Cat Heaven, El Cajon, CA  
 Celebrate History, Inc., Berkeley, CA  
 Center for the Preservation & Education of Ancient Western Civilization Art and, Tucson, AZ  
 Central Alabama Pride, Inc., Birmingham, AL  
 Central Dupage Kiwanis Club Foundation, Wheaton, IL  
 Central Texas Elite Track Club, Austin, TX  
 Centre for Early Christian Studies, San Jose, CA  
 Ceres Food Society, Inc., Palm Coast, FL  
 Challenges Foundation, Los Angeles, CA  
 Challenges Unlimited, Asheville, NC  
 Cherokee Childrens Nutrition, Brentwood, TN  
 Cherry Street Memorial A M E Zion Lay Council, Pine Bluff, AR  
 Chesapeake Sheriffs Pipe Band, Inc., Chesapeake, VA  
 Chesterfield Education and Training Institute, Seattle, WA  
 Child and Adult Care Services, Inc., Wilmington, NC  
 Childrens Place PTO, Inc., New Windsor, NY  
 Childrens Resource Foundation, Spring, TX  
 Childrens Scholarship Fund Miami, Inc., Miami, FL  
 Chinatown Community Housing Corporation, Honolulu, HI  
 Christian Lewis Holdings, Inc., Swansea, UK  
 Christian Research Hospital, Cedar Rapids, IA  
 Christians in Emergency Services, Nashville, TN  
 Church of Alternative Nutritional Science, Las Vegas, NV  
 Citizens Against Illegal Drugs, Inc., Watertown, NY  
 City School Press, Inc., Brooklyn, NY  
 Classics Gymnastics Parents Boosters Club, Inc., Copley, OH  
 Clear Brook Volleyball Booster Club, Friendswood, TX  
 Cleveland Little Dribblers, Cleveland, TX  
 Club Morelia, Blue Island, IL  
 Coastwatch Wildlife Society, Sausalito, CA  
 Coleman Hawkins Jazz Heritage Society, St. Joseph, MO  
 Collecting Kids for Christ Ministries - The Kids House, Inc., Sanford, FL  
 Collins Graham H O P E Foundation, Atlanta, GA  
 Columbia Soccer Association, Inc., Columbia, TN  
 Columbus Chinese Association, Columbus, IN  
 Come Together Steering Committee, San Angelo, TX  
 Coming Together to Help Promotions, Inc., Philadelphia, PA  
 Community Activators Breast Cancer Project, Vashon, WA  
 Community Art Partners, Glen Ellyn, IL  
 Community by the Sea, Inc., Malabar, FL  
 Community Developmental Leadership Organization, Roseboro, NC  
 Community Restoration Center, Columbus, OH  
 Community Supported Housing for the Underprivileged, Memphis, TN  
 Competition, Iowa Park, TX  
 Connecticut Babe Ruth Softball Leagues, New Milford, CT  
 Connecticut Supportive Housing Development Co., Inc., New Haven, CT  
 Conservation Technology Support Program, San Francisco, CA  
 Consumer Debt Reduction Institute, Rockford, IL  
 Coral Park Baseball Booster Club, Inc., Miami, FL  
 Corpus Christi Foundation of Holland/Zeeland, Holland, MI  
 Courts in Session, Inc., Lexington, KY  
 Cove Foundation, Inc., Key Largo, FL  
 Creators Gift 137, Deltona, FL  
 Crichton Economic Development, Inc., Crichton, AL  
 Cunningham Charitable Group, Los Angeles, CA  
 D C Public Charter School Resource, Washington, DC  
 Daniel Andresen Foundation, Dekalb, IL  
 Dansarte, Inc., Burlington, VT  
 Dare to Dream, Inc., New York, NY  
 Darke County Search & Rescue, Inc., Greenville, OH  
 David H. Jones Ministries, Springfield, MO

Davis Dimension Christian Womens Organization, Incorporated, South Holland, IL  
 Daytona Beach Housing Development Corporation, Daytona Beach, FL  
 Deaf and Hard of Hearing in Government, Inc., Washington, DC  
 Delco Associates Limited, Quincy, MA  
 Desoto Community Economic Development Foundation, Inc., Mansfield, LA  
 Detroit Black Womens Health Project, Detroit, MI  
 Detroit Food Security Council, Troy, MI  
 DHS Baseball Boosters, Duncanville, TX  
 Direct Action, Inc., El Cajon, CA  
 Dominican Republic Health Education Language Project, Gainesville, FL  
 Down Syndrome Association of Polk County, Lakeland, FL  
 Downtown Miami Transportation Management Association, Inc., Miami, FL  
 Eagle Heights, Boise, ID  
 Eastern Market Community Advisory Committee, Washington, DC  
 Eastside Cardinals, Detroit, MI  
 Ed Rimer Ministries, Inc., Albuquerque, NM  
 Edgewood Elementary School Parent Teacher Organization, Moriarty, NM  
 Eduskate Foundation, Inc., Boca Raton, FL  
 El Paso Barrios Unidos, El Paso, TX  
 Elohim Outreach Center, Hartsville, SC  
 Eluzai, Inc., Riverdale, GA  
 Empact Southeast Alabama, Inc., Dothan, AL  
 Empty Arms Foundation, Inc., Hackensack, NJ  
 Encore Theatre, Inc., Lucas, TX  
 Endless Mountains Theatre Company, New Milford, PA  
 Ephesus Road Housing Corporation, Raleigh, NC  
 Epic Blitz Soccer, Harpers Ferry, WV  
 Evangelique Economic Development, Inc., Delray Beach, FL  
 Evin Thayer Scholarship Fund, Houston, TX  
 Eye of the Storm, Bowie, MD  
 Fabulous Feet Parents Club, Brentwood, CA  
 Familia Unidas De Val Verde County, Del Rio, TX  
 Faubourg Theatre, Inc., Hanover Park, IL  
 FertilityCare Centers International, Inc., Omaha, NE  
 Fido in Prospect Park, Brooklyn, NY  
 Fighting for Equality in Allocation of Textbooks, Inc., Roosevelt Island, NY  
 Five Thousand Orphans, Arlington, VA  
 Flora D. Parrish Foundation, Tucson, AZ  
 Florida West Coast Resource Conservation & Development Council, Ellenton, FL  
 Follow Your Dream, Inc., Methuen, MA  
 Fort Collins International Visitors Council, Fort Collins, CO  
 Fort Worth Rugby Football Corporation, Fort Worth, TX  
 Foundation Ridge Housing Corporation, Raleigh, NC  
 Friends for Christmas at the Zoo, Inc., Ltl Suamico, WI  
 Friends of Abused Children Everywhere, Inc., Blanco, TX  
 Friends of Crest, El Cajon, CA  
 Friends of Frederick County Public Libraries, Inc., Frederick, MD  
 Friends of Mama D, Inc., Roseville, MN  
 Friends of the Globe Public Library, Globe, AZ  
 Friends of the Grand County Childrens Justice Center, Moab, UT  
 Fundacion Boriqua, Inc., Oviedo, FL  
 Future American Scientists and Technologists, Inc., Tulsa, OK  
 Future Awareness, Oakland, CA  
 Gateways Incorporation, Boston, MA  
 Gator Country Resource Conservation & Development Council, Inc., Live Oak, FL  
 Generation Gerannomo, Philadelphia, PA  
 Gentle Hearts Animal Shelter of Taylor County, Incorporated, Medford, WI  
 Get Real Ministries, Jonesboro, AR  
 GI Bill Alumni Association, Philadelphia, PA  
 Glen Rose Youth Baseball Association, Glen Rose, TX  
 Global Dialoge Institute, Gladwyne, PA  
 Global Harmony Productions, Houston, TX  
 Gods Special Care, Gary, IN  
 Golden Triangle Public Improvement Corporation, Inc., Starkville, MS  
 Good Son Ministries, Pelham, AL  
 Goodvillage Foundation, Friendship, WI  
 Grace House of Madison County, Inc., Anderson, IN  
 Grand Glaice Safe Boating Association, Osage Beach, MO  
 Grandview High School of Boca Raton, Inc., Boca Raton, FL  
 Great Dane Rescue of WI, Inc., Stoughton, WI  
 Great Falls Elks Lodge Charitable Corp., Great Falls, MT  
 Greater Squaw Bay Association, Inc., Coeur D Alene, ID  
 Greater Washington Shores Area Association of Orlando, Inc., Orlando, FL  
 Green Mountain State Games, Winooski, VT  
 Greer High School Alumni and Friends Association, Greer, SC  
 Guardettes of Orange County, Inc., Garden Grove, CA  
 Guest House, Inc., Dallas, TX  
 Gull Lake Little League, Richland, MI  
 Hamilton Diagnostics-Ellijay, Inc., East Ellijay, GA  
 Hampton Supportive Housing, Inc., Glendale, CA  
 Healthy Families Jacksonville, Inc., Jacksonville, FL  
 Heart & Hands, Inc., Winterset, IA  
 Heartwood Foundation, Seattle, WA  
 Helendale Silver Lakes Little League, Helendale, CA  
 Help, Inc., Atlanta, GA  
 Help Other People Evolve, Inc., Oakland, CA  
 H I G H, Inc., Missouri City, TX  
 Historic Music Broadcasts, Inc., New York, NY  
 Ho Okupu, Inc., Atlanta, GA  
 Holmes Elementary Parent Teacher Group, Spokane, WA  
 Homa Lusa Corporation, Richmond, CA  
 Honorable Elijah Muhammad Educational Foundation, Chicago, IL  
 Housing Services of Alabama, Inc., Dothan, AL  
 Houston Repertory Theatre, Houston, TX  
 Howard K. Russell Memorial Scholarship Fund, Chino Hills, CA  
 Howell Wrestling Club, Inc., Howell, NJ  
 Human Support Systems Foundation, Cleveland, OH  
 I Am Somebody Pantry, Inc., Dallas, TX  
 I Need a Miracle Foundation, Flippin, AR  
 I C E P S Ltd., Ulman, MO  
 Idaho Education Alliance for Solutions, Inc., Shelley, ID  
 Image for Success, San Rafael, CA  
 Immerse Yourself in Celebration, Inc., Ft. Lauderdale, FL  
 Independence Preserve Our Legacy Foundation, Independence, IA  
 Infants Palace Day Care, Inc., Raleigh, NC  
 Informing Seniors in Crisis, Corona, CA  
 Inneract Foundation, Inc., Marietta, GA



Innercircle - Integrating Spirituality and Healing, San Francisco, CA  
 Institute for Computer Research and Jewish Jurisprudence, Inc., New York, NY  
 Intalab, Inc., - International Affairs Laboratory for Research and Education, Oklahoma City, OK  
 International Academy of Voice and Stage, Incorporated, Hollywood, FL  
 International Court of the Environment Foundation, New York, NY  
 International Design Center for the Environment, Raleigh, NC  
 International Science Foundation of Cambridge, Somerville, MA  
 International Womens Taekwondo Federation, Canoga Park, CA  
 Investing in People, Arlington, TX  
 Invisible Gift Foundation for Childrens Fund, Inc., Miami, FL  
 It's A Wonderful Life, Midland Park, NJ  
 Ja Dal Community Development, Inc., Shorter, AL  
 Jack and Jill Daycare Preschool, Pine Bluff, AR  
 Jacksonville Art Museum, Inc., Jacksonville, FL  
 Jazz Center, Cambridge, MA  
 Jendayi Home, Oakland, CA  
 Jewish Armed Forces Association, Miami, FL  
 JFJ Christian Foundation, Houston, TX  
 Jim Pecota Ministries, Kent, WA  
 Jo Ella Ellison Ministries dba Therapon Counseling Center, Austin, TX  
 Joot Media Production, Bastrop, TX  
 Joshua Faith Ministries, Kent, WA  
 Joy Senior Apartments, Inc., Petersburg, WV  
 Judo Affiliates of Michigan JAM, Southfield, MI  
 Jump Start, Las Vegas, NV  
 Junction City Swimming Pool & Community Center Foundation, Junction City, OR  
 Kalamazoo Chapter of Te Links, Inc., Kalamazoo, MI  
 Katies Kids, Philadelphia, PA  
 Keylife Foundation, Encino, CA  
 Keys, Inc., Virginia Beach, VA  
 Kids Et Cetera Day Care Center, Inc., Brooklyn, NY  
 Kids Tech the Cool School, Chicago, IL  
 Kinship Institute, Santa Fe, NM  
 Kiwanis Club of the Boulevard Amherst Foundation, Inc., Tonawanda, NY  
 Klein Oak Area Swim Team, Inc., Spring, TX  
 Klothes for Kids, Inc., Phoenix, AZ  
 Kollel Torah Mitzion, Inc., Chicago, IL  
 L. McNeese Ministries, Clarksville, TN  
 Lake Prince Center, Inc., Newton, NC  
 Lake Region Thunder Softball Boosters, Inc., Winter Haven, FL  
 Lake Shore Charter Chapter Scholarship Fund, Oak Park, MI  
 Landskroner Foundation for Children, Cleveland, OH  
 Latchery, Inc., Ruston, LA  
 Lathrop Tumbling Foundation, Rockford, IL  
 Lawrence County School-to-Work, Inc., New Castle, PA  
 L E A D Ministries, Inc., Washington, DC  
 Leaping Frogs, Inc., Mattituck, NY  
 Lebanon High School Sports Boosters, Inc., Lebanon, IN  
 Les Ballets Grandiva, Ltd., New York, NY  
 Liberty Elementary School District Educational Foundation, Buckeye, AZ  
 Life Candle Light, Venice, IL  
 Life Resources, Inc., Mandeville, LA  
 Lightbox Films, Pleasanton, CA  
 Little Bear Child Development Center, Waukegan, IL  
 Long View Learning, Inc., Raleigh, NC  
 Los Amigos Baseball Association of Santa Monica, Santa Monica, CA  
 Los Angeles Chapter of National Football League Retired Players, Whitties, CA  
 Los Angeles Community Chest, Los Angeles, CA  
 Lost Voices Foundation, Inc., Staten Island, NY  
 Lowell Community Charter School Friends, Inc., Lowell, MA  
 Lubbock Korean Christian Fellowship, Lubbock, TX  
 Luminous Group, Inc., New York, NY  
 Mabak International, Los Angeles, CA  
 Madison Aquatic Club, Inc., Madison, WI  
 Mafio, Inc., Worcester, MA  
 Major Taylor Alliance, Inc., Indianapolis, IN  
 Make a Dream Come True Project Rhema Paradise for Street Children, St. Augustine, FL  
 Malama Na Keiki Foundation, Honolulu, HI  
 Mantech International Special Assistance Fund, Inc., Fairfax, VA  
 Marion Youth Organization, Marion, TX  
 Martin Luther King Cello Program, Santa Monica, CA  
 Mary Elizabeth Baker Parent and Child Development Center, Long Beach, CA  
 Mary Stewart Health and Education Foundation, Carson, CA  
 Master Care Ministries, Minnetonka, MN  
 Masters Plan Foundation, Scottsdale, AZ  
 Matts House, Inc., Appleton, WI  
 Mavericks Swimming Association, Half Moon Bay, CA  
 Mechanicsburg Summer Youth Leagues, Mechanicsburg, OH  
 Media, Houston, TX  
 Media Knowledge, Incorporated, New Fairfield, CT  
 Melador Foundation, Carson, CA  
 Mennello Museum of American Folk Art, Inc., Orlando, FL  
 Mentally Challenged Advocacy Council, Inc., Corpus Christi, TX  
 Mercy Home Healthcare, Memphis, TN  
 Mercy Road, Murrieta, CA  
 Metropolitan Kappa Youth Development & Scholarship Foundation, Silver Spring, MD  
 Metropolitan Oval Foundation, Inc., Brooklyn, NY  
 Mexico Academy Educational Foundation, Mexico, NY  
 Meyer Group, Incorporated, Key Biscayne, FL  
 Michigan Intertribal Coalition of Ishpeming & Negaunee, Negaunee, MI  
 Michigan Panthers Baseball Club, Inc., Wixom, MI  
 Mid-Northeast Collaborative, Washington, DC  
 Mid-Pinellas Homeless Outreach, Inc., St. Petersburg, FL  
 Mid-Willamette Valley Senior Services Foundation, Salem, OR  
 Middle Peninsula Hospice & Pallative Care, St. Stephens Church, VA  
 Middle School Connection, Minneapolis, MN  
 Midland Park Public Education Foundation, Inc., Short Hills, NJ  
 Millenium Dance Syndicate, Inc., Delray Beach, FL  
 Milton Avenue Community Association, Inc., Baltimore, MD  
 Milton-Freewater Valley Swim Team, Milton Freewater, OR  
 Milwaukee Swish, Inc., Milwaukee, WI  
 Ministerio Economico Educativo, Chula Vista, CA  
 Minnesota Skating Scholarship, Edina, MN

Mirror Image Education Thru Drama,  
Greenwood Village, CO

Mission That Cares, Inc., Catonsville, MD

Mississippi Propane Education and  
Research Council, Jackson, MS

Molly K. Gibson Memorial Scholarship  
Fund, Inc., Franklin, IN

Monumental Redevelopment Corporation,  
Memphis, TN

Moose Mountain Alpine Sports Club,  
Inc., Fairbanks, AK

Moshannon Valley Parent Teacher  
Organization, Houtzdale, PA

Mount Jumbo West Little League,  
Missoula, MT

Mountain Do Ers, Spanaway, WA

Mountain View Residential Homes, Inc.,  
Clinton, TN

Ms Interact, Westchester, PA

MSU Ice Breakers Club, East Lansing, MI

Muhammad Development Corporation,  
Springfield, MA

Multi-Cultural Artists Organization,  
San Francisco, CA

Munuscong River Watershed Association,  
Kinross, MI

Museum of Human Rights, Union City, NJ

National Abuse Prevention Council,  
Costa Mesa, CA

National Association for Gifted Youth,  
Charlotte, NC

National Association of Farmers Market  
Nutrition Programs, Alexandria, VA

National Highway Traffic Safety  
Foundation, Inc., Englewood, FL

National Institute on Youth Camp Safety,  
Inc., Staten Island, NY

Ndu Time Inner City Youth Ministry,  
Wilmington, DE

Needham High School Parent Teacher  
Council Trust, Needham, MA

Nehemiah Group, Little Rock, AR

Neighbors Helping Neighbors Interfaith  
Volunteer Caregivers, Martinsburg, WV

Nelson Hockey Association, Inc.,  
Arnold, MD

Nevada Museum of Aviation & Military  
History, Las Vegas, NV

New Art Music International,  
Bellingham, WA

New Canaan Soccer Association,  
New Canaan, CT

New Day Faith Foundation,  
Philadelphia, PA

New Directors Charity Group, Inc.,  
Pacific Palisades, CA

New England Graduate Accounting Study  
Conference, Inc., Providence, RI

New Horizon Ministries, Inc.,  
Chandler, AZ

New Initiatives Community Development  
Corporation, Washington, DC

New Jersey Hepatitis C Coalition, Inc.,  
Toms River, NJ

New Life in Christ Ministries,  
Lanham, MD

New Mexico Alternative Transit,  
Santa Fe, NM

New River Jazz, Beckley, WV

New Rythms Foundation, Tiburon, CA

New Sudan-American Hope,  
Rochester, MN

Nguoi Viet Foundation, Westminster, CA

Nicaraguan Mission Project, Inc.,  
East Amherst, NY

Nightingale Hospice,  
Sault Sainte Marie, MI

NM Crime Stoppers Commission,  
Albuquerque, NM

Noblesville Boys & Girls Club Auxiliary,  
Inc., Noblesville, IN

Noon, Inc., New York, NY

North American Youth Sports, Gurnee, IL

North Beach Kiwanis Foundation,  
Kitty Hawk, NC

North Carolina Advance Training Center,  
High Point, NC

North East Florida Resource Conservation  
& Development Council, Live Oak, FL

North Idaho Timber and Train Interpretive  
Center, Inc., Sandpoint, ID

North Santa Barbara County Substance  
Abuse Treatment Court Alumni,  
Santa Maria, CA

Northglenn Middle School Booster Club,  
Northglenn, CO

Nu Chapter of Chi Eta Phi Sorority, Inc.,  
Miramar, FL

Nuestra Palabra Latino Care of Writers  
Having Their Say, Houston, TX

Nurturing Love, Inc., Humble, TX

Oak Grove Music Boosters, Concord, CA

Oakland Community Pools Project,  
Oakland, CA

Oakland Jazzthere Festival, Oakland, CA

Oakland Learning Center,  
Bel Tiburon, CA

Oasis Center for the Arts OTC,  
Glendale, AZ

Oklahoma Education Enhancement  
Foundation, Mustang, OK

Old Glory 2000, Irving, TX

On Solid Grounds, N. Charleston, SC

On Stage Productions, Inc.,  
Fall River, MA

One Lord One Faith Development Corp.,  
Chicago, IL

Open Classrooms Chartered A New Jersey  
Nonprofit Corporation, Baltimore, MD

Optimist Club of Chatham, Inc.,  
Siler City, NC

Orange Villa Park Girls Softball League,  
Orange, CA

Organization for Educational & Economic  
Development, Highland Park, MI

Our Kids Our Future, Kalamazoo, MI

Owens Booster Club, Inc., Athens, AL

Pacific Rim Community Foundation,  
Costa Mesa, CA

Pacific Youth Ballet, Honolulu, HI

Pacifica Sea Lions Aquatic Club, Inc.,  
Pacifica, CA

Padres De Familia for Un Futuro Mejor,  
Pacoima, CA

Pakistan Public Health Foundation, Inc.,  
Baltimore, MD

Palm Beach Panthers Hockey, Inc.,  
Wellington, FL

Panther Girls Basketball Association,  
Inc., Indianapolis, IN

Papillion Firefighters Foundation,  
Incorporated, Papillion, NE

Paramount Foundation, Bloomingdale, IL

Parent Information Network of Kentucky,  
Louisville, KY

Parents for Education, San Rafael, CA

Pasadena Lyric Opera, Inc., Pasadena, CA

Pathway Ministries, Ltd., Calais, VT

Pennsylvania Appalachian Capital  
Alliance, Pittston, PA

People Work for People, Tifton, GA

Perspective Publications, Inc.,  
Santa Fe, NM

Phillips Tutoring-Learning Center, Inc.,  
Owensboro, KY

Pillars of the Community, Inc.,  
Wallingford, PA

Pine Bush Girls Softball League, Inc.,  
Guilderland, NY

Pinellas Park Middle School Music  
Boosters, Inc., Pinellas Park, FL

Pleasant House Recovery, Inc.,  
Louisville, KY

Polar Path Communications Corporation,  
Anchorage, AK

Police Activities League of Sherwood,  
Sherwood, OR

Pompano Beach Cultural Arts Foundation,  
Inc., Pompano Beach, FL

Positive Solutions, Inc., Tuscaloosa, AL

Postsecondary Education and Technology,  
Inc., Washington, DC

Preferred Credit Management, Inc.,  
 Phoenix, AZ  
 Primary Healthcare Prevention and  
 Education Foundation for Africa,  
 Southfield, MI  
 Prisma Zona Exploration De Puerto Rico,  
 Inc., Santurce, PR  
 Project Christian Care, Flagstaff, AZ  
 Project Steamboat, Sumrall, MS  
 Project S T O R M, Inc., Evans, GA  
 Projects, Inc., Washington, DC  
 Providers Group, Inc., Milwaukee, WI  
 Q Cinema, Inc., Fort Worth, TX  
 Quad Cities Education Incentive,  
 Davenport, IA  
 Quad City Reds, Rock Island, IL  
 Queens Division Hatzolo, New York, NY  
 R. L. Alford Scholarship Foundation,  
 Conway, SC  
 Rainbows and Sunshine for Kids,  
 La Quinta, CA  
 Rainier Valley Community Development  
 Association, Seattle, WA  
 Ralph E. Noddin Home and School Club,  
 San Jose, CA  
 Ranger Foundation, Inc., Portsmouth, NH  
 Reach Community Health Foundation,  
 Inc., North Adams, MA  
 Recycle Otesgo County, Gaylord, MI  
 Reformers Ministries International, Inc.,  
 Bronx, NY  
 Rehoboth Youth Basketball, Inc.,  
 Rehoboth, MA  
 Relief Alliance, Provo, UT  
 Renaissance Corporation of Albany,  
 Albany, NY  
 Richard Burdell Memorial Foundation,  
 Portland, OR  
 Right Move Support Law Enforcement,  
 Inc., Sonora, CA  
 River of Light Enterprise, Inc.,  
 Fredericksburg, VA  
 Rochester Flute Association, Inc.,  
 Fairport, NY  
 Rockland Affordable Housing, Inc.,  
 Monsey, NY  
 Rodney Dangerfields Respect Foundation,  
 Beverly Hills, CA  
 Rose City Chamber Orchestra,  
 Portland, OR  
 Rose Education Center, Portland, OR  
 Rotary Club of Lynbrook East  
 Rockaway Charitable Foundation,  
 Inc., Lynbrook, NY  
 Round Valley Housing Management  
 Corporation, Pinon, AZ  
 Rude Mechanical Productions,  
 Okemos, MI  
 Rural Alabama Area Health Education  
 Center, Tuscaloosa, AL  
 Sacramento Southern Gospel Music,  
 Sacramento, CA  
 Sacramento Works, Inc., Sacramento, CA  
 Safe Community Coalition of Lapeer  
 County, Lapeer, MI  
 Safer-Teens, Inc., Elberton, GA  
 Safetyed International, Boulder Creek, CA  
 Sagola Fire Department Auxiliary,  
 Channing, MI  
 Sailing Development Fund, Detroit, MI  
 San Joaquin Student Athletes,  
 Stockton, CA  
 San Pedro Teen Center, San Pedro, CA  
 Sandough Komak Be Masajed Va  
 Madares, Inc., New York, NY  
 Saving Soles Foundation, Chicago, IL  
 Schererville Splash, Schererville, IN  
 Schlenker-Farmer Management  
 Association, Inc., Collingsworth, NJ  
 Scioto Ridge Parent Teacher Organization,  
 Powell, OH  
 Scottown Area Community Food &  
 Clothing Bank, Scottown, OH  
 Select F C, Libertyville, IL  
 S E N D Ministry, Whitewright, TX  
 Seniorlife of New England, Providence, RI  
 Shelter Hawaii, Honolulu, HI  
 Shenandoah County Thrift Store, Inc.,  
 Woodstock, VA  
 Shine Publications, Inc., Richmond, VA  
 Shoreline Recreational Support Services,  
 North Branford, CT  
 Silicon Valley Visual Arts, Inc.,  
 Palo Alto, CA  
 Sims' Institute, Inc., Montgomery, AL  
 Sisters Healing Sisters in the New  
 Millenium, Houston, TX  
 Sisters of Joy, Inc., Houston, TX  
 Sky High Broadcasting, Inc., El Paso, TX  
 Society for Human Kindness, Inc.,  
 Bethesda, MD  
 Socrates Opportunity Scholarship  
 Foundation, Calabasas, CA  
 Software for Seniors, Inc., Seminole, FL  
 Solutions Behavioral Health Care  
 Professionals, Moorhead, MN  
 Somerset County Cultural Arts Center,  
 Inc., Bound Brook, NJ  
 Sonny Parker Youth Foundation, Inc.,  
 Chicago, IL  
 Southeast AIDS Project, Poplar Bluff, MO  
 Southeastern Amateur Hockey  
 Association, Inc., Columbia, MD  
 Southern California Waves,  
 Santa Barbara, CA  
 Southern Tech. Apparel & Textile  
 Education Foundation, Inc., Atlanta, GA  
 Southern Wyoming Intertribal Foundation,  
 Cheyenne, WY  
 Southwest Mississippi Adult Services,  
 McComb, MS  
 Spirit of Youth Baseball, Inc.,  
 Vero Beach, FL  
 Sports and Recreation Authority, Ltd.,  
 St. Louis, MO  
 St. Bruno School Foundation,  
 Whittier, CA  
 St. Croix Valley Juniors, Stillwater, MN  
 St. Francis Xavier Home & School  
 Association, Inc., Brunswick, GA  
 Stand and be Counted, Palmdale, CA  
 Stanley Grierson Nature Foundation,  
 Bass Harbor, ME  
 Staples of Life Foundation, Dallas, TX  
 Starbase, Inc., Beaufort, SC  
 Step Into the Light Day Care Center, Inc.,  
 Memphis, TN  
 Strafford Community Betterment Team,  
 Strafford, MO  
 Stuart Wrestling Club, Palm City, FL  
 Suisun Valley Parent Club, Fairfield, CA  
 Summerdance Santa Barbara,  
 Santa Barbara, CA  
 Sun City Hoops Girls Basketball Club,  
 El Paso, TX  
 Sun Coast Resource Conservation  
 & Development Council, Inc.,  
 Live Oak, FL  
 Sunflower County Crimestoppers, Inc.,  
 Indianola, MS  
 Super Kids International, Yakima, WA  
 Suwanee Area Little Theatre, Inc.,  
 Suwanee, GA  
 Svenskarnas Dag Girls Choir, Eagan, MN  
 Synchro Saint Louis, Ballwin, MO  
 Tampa Bay Reads, Inc., Tampa, FL  
 Tate White & Smith Association for  
 Community Development, Inc.,  
 Steelton, PA  
 Tazewell County Kids Wrestling Club,  
 Pekin, IL  
 Team Fast Pitch Softball, Sarasota, FL  
 Technology R&D, Inc.,  
 San Luis Obispo, CA  
 Teen Community Forum, Inc.,  
 Dayton, MD  
 Temecula Valley Grizzlies Baseball Club,  
 Temecula, CA  
 Tender Loving Pets, Saint Charles, MO  
 Texas Israel Resource Fund, Inc.,  
 Houston, TX  
 Texas Music Hall of Fame Foundation,  
 Inc., Austin, TX

Therapeutic Art Program of Beaufort  
County, Beaufort, SC

Tikar, Inc., Temple, TX

Timestep Players Educational Childrens  
Theater, Oviedo, FL

Tom Bradley Library Foundation,  
Burbank, CA

Total Impact Center for Youth,  
Houston, TX

Touch N Tutor Research and Development  
Foundation, New York, NY

Transformation Titusville Coalition, Inc.,  
Titusville, FL

Transitional Housing Corporation of Cass  
County Indiana, Logansport, IN

Tres Dias Central Georgia, Inc.,  
Warner Robins, GA

Tri-Ad Veterans League, Dorchester, MA

Tri-City Project T.E.A.M.,  
Winston-Salem, NC

Tri County Childrens Advocacy Center,  
Lafayette, AL

Tri-Scue, Ltd., Canyon Country, CA

Tsunami on the Square, Prescott, AZ

Tucson Mormon Battalion Monument  
Foundation, Tucson, AZ

Turn in Around, Inc., Nashville, TN

Turtle Island Institute, Carlsbad, CA

Two Worlds United, Simi Valley, CA

United Fishing Association Foundation,  
Inc., Tuckahoe, NY

United Ministries, Inc., Buckeye, AZ

Unlimited Outreach, Tylertown, MS

Upper Kanawha Valley Enterprise  
Community, Inc., Cabin Creek, WV

Urban Action Engine, Inc.,  
Lake Oswego, OR

Urban Aspirations, San Francisco, CA

Urban Choice Community Development  
Corporation, Picayune, MS

Urban Intervention Community Center,  
Inc., Detroit, MI

Urban Wellness Institute, Inc.,  
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Urban Youth Outreach, Inc.,  
Wind Gap, PA

Ventura Breakers Basketball Club,  
Ventura, CA

Venture Ministries, Lake Oswego, OR

Vermont Mobile Imaging, Inc.,  
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Viet Nam E R A, O Fallon, MO

Village Hands Resource Center, Inc.,  
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Violeta Barrios De Chamorro Foundation,  
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Virginia Felder-Pipkins Care Center,  
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Virginia Storm, Inc., Chesapeake, VA

Virtual Christianity, Inc., Los Angeles, CA

Visions Plus Community Development  
Corporation, Cocoa, FL

Voice of Life World Outreach Ministries,  
Inc., Jacksonville, FL

Volunteers for Students Foundation,  
Algonquin, IL

Volunteers of Africa, Inglewood, CA

Waking the World Foundation,  
Bloomfield, MI

Warr-Women at Real Risk,  
Washington, DC

Warren-Bradley County Civic League,  
Warren, AR

Waterheart International, Inc.,  
Scottsdale, AZ

Watermark Pictures, Inc.,  
San Francisco, CA

Way to Be Educational, Inc.,  
West New York, NJ

Webb Bridge Park Community  
Playground, Inc., Alpharetta, GA

Wellington Childrens Association,  
Clinton, WA

Wesley Youth Foundation, Inc.,  
Jackson, MS

West Alabama Child Nutrition, Eutaw, AL

West Columbus Development Corp.,  
Cerro Gordo, NC

West High Alumni Athletic Assn.,  
Anchorage, AK

West Houston Dance Company,  
Houston, TX

Westbank Community Youth Association,  
Austin, TX

Western New York Soccer Association,  
Inc., Hilton, NY

Wild Heart Animal Rescue,  
Yucca Valley, CA

Wildcat Booster Club, North Bend, WA

Wireless Consumers Alliance, Inc.,  
Del Mar, CA

Wisconsin Crime Prevention Practitioners  
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Wisconsin Self Help for Hard of Hearing  
People, Minocqua, WI

Wolverine Basketball Association,  
Duluth, GA

Women in Need, Seattle, WA

Words on Dance, San Francisco, CA

World Limb Project, Fayetteville, NC

Worldstories, Inc., Oakland, CA

XLR8, Midland, TX

Youth Emergency Shelter Services, Inc.,  
Detroit, MI

Youth of the Beaches Arts Guild, Inc.,  
Jacksonville Beach, FL

Youth Rebuild, Inc., Bridgeport, CT

Youth Recreation Association of Hobe  
Sound, Inc., Hobe Sound, FL

Youth Vision, Inc., College Park, MD

Zhi-Qing Association of Southern  
California, Temple City, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

# Definition of Terms

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

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

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

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

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

and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance

of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

# Abbreviations

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

A—Individual.  
Acq.—Acquiescence.  
B—Individual.  
BE—Beneficiary.  
BK—Bank.  
B.T.A.—Board of Tax Appeals.  
C—Individual.  
C.B.—Cumulative Bulletin.  
CFR—Code of Federal Regulations.  
CI—City.  
COOP—Cooperative.  
Ct.D.—Court Decision.  
CY—County.  
D—Decedent.  
DC—Dummy Corporation.  
DE—Donee.  
Del. Order—Delegation Order.  
DISC—Domestic International Sales Corporation.  
DR—Donor.  
E—Estate.  
EE—Employee.  
E.O.—Executive Order.

ER—Employer.  
ERISA—Employee Retirement Income Security Act.  
EX—Executor.  
F—Fiduciary.  
FC—Foreign Country.  
FICA—Federal Insurance Contributions Act.  
FISC—Foreign International Sales Company.  
FPH—Foreign Personal Holding Company.  
F.R.—Federal Register.  
FUTA—Federal Unemployment Tax Act.  
FX—Foreign corporation.  
G.C.M.—Chief Counsel's Memorandum.  
GE—Grantee.  
GP—General Partner.  
GR—Grantor.  
IC—Insurance Company.  
I.R.B.—Internal Revenue Bulletin.  
LE—Lessee.  
LP—Limited Partner.  
LR—Lessor.  
M—Minor.  
Nonacq.—Nonacquiescence.  
O—Organization.  
P—Parent Corporation.  
PHC—Personal Holding Company.  
PO—Possession of the U.S.  
PR—Partner.

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

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Rev. Proc. 2004-11, 2004-3 I.R.B. 311  
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Ann. 2004-16, 2004-13 I.R.B. 668

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Rev. Proc. 2004-13, 2004-4 I.R.B. 335

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Rev. Proc. 2004-1, 2004-1 I.R.B. 1

#### 2003-2

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#### 2003-4

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Obsoleted, except as provided in section 5.02, by  
Rev. Proc. 2004-24, 2004-16 I.R.B. 790

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<sup>1</sup> A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2003–27 through 2003–52 is in Internal Revenue Bulletin 2003–52, dated December 29, 2003.



**Revenue Rulings:**

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Modified and superseded by  
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Rev. Rul. 2004-18, 2004-8 I.R.B. 509

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Rev. Proc. 2004-22, 2004-15 I.R.B. 727

**Treasury Decisions:**

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Corrected by  
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