Internal Revenue
bulletin

Bulletin No. 2007-40
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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

T.D. 9353, page 721.

Final regulations under section 1045 of the Code relate to partnerships and their partners. The regulations provide rules regarding the deferral of gain on a partnership's sale of qualified small business stock (QSB stock) and a partner's sale of QSB stock distributed by a partnership. The regulations also provide rules for a taxpayer (other than a C corporation) who sells QSB stock and purchases replacement QSB stock through a partnership. Rev. Proc. 98–48 modified.

Notice 2007–70, page 735.

This notice provides guidance to taxpayers to file all Forms 1098–C, *Contributions of Motor Vehicles, Boats, and Airplanes,* along with Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, at the Kansas City Service Center after December 31, 2007. The Internal Revenue Service Center at Ogden remains the location for Forms 1098–C filed on or before December 31, 2007. The Form 1098–C is an information form used by a donee organization to report a contribution of a qualified vehicle with a claimed value of more than $500. Notice 2006–1 modified.

Notice 2007–76, page 735.

This notice delays the effective date of Rev. Rul. 2006–57, 2006–47 I.R.B. 911. Rev. Rul. 2007–57 provides guidance to employers on the use of smartcards or other electronic media to provide qualified transportation fringes under sections 132(a)(5) and (f) of the Code. The guidance is intended to provide relief to mass transit providers that are currently finding it difficult to update their present systems in order to comply with the Rev. Rul. 2006–57 guidelines prior to the effective date. Rev. Rul. 2006–57 modified.

Notice 2007–77, page 735.

This notice provides adjusted limitations on housing expenses for tax year 2007 for purposes of section 911 of the Code.

Rev. Proc. 2007–59, page 745.

This procedure permits certain partnerships to aggregate gains and losses from an expanded class of qualified financial assets for purposes of making reverse section 704(c) allocations under regulations section 1.704–3(e)(3).

Rev. Proc. 2007–61, page 747.

This procedure provides a safe harbor under which companies taxable under Subchapter L do not have to include any portion of the increase for the taxable year in policy cash values of life insurance contracts described in section 264(f)(4)(A) of the Code (ICOLI Contracts) for purposes of applying the insurance company proration rules in sections 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5). Stakeholders are asked to comment on the need for additional guidance in this area, specifically with regard to the existence of any non-tax regulatory rules or other requirements that limit an insurance company's ability to invest in ICOLI Contracts and the effect of any experience rating, inter-insurance, reciprocal, or reinsurance arrangement on transactions involving ICOLI Contracts.

(Continued on the next page)

Actions Relating to Court Decisions is on the page following the Introduction.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

EXEMPT ORGANIZATIONS

Notice 2007–70, page 735.
This notice provides guidance to taxpayers to file all Forms 1098–C, *Contributions of Motor Vehicles, Boats, and Airplanes,* along with Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, at the Kansas City Service Center after December 31, 2007. The Internal Revenue Service Center at Ogden remains the location for Forms 1098–C filed on or before December 31, 2007. The Form 1098–C is an information form used by a donee organization to report a contribution of a qualified vehicle with a claimed value of more than $500. Notice 2006–1 modified.

Announcement 2007–82, page 749.
A list is provided of organizations now classified as private foundations.

Announcement 2007–87, page 753.
This announcement describes rules under section 509 of the Code that the Treasury Department and the IRS anticipate proposing in a notice of proposed rulemaking (REG–155929–06) regarding (1) the payout requirements for Type III supporting organizations that are not functionally integrated, and (2) the criteria for determining whether a Type III supporting organization is functionally integrated. It also addresses some additional matters regarding Type III supporting organizations in response to changes in the law made by the Pension Protection Act of 2006.

EMPLOYMENT TAX

Notice 2007–76, page 735.
This notice delays the effective date of Rev. Rul. 2006–57, 2006–47 I.R.B. 911. Rev. Rul. 2007–57 provides guidance to employers on the use of smartcards or other electronic media to provide qualified transportation fringes under sections 132(a)(5) and (f) of the Code. The guidance is intended to provide relief to mass transit providers that are currently finding it difficult to update their present systems in order to comply with the Rev. Rul. 2006–57 guidelines prior to the effective date. Rev. Rul. 2006–57 modified.

ADMINISTRATIVE

Announcement 2007–79, page 749.
This document contains corrections to proposed regulations (REG–138707–06, 2007–32 I.R.B. 342) that modify final regulations issued under sections 883(a) and (c) of the Code, relating to income derived by foreign corporations from the international operation of ships or aircraft.

Announcement 2007–83, page 752.
This document contains a correction to final and temporary regulations (T.D. 9332, 2007–32 I.R.B. 300) that relate to the exclusion from gross income derived by certain foreign corporations engaged in the international operation of ships or aircraft.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. "Nonacquiescence" signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a "nonacquiescence" indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletin are consolidated semiannually and appear in the first Bulletin for July and the Cumulative Bulletin for the first half of the year. A semiannual consolidation also appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner does NOT ACQUIESCE in the following decision:

United States v. Roxworthy,[1]
457 F.3d 590 (6th Cir. 2006),
rev'g No. 04–MC–18–C
(W.D. Ky. Apr. 4, 2005)

[1] Nonacquiescence relating to whether an accounting firm's opinion letters, issued to a company while the company's federal income tax return was being prepared, are protected by the work product doctrine.

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

Section 805.—General Deductions

A revenue procedure to provide a safe harbor under which companies taxable under Subchapter L do not have to include any portion of the increase for the taxable year in policy cash values of life insurance contracts described in section 264(f)(4)(A) ("ICOLI Contracts") for purposes of applying the insurance company proration rules in sections 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5). See Rev. Proc. 2007-61, page 747.

Section 807.—Rules for Certain Reserves

A revenue procedure to provide a safe harbor under which companies taxable under Subchapter L do not have to include any portion of the increase for the taxable year in policy cash values of life insurance contracts described in section 264(f)(4)(A) ("ICOLI Contracts") for purposes of applying the insurance company proration rules in sections 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5). See Rev. Proc. 2007-61, page 747.

Section 812.—Definition of Company's Share and Policyholders' Share

A revenue procedure to provide a safe harbor under which companies taxable under Subchapter L do not have to include any portion of the increase for the taxable year in policy cash values of life insurance contracts described in section 264(f)(4)(A) ("ICOLI Contracts") for purposes of applying the insurance company proration rules in sections 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5). See Rev. Proc. 2007-61, page 747.

Section 832.—Insurance Company Taxable Income

A revenue procedure to provide a safe harbor under which companies taxable under Subchapter L do not have to include any portion of the increase for the taxable year in policy cash values of life insurance contracts described in section 264(f)(4)(A) ("ICOLI Contracts") for purposes of applying the insurance company proration rules in sections 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5). See Rev. Proc. 2007-61, page 747.

Section 1045.—Rollover of Gain From Qualified Small Business Stock to Another Qualified Small Business Stock

26 CFR 1.1045–1: Application to partnerships.

T.D. 9353

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Section 1045 Application to Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the application of section 1045 of the Internal Revenue Code (Code) to partnerships and their partners. These regulations provide rules regarding the deferral of gain on a partnership's sale of qualified small business stock (QSB stock) and a partner's sale of QSB stock distributed by a partnership. These regulations also provide rules for a taxpayer (other than a C corporation) who sells QSB stock and purchases replacement QSB stock through a partnership. The regulations affect partnerships that invest in QSB stock and their partners.

DATES: *Effective Date:* These regulations are effective August 14, 2007.

Applicability Dates: For dates of applicability of these regulations, see §1.1045–1(j).

FOR FURTHER INFORMATION CONTACT: Jian H. Grant at (202) 622–3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1893. Responses to these collections of information are mandatory and are required to obtain a benefit. The collections of information in these final regulations are in §1.1045–1(b)(3)(ii)(C), (b)(5)(ii), and (c)(4)(ii). The information collected in §1.1045–1(b)(5)(ii) is required to ensure that gain from the sale of QSB stock by a partnership is reported correctly. The information collected in §1.1045–1(b)(3)(ii)(C) and (c)(4)(ii) will be used by the partnership and the partner to make the basis adjustments upon the sale of QSB stock and the purchase of replacement QSB stock when necessary. The likely respondents are businesses or other for-profit institutions and small businesses or organizations.

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

Estimated total annual reporting burden: 1,500 hours.

The estimated annual burden per respondent varies from 45 to 75 minutes, depending on individual circumstances, with an estimated average of 1 hour.

Estimated number of respondents: 1,500.

Estimated annual frequency of responses: On occasion.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

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

Background

This document amends 26 CFR Part 1 under section 1045 of the Code by adding §1.1045–1 regarding the application of section 1045 to partnerships and their partners.

Section 1045 permits a non-corporate taxpayer that holds QSB stock for more than six months and sells it after August 5, 1997, to elect to defer recognizing gain (other than gain treated as ordinary income) on the sale. To qualify for such deferral, the taxpayer must purchase QSB stock (replacement QSB stock) within a 60-day period beginning on the date of the sale of the QSB stock. Any gain not recognized reduces the cost basis of the replacement QSB stock. The taxpayer recognizes gain to the extent the amount realized on the sale of the QSB stock exceeds the cost basis of the replacement QSB stock. The benefits of section 1045 with respect to a sale of QSB stock by a partnership flow through to a non-corporate partner that held an interest in the partnership at all times the partnership held the QSB stock. See section 1045(b)(5) and the legislative history accompanying section 6005(f)(2) of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105–206 (112 Stat. 6005(f)(2)), July 22, 1998. In response to inquiries, the IRS issued Rev. Proc. 98–48, 1998–2 C.B. 367, which provides procedures for taxpayers (including passthrough entities and individuals holding interests in a passthrough entity) to elect to apply section 1045. Since Rev. Proc. 98–48 was published, the IRS and the Treasury Department received further inquiries regarding the application of section 1045 to partnerships and their partners. See §601.601(d)(2)(ii)(*b*) of this chapter.

On July 15, 2004, in response to those inquiries, a notice of proposed rulemaking and a notice of public hearing (REG–150562–03, 2004–2 C.B. 175) were published in the **Federal Register** (69 FR 42370) regarding the application of section 1045 to partnerships and their partners. No one requested to speak at the public hearing. Accordingly, the public hearing scheduled for November 9, 2004, was cancelled in the **Federal Register** (69 FR 62631) on October 27, 2004. Comments responding to the proposed regulations were received. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

Summary of Comments and Explanation of Revisions

1. *QSB Stock — Replacement QSB Stock Requirement*

The proposed regulations provided that the term "QSB stock" had the same meaning given such term by section 1202(c) and did not include an interest in a partnership that held QSB stock. Thus, under the proposed regulations, an investment in a partnership that held QSB stock was not treated as an investment in QSB stock. Consequently, a partner that sold an interest in a partnership that held QSB stock was not treated as selling QSB stock, and could not elect to apply section 1045 with respect to gain realized on the sale of the partnership interest. Similarly, under the proposed regulations, a partner that made a section 1045 election with respect to QSB stock sold by the partnership could not treat as replacement QSB stock an interest in a second partnership that held QSB stock.

Commentators agreed that an interest in a partnership that owns QSB stock should not be treated as an investment in QSB stock. Some commentators, however, argued that the final regulations should permit a partner that makes a section 1045 election with respect to QSB stock sold by one partnership to satisfy the replacement QSB stock requirement of section 1045 by holding an interest in a partnership, which acquires QSB stock within the statutory period. Commentators believed that the suggested rule is consistent with the intent of Congress to encourage investments in QSB stock.

The final regulations adopt this comment. A taxpayer (other than a C corporation) that sells QSB stock and elects to apply section 1045 may satisfy the replacement QSB stock requirement with QSB stock that is purchased within the statutory period by a partnership in which the taxpayer is a partner on the date the QSB stock is purchased (purchasing partnership). In addition, the final regulations provide that an eligible partner of a partnership that sells QSB stock (selling partnership) and elects to apply section 1045 may satisfy the replacement QSB stock requirement with QSB stock purchased by a purchasing partnership during the statutory period. The IRS and the Treasury Department believe that these rules are appropriate because they are consistent with the underlying continuous economic interest requirement of section 1045. Although the final regulations permit the replacement QSB stock requirement to be satisfied in this manner, for the reasons stated, a partner that sells its interest in the purchasing partnership is not treated as selling replacement QSB stock.

The final regulations contain rules for calculating a partner's distributive share of partnership gain that is not recognized as a result of an election under section 1045 by the partner. These rules are necessary for determining how much gain a partner can defer upon a sale of QSB stock under section 1045. These rules address instances in which the eligible partner continues to defer gain under section 1045 from a prior sale or sales of QSB stock.

2. *Basis Adjustments*

The proposed regulations provided rules regarding adjustments to an eligible partner's basis in a partnership interest and a partnership's basis in replacement QSB stock. One rule required a partnership to make a basis adjustment to the partnership's replacement QSB stock by the amount of gain from the partnership's sale of QSB stock that is deferred by an eligible partner, the effect of which is determined under the principles of §1.743–1(g), (h), and (j). Under this rule, the basis adjustments constitute an adjustment to the basis of the partnership's replacement QSB stock with respect to that eligible partner only. To allow the partnership to make the appropriate basis adjustments, the proposed regulations required any partner that must recognize all or a part of the partner's distributive share of partnership section 1045 gain to notify the partnership of the amount of the partnership section 1045 gain that was recognized.

One commentator argued that many partnerships that invest in QSB stock are thinly staffed, and that they would incur additional administrative expenses to comply with the notification and basis adjustment requirements. Therefore, the commentator suggested that the partner

make the basis adjustments with respect to the partnership's replacement QSB stock, unless the partnership makes an election to make the basis adjustments.

The IRS and the Treasury Department believe that, if the partnership makes an election under section 1045 and purchases replacement QSB stock, the partnership is the proper party to make the appropriate basis adjustments with respect to that stock. Accordingly, this comment is not adopted. As noted below, a partnership is not required to maintain these basis adjustments for eligible partners that separately make the election under section 1045. The final regulations also clarify that if a partnership makes an election under section 1045, the partnership must attach a statement to the partnership return for the taxable year in which the partnership purchases replacement QSB stock setting forth the computation of the adjustment, the replacement QSB stock to which the adjustment has been made, the date(s) on which such stock was acquired by the partnership, and each partner's distributive share of deferred partnership section 1045 gain.

If a taxpayer or an eligible partner makes an election under section 1045 and treats its interest in QSB stock purchased by a purchasing partnership as its replacement QSB stock, the final regulations provide specific rules for the determination of the partner's basis in the replacement QSB stock and interest in the purchasing partnership. In these cases, the partner's adjusted basis in the partnership interest is reduced by the partner's gain that is deferred under section 1045, and the electing partner must reduce its share of the partnership's adjusted basis of the replacement QSB stock by the amount of gain deferred. When the basis reduction results from a partner-level election, the final regulations require the partner, rather than the partnership, to retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment has been made, and the date(s) on which such stock was acquired by the purchasing partnership.

3. *Gain Recognition Upon Certain Distributions*

The final regulations provide rules requiring a partner to recognize gain upon a distribution of replacement QSB stock to another partner that reduces the partner's share of the replacement QSB stock held by a partnership. The amount of gain that the partner must recognize is determined based on the amount of gain that the partner would have recognized upon a sale of the distributed replacement QSB stock for its fair market value on the date of the distribution (not to exceed the amount of gain previously deferred by the partner with respect to the distributed replacement QSB stock). Any gain recognized by a partner whose interest is reduced must be taken into account in determining the adjusted basis of the partner's interest in the partnership and also taken into account in determining the partnership's adjusted basis in the QSB stock distributed to another partner under §1.1045–1(e)(4). These rules apply in the case of a partner election or a partnership election under section 1045.

4. *Nonrecognition Limitation*

The proposed regulations provided that the amount of gain that an eligible partner may defer under section 1045 may not exceed: (A) the partner's smallest percentage interest in the partnership's income, gain, or loss with respect to the QSB stock that was sold, multiplied by (B) the partnership's realized gain from the sale of such stock. This nonrecognition rule follows section 1202(g)(2) and (3) by ensuring that the partner can defer recognition of only the gain that relates to the partner's continuous economic interest in the QSB stock that was sold.

Commentators agreed with the underlying "continuous ownership" requirement in the proposed regulations, but raised concerns that the nonrecognition limitation rule may be difficult to administer when a partnership does not have a simple "*pro rata*" partnership arrangement. One commentator suggested that the nonrecognition limitation rule only apply in certain situations.

The IRS and the Treasury Department continue to believe that a nonrecognition limitation rule is consistent with section 1045 and the underlying continuous economic interest requirement in section 1202(g)(2) and (3). The continuous economic interest requirement as applied under section 1202(c)(1)(B) requires that QSB stock must be acquired by the taxpayer at its original issuance in exchange for money or other property or as compensation for services provided to such corporation. Taxpayers that invest through a partnership acquire the requisite interest for purposes of the continuous economic interest requirement by an investment of capital in the partnership. Accordingly, to address the commentator's concerns, the nonrecognition rule has been modified to provide that the amount of gain that an eligible partner may defer under section 1045 may not exceed: (A) the partner's smallest percentage interest in partnership capital from the time the QSB stock is acquired until the time the QSB stock is sold, multiplied by (B) the partnership's realized gain from the sale of such stock. The IRS and the Treasury Department believe that this nonrecognition rule in the final regulations will be easier to administer, is consistent with each partner's economic interest in the partnership, and will not inappropriately limit the amount of gain that can be deferred.

5. *Opt Out of Partnership Election by Partner*

The proposed regulations allowed an eligible partner to make a section 1045 election with respect to all or part of the partner's share of gain from the partnership's sale of QSB stock only if the partnership did not make a section 1045 election, or the partnership did make a section 1045 election, but failed to purchase any (or enough) replacement QSB stock within the statutory time period. If a partnership elected to apply section 1045 and purchased replacement QSB stock, all eligible partners of the partnership were required to defer their distributive shares of the partnership section 1045 gain. One commentator suggested that an eligible partner should be allowed to opt out of a partnership section 1045 election and either purchase separate replacement QSB stock directly, and elect to apply section 1045 at the partner level, or recognize the partner's distributive share of the partnership section 1045 gain. The IRS and the Treasury Department believe that allowing a partner to opt out of a partnership section 1045 election is consistent with providing the intended and desired flexibility for investments in QSB stock. Accordingly, this comment is

adopted. The final regulations provide that a partner that elects out of a partnership's section 1045 election must notify the partnership in writing. If an eligible partner opts out of a partnership section 1045 election, such action does not constitute a revocation of the partnership section 1045 election and the partnership section 1045 election continues to apply to the other partners.

The final regulations do not impose a deadline for when a partner must notify the partnership that the partner is opting out of a partnership section 1045 election. The IRS and the Treasury Department believe partnerships are responsible for obtaining the required information to report gain properly, and that the partnership agreement should require that partners supply this notice to the partnership in a timely manner.

6. *Tiered-partnership Rules*

Under the proposed regulations, only an eligible partner was entitled to defer gain under section 1045. The proposed regulations provided special rules for determining whether a partner was an eligible partner if a partnership (upper-tier partnership) held an interest in a partnership (lower-tier partnership) that held QSB stock. The proposed regulations disregarded the upper-tier partnership's ownership of the lower-tier partnership and treated each partner of the upper-tier partnership as owning an interest in the lower-tier partnership directly. The preamble to the proposed regulations explained that, although this rule provided a simple approach, it limited the availability of section 1045 in situations involving tiered partnerships. The IRS and the Treasury Department requested comments specifically on the application of section 1045 in tiered-partnership situations.

Commentators suggested that an upper-tier partnership should be an "eligible partner" of a lower-tier partnership and allowed to make an election to defer gain under section 1045 with respect to the distributive share of the gain from the lower-tier partnership's sale of QSB stock. After careful consideration, the IRS and the Treasury Department have concluded that treating an upper-tier partnership as an "eligible partner" of a lower-tier partnership would create an unacceptable administrative burden and increased complexity to the rules. Therefore, the final regulations retain the rule in the proposed regulations relating to tiered-partnership structures. The final regulations, however, clarify that the rule does not preclude a partner in an upper-tier partnership from treating its interest in QSB stock that was purchased by either the upper-tier partnership or a lower-tier partnership as replacement QSB stock. The final regulations contain an example illustrating this rule.

7. *Disregarded Entity Rules*

One commentator suggested that the final regulations set forth rules that are specific to disregarded entities. It has been determined that this suggestion is beyond the scope of the regulations and, therefore, is not included in the final regulations.

8. *Election Procedures and Reporting Rules*

The proposed regulations provided that a partnership making a section 1045 election must do so on the partnership's timely filed return (including extensions) for the taxable year during which the partnership sells the QSB stock. The proposed regulations also provided that a partner making an election under section 1045 with respect to its distributive share of gain on the partnership's sale of QSB stock must do so on the partner's timely filed Federal income tax return (including extensions) for the taxable year in which such gain is taken into account. The final regulations retain these rules. However, in both cases, the proposed regulations stated that the electing partnership or partner also must follow the procedures of Rev. Proc. 98–48. In contrast, the final regulations provide that a partnership making an election under section 1045 or a partner making an election under section 1045 must do so in accordance with the applicable forms and instructions. It is anticipated that the applicable forms and instructions will be revised to take into account the rules in the final regulations.

Effective/Applicability Date

The final regulations apply to sales of QSB stock on or after August 14, 2007.

Effect on Other Documents

Rev. Proc. 98–48, 1998–2 C.B. 367, is modified to include the following sentence at the end of the PURPOSE section: "This revenue procedure does not apply in situations described in §1.1045–1 of the Income Tax regulations." See §601.601(d)(2)(ii)(*b*) of this chapter.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that QSB stock is not held by a substantial number of small entities and that the time required to make the election is estimated to average 1 hour. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Jian H. Grant, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

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

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

Par. 2. Section 1.1045–1 is added to read as follows:

§1.1045–1 Application to partnerships.

(a) *Overview of section.* A partnership that holds qualified small business stock (QSB stock) (as defined in paragraph (g)(1) of this section) for more than 6 months, sells such QSB stock, and purchases replacement QSB stock (as defined in paragraph (g)(2) of this section) may elect to apply section 1045. An eligible partner (as defined in paragraph (g)(3) of this section) of a partnership that sells QSB stock, may elect to apply section 1045 if the eligible partner purchases replacement QSB stock directly or through a purchasing partnership (as defined in paragraph (c)(1)(i) of this section). A taxpayer (other than a C corporation) that holds QSB stock for more than 6 months, sells such QSB stock and purchases replacement QSB stock through a purchasing partnership may elect to apply section 1045. A section 1045 election is revocable only with the prior written consent of the Commissioner. To obtain the Commissioner's prior written consent, the person who made the section 1045 election must submit a request for a private letter ruling. (For further guidance, see Rev. Proc. 2007–1, 2007–1 C.B. 1 (or any applicable successor) and §601.601(d)(2)(ii)(*b*) of this chapter.) Paragraph (b) of this section provides rules for partnerships that elect to apply section 1045. Paragraph (c) of this section provides rules for certain taxpayers other than C corporations and for eligible partners that elect to apply section 1045. Paragraph (d) of this section provides a limitation on the amount of gain that an eligible partner does not recognize under section 1045. Paragraph (e) of this section provides rules for partnership distributions of QSB stock to an eligible partner. Paragraph (f) of this section provides rules for contributions of QSB stock or replacement QSB stock to a partnership. Paragraph (g) of this section provides definitions of certain terms used in section 1045 and this section. Paragraph (h) of this section provides reporting rules for partnerships and partners that elect to apply section 1045. Paragraph (i) of this section provides examples illustrating the provisions of this section. Paragraph (j) of this section contains the effective date.

(b) *Partnership election*—(1) *Partnership purchase of replacement QSB stock.* A partnership that holds QSB stock for more than 6 months, sells such QSB stock, and purchases replacement QSB stock may elect in accordance with paragraph (h) of this section to apply section 1045. If the partnership elects to apply section 1045, then, subject to the provisions of paragraphs (b)(4) and (d) of this section, each eligible partner shall not recognize its distributive share of any partnership section 1045 gain (as determined under paragraph (b)(2) of this section). For this purpose, partnership section 1045 gain equals the partnership's gain from the sale of the QSB stock reduced by the greater of—

(i) The amount of the gain from the sale of the QSB stock that is treated as ordinary income; or

(ii) The excess of the amount realized by the partnership on the sale over the total cost of all replacement QSB stock purchased by the partnership (excluding the cost of any replacement QSB stock purchased by the partnership that is otherwise taken into account under section 1045).

(2) *Partner's distributive share of partnership section 1045 gain.* A partner's distributive share of partnership section 1045 gain shall be in the same proportion as the partner's distributive share of the partnership's gain from the sale of the QSB stock. For this purpose, the partnership's gain from the sale of QSB stock and the partner's distributive share of that gain are determined without regard to basis adjustments under section 743(b) and paragraph (b)(3)(ii) of this section.

(3) *Basis adjustments*—(i) *Partner's interest in a partnership.* The adjusted basis of an eligible partner's interest in a partnership shall not be increased under section 705(a)(1) by gain from a partnership's sale of QSB stock that is not recognized by the partner as the result of a partnership election under paragraph (b)(1) of this section.

(ii) *Partnership's replacement QSB stock*—(A) *Rule.* The basis of a partnership's replacement QSB stock is reduced (in the order acquired) by the amount of gain from the partnership's sale of QSB stock that is not recognized by an eligible partner as a result of the partnership's election under section 1045. The basis adjustment with respect to any amount described in this paragraph (b)(3)(ii) constitutes an adjustment to the basis of the partnership's replacement QSB stock with respect to that partner only. The effect of such a basis adjustment is determined under the principles of §1.743–1(g), (h), and (j) except as modified in this paragraph (b)(3)(ii)(A). If a partnership sells QSB stock with respect to which a basis adjustment has been made under this paragraph (b)(3)(ii), and the partnership makes an election under paragraph (b)(1) of this section with respect to the sale and purchases replacement QSB stock, the basis adjustment shall carry over to the replacement QSB stock except to the extent otherwise provided in this paragraph (b)(3)(ii). The basis adjustment that carries over to the replacement QSB stock shall be reduced (but not below zero) by the eligible partner's distributive share of the excess, if any, of the greater of the amount determined under paragraph (b)(1)(i) or (ii) of this section from the sale of the QSB stock, over the partnership's gain from the sale of the QSB stock (determined without regard to basis adjustments under section 743 or paragraph (b)(3)(ii) of this section). The excess amount that reduces the basis adjustment shall be accounted for as gain in accordance with §1.743–1(j)(3). See *Example 5* of paragraph (i) of this section. For purposes of this paragraph (b)(3)(ii), a partnership must presume that a partner did not recognize that partner's distributive share of the partnership section 1045 gain as a result of the partnership's section 1045 election unless the partner notifies the partnership to the contrary as described in paragraph (b)(5)(ii) of this section. However, if a partnership knows that a particular partner is classified, for Federal tax purposes, as a C corporation, then the partnership may presume that the partner did not defer recognition of its distributive share of the partnership section 1045 gain, even in the absence of a notification by the partner. If a partnership makes an election under section 1045, but an eligible partner opts out of the election under paragraph (b)(4) of this section and provides to the partnership the notification required under paragraph (b)(5)(ii) of this section, no basis adjustments under this paragraph (b)(3)(ii) are required with respect to that partner as a result of the section 1045 election by the partnership.

(B) *Tiered-partnership rule.* If a partnership (upper-tier partnership) holds an interest in another partnership (lower-tier partnership) that makes an election under section 1045, the portion of the lower-tier

partnership's basis adjustment as provided in paragraph (b)(3)(ii)(A) of this section in the replacement QSB stock must be segregated and allocated to the upper-tier partnership and any eligible partner as defined in paragraph (g)(3)(iii) of this section. Similarly, that portion of the basis of the upper-tier partnership's interest in the lower-tier partnership attributable to the basis adjustment as provided in paragraph (b)(3)(ii)(A) of this section in the lower-tier partnership's replacement QSB stock must be segregated and allocated solely to any eligible partner as defined in paragraph (g)(2)(iii) of this section.

(C) *Statement of adjustments*. A partnership that must adjust the basis of replacement QSB stock under this paragraph (b) must attach a statement to the partnership return for the taxable year in which the partnership purchases replacement QSB stock setting forth the computation of the adjustment, the replacement QSB stock to which the adjustment has been made, the date(s) on which such QSB stock was acquired by the partnership, and the amount of the adjustment that is allocated to each partner.

(4) *Eligible partners may opt out of partnership's section 1045 election*. An eligible partner may opt out of the partnership's section 1045 election with respect to QSB stock either by recognizing the partner's distributive share of the partnership section 1045 gain, or by making a partner section 1045 election under paragraph (c) of this section with respect to the partner's distributive share of the partnership section 1045 gain. See paragraph (b)(5)(ii) of this section for applicable notification requirements. Opting out of a partnership's section 1045 election under this paragraph (b)(4) does not constitute a revocation of the partnership's election, and such election shall continue to apply to other partners of the partnership.

(5) *Notice requirements*—(i) *Partnership notification to partners*. A partnership that makes an election under paragraph (b)(1) of this section must notify all of its partners of the election and the purchase of replacement QSB stock, in accordance with the applicable forms and instructions, and separately state each partner's distributive share of partnership section 1045 gain from the sale of QSB stock under section 702. Each partner shall determine whether the partner is an eligible partner within the meaning of paragraph (g)(3) of this section and report the partner's distributive share of partnership section 1045 gain from the partnership's sale of QSB stock, including gain not recognized, in accordance with the applicable forms and instructions.

(ii) *Partner notification to partnership*. Any partner that must recognize all or part of the partner's distributive share of partnership section 1045 gain must notify the partnership, in writing, of the amount of partnership section 1045 gain that is recognized by the partner. Similarly, an eligible partner that opts out of a partnership's section 1045 election under paragraph (b)(4) of this section must notify the partnership, in writing, that the partner is opting out of the partnership's section 1045 election.

(c) *Partner election*—(1) *In general*—(i) *Rule*. An eligible partner of a partnership that sells QSB stock (selling partnership) may elect in accordance with paragraph (h) of this section to apply section 1045 if replacement QSB stock is purchased by the eligible partner. An eligible partner of a selling partnership may elect in accordance with paragraph (h) of this section to apply section 1045 if replacement QSB stock is purchased by a partnership in which the taxpayer is a partner (directly or through an upper-tier partnership) on the date on which the partnership acquires the replacement QSB stock (purchasing partnership). A taxpayer other that a C corporation that sells QSB stock held for more than 6 months at the time of the sale may elect in accordance with paragraph (h) of this section to apply section 1045 if replacement QSB stock is purchased by a purchasing partnership (including a selling partnership).

(ii) *Partner purchase of replacement QSB stock*. Subject to paragraph (d) of this section, an eligible partner of a selling partnership that elects to apply section 1045 with respect to the eligible partner's purchase of replacement QSB stock must recognize its distributive share of gain from the sale of QSB stock by the selling partnership only to the extent of the greater of—

(A) The amount of the eligible partner's distributive share of the selling partnership's gain from the sale of the QSB stock that is treated as ordinary income; or

(B) The excess of the eligible partner's share of the selling partnership's amount realized (as determined under paragraph (c)(2) of this section) on the sale by the selling partnership of the QSB stock (excluding the cost of any replacement QSB stock purchased by the selling partnership) over the cost of any replacement QSB stock purchased by the eligible partner (excluding the cost of any replacement QSB stock that is otherwise taken into account under section 1045).

(iii) *Partnership purchase of replacement QSB stock*—(A) *Partner of a selling partnership*. Subject to paragraph (d) of this section, an eligible partner that treats its interest in QSB stock purchased by a purchasing partnership as a purchase of replacement QSB stock by the eligible partner and that elects to apply section 1045 with respect to such purchase must recognize its total gain (the eligible partner's distributive share of gain from the selling partnership's sale of QSB stock and any gain taken into account under paragraph (c)(5) of this section from the sale of replacement QSB stock) only to the extent of the greater of—

(*1*) The amount of the eligible partner's distributive share of the selling partnership's gain from the sale of the QSB stock that is treated as ordinary income; or

(*2*) The excess of the eligible partner's share of the selling partnership's amount realized (as determined under paragraph (c)(2) of this section) on the sale by the selling partnership of the QSB stock (excluding the cost of any replacement QSB stock purchased by the selling partnership) over the eligible partner's share of the purchasing partnership's cost of the replacement QSB stock, as determined under paragraph (c)(3) of this section (excluding the cost of any QSB stock that is otherwise taken into account under section 1045).

(B) *Taxpayer other than a C corporation*. Subject to paragraph (d) of this section, a taxpayer other than a C corporation that treats its interest in QSB stock purchased by a purchasing partnership with respect to which the taxpayer is a partner as a purchase of replacement QSB stock by the taxpayer must recognize its gain from the sale of the QSB stock only to the extent of the greater of—

(*1*) The amount of gain from the sale of the QSB stock that is treated as ordinary income; or

(*2*) The excess of the amount realized by the taxpayer on the sale of the QSB stock over the partner's share of the purchasing partnership's cost of the replacement QSB stock, as determined under paragraph (c)(3) of this section (excluding the cost of any QSB stock that is otherwise taken into account under section 1045).

(2) *Eligible partner's share of amount realized by partnership*—(i)—*General rule*. The eligible partner's share of the amount realized by the selling partnership is the amount realized by the partnership on the sale of the QSB stock (excluding the cost of any replacement QSB stock otherwise taken into account under section 1045) multiplied by the following fraction—

(A) The numerator of which is the eligible partner's distributive share of the partnership's realized gain from the sale of the QSB stock; and

(B) The denominator of which is the partnership's realized gain on the sale of the QSB stock.

(ii) *General rule modified for determining eligible partner's share of amount realized by purchasing partnership upon a sale of replacement QSB stock in certain situations*—(A) *No gain realized or loss realized on sale of replacement QSB stock*. If a purchasing partnership does not realize a gain or realizes a loss from the sale of replacement QSB stock for which an election under this section was made for purposes of applying paragraph (c)(1)(iii)(A) of this section, the eligible partner's share of the amount realized is—

(*1*) The greater of—

(*i*) The amount determined in paragraph (c)(2)(i) of this section from a prior sale of QSB stock (that is not otherwise taken into account under paragraph (c)(2) of this section) in which the eligible partner had a distributive share of gain allocated to the eligible partner that was not recognized under paragraph (c)(1)(iii)(A) of this section; or

(*ii*) The amount realized by a taxpayer other than a C corporation from a prior sale of QSB stock (that is not otherwise taken into account under paragraph (c)(2) of this section) in which the taxpayer realized gain that was not recognized under paragraph (c)(1)(iii)(B) of this section; less

(*2*) The eligible partner's distributive share of any loss recognized on the sale of replacement QSB stock, if applicable.

(B) *Eligible partner's interest in purchasing partnership is reduced and gain realized on sale of replacement QSB stock*. If an eligible partner's interest in a purchasing partnership is reduced subsequent to the sale of QSB stock and the purchasing partnership realizes a gain from the sale of the replacement QSB stock, the eligible partner's share of the amount realized upon a sale of replacement QSB stock must be determined under paragraph (c)(2)(i) of this section based on the distributive share of the partnership's realized gain that would have been allocated to the eligible partner if the eligible partner's interest in the partnership had not been reduced.

(iii) *Eligible partner's share of the amount realized*. For purposes of determining the eligible partner's share of the amount realized by the partnership, the partnership's realized gain from the sale of QSB stock and the eligible partner's distributive share of that gain are determined without regard to basis adjustments under section 743(b) and paragraphs (b)(3)(ii) and (c) of this section.

(3) *Partner's share of the cost of QSB stock purchased by a purchasing partnership*. The partner's share of the cost (adjusted basis) of replacement QSB stock purchased by a purchasing partnership is the percentage of the partnership's future income and gain, if any, that is reasonably expected to be allocated to the partner (determined without regard to any adjustment under section 1045) with respect to the replacement QSB stock that was purchased by the partnership, multiplied by the cost of that replacement QSB stock. The assumptions made by a partnership in determining the reasonably expected allocation of income and gain must be consistent for each partner. For example, a partnership may not treat the same item of income or gain as being reasonably expected to be allocated to more than one partner.

(4) *Basis adjustments*—(i) *Eligible partner's interest in selling partnership*. Under section 705(a)(1), the adjusted basis of an eligible partner's interest in a selling partnership that sells QSB stock is increased by the partner's distributive share of gain without regard to paragraph (c)(1) of this section. However, if the selling partnership is also a purchasing partnership, the adjusted basis of an eligible partner's interest in a partnership that sells QSB stock may be reduced under paragraph (c)(4)(iii) of this section.

(ii) *Replacement QSB stock*. A partner's basis in any replacement QSB stock that is purchased by the partner, as well as the adjusted basis of any replacement QSB stock that is purchased by a purchasing partnership and that is treated as the partner's replacement QSB stock must be reduced (in the order replacement QSB stock is acquired by the partner and purchasing partnership, as applicable) by the partner's distributive share of the gain on the sale of the selling partnership's QSB stock that is not recognized by the partner under paragraph (c)(1) of this section, or by the gain on a sale of QSB stock by the partner that is not recognized by the partner under section 1045, as applicable. If replacement QSB stock is purchased by the purchasing partnership, the purchasing partnership shall maintain its adjusted basis in the replacement QSB stock without regard to any basis adjustments required by this paragraph (c)(4)(ii). The eligible partner, however, shall in computing its distributive share of income, gain, loss and deduction from the purchasing partnership with respect to the replacement QSB stock take into account the variation between the adjusted basis in the QSB stock as determined under this paragraph (c)(4)(ii) and the adjusted basis determined without regard to this paragraph (c)(4)(ii). A partner must retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment has been made, and the date(s) on which such stock was acquired. See *Examples 7* and *8* of paragraph (i) of this section.

(iii) *Partner's basis in purchasing partnership interest*. A partner that treats the partner's interest in QSB stock purchased by a purchasing partnership as the partner's replacement QSB stock must reduce (in the order replacement QSB stock is acquired) the adjusted basis of the partner's interest in the purchasing partnership by the partner's distributive share of the gain on the sale of the selling partnership's QSB stock that is not recognized by the partner pursuant to paragraph (c)(1) of this section, or by the gain on a sale of QSB stock

by the partner that is not recognized by the partner under section 1045, as applicable. Similarly, a partner of an upper-tier partnership that treats the partner's interest in QSB stock purchased by a lower-tier purchasing partnership as the partner's replacement QSB stock must reduce (in the order replacement QSB stock is acquired) the adjusted basis of the partner's interest in the upper-tier partnership by the partner's distributive share of the gain on the sale of the selling partnership's QSB stock that is not recognized by the partner pursuant to paragraph (c)(1) of this section, or by the gain on a sale of QSB stock by the partner that is not recognized by the partner under section 1045, as applicable.

(iv) *Increase in basis on sale of QSB stock by purchasing partnership*. A partner that recognizes gain under paragraph (c)(5) of this section must increase the adjusted basis of the partner's interest in the purchasing partnership under section 705(a)(1) by the amount of the gain recognized by that partner. Similarly, a partner in an upper-tier partnership that recognizes gain under paragraph (c)(5) of this section must increase the adjusted basis of the partner's interest in the upper-tier partnership under section 705(a)(1) by the amount of the gain recognized by that partner.

(5) *Partner recognition of gain*. At the time that either the partner or the purchasing partnership (whichever applies) sells or exchanges replacement QSB stock, the amount recognized by the partner is determined by taking into account the basis adjustments described in paragraph (c)(4)(ii) of this section. Similarly, a partner of an upper-tier partnership that owns an interest in a lower-tier partnership that holds replacement QSB stock must take into account the basis adjustments described in paragraph (c)(4)(ii) of this section in determining the amount recognized by the partner on a sale of the interest in the lower-tier partnership by the upper-tier partnership or the partner's distributive share of gain from the upper-tier partnership. See paragraph (e)(4) of this section for rules applicable to certain distributions of replacement QSB stock.

(d) *Nonrecognition limitation*—(1) *In general*. For purposes of this section, the amount of gain that an eligible partner does not recognize under paragraphs (b)(1) and (c)(1) of this section cannot exceed the nonrecognition limitation. Except as otherwise provided in paragraph (d)(2) of this section, the nonrecognition limitation is equal to the product of—

(i) The partnership's realized gain from the sale of the QSB stock, determined without regard to any basis adjustment under section 734(b) or section 743(b) (other than basis adjustments described in paragraph (b)(3)(ii) of this section); and

(ii) The eligible partner's smallest percentage interest in partnership capital as determined in paragraph (d)(2) of this section. See *Example 9* of paragraph (i) of this section.

(2) *Eligible partner's smallest percentage interest in partnership capital*. An eligible partner's smallest percentage interest in partnership capital is the eligible partner's percentage share of capital determined at the time of the acquisition of the QSB stock as adjusted prior to the time the QSB stock is sold to reflect any reduction in the capital of the eligible partner including a reduction as a result of a disproportionate capital contribution by other partners, a disproportionate capital distribution to the eligible partner or the transfer of an interest by the eligible partner, but excluding income and loss allocations.

(3) *Special rule for tiered partnerships*. For purposes of paragraph (d)(1)(ii) of this section, if an eligible partner is treated as owning an interest in a lower-tier purchasing partnership through an upper-tier partnership, the eligible partner's percentage interest in the purchasing partnership shall be proportionately adjusted to reflect the eligible partner's percentage interest in the upper-tier partnership.

(e) *Partnership distribution of QSB stock to a partner*—(1) *In general*. Subject to paragraphs (e)(2) and (3) of this section, in the case of a partnership distribution of QSB stock to a partner, the partner shall be treated for purposes of this section as—

(i) Having acquired such stock in the same manner as the partnership; and

(ii) Having held such stock during any continuous period immediately preceding the distribution during which it was held by the partnership. See *Examples 10* and *11* of paragraph (i) of this section.

(2) *Eligibility under section 1202(c)*. Paragraph (e)(1) of this section does not apply unless all eligibility requirements with respect to QSB stock as defined in section 1202(c) are met by the distributing partnership with respect to its investment in QSB stock.

(3) *Distribution nonrecognition limitation*—(i) *Generally*. The amount of gain that an eligible partner does not recognize under this section on the sale of QSB stock that was distributed by the partnership to the partner cannot exceed the distribution nonrecognition limitation. For this purpose, the distribution nonrecognition limitation is—

(A) The partner's section 1045 amount realized (determined under paragraph (e)(3)(ii) of this section); reduced by

(B) The partner's section 1045 adjusted basis (determined under paragraph (e)(3)(iii) of this section).

(ii) *Section 1045 amount realized*—(A) *QSB stock received in liquidation of partner's interest and in certain nonliquidating distributions*. If a partner receives QSB stock from the partnership in a distribution in liquidation of the partner's interest in the partnership or as part of a series of related distributions by the partnership in which the partnership distributes all of the partnership's QSB stock of a particular type, then the partner's section 1045 amount realized is the partner's amount realized from the sale of the distributed QSB stock, multiplied by a fraction—

(*1*) The numerator of which is the partner's smallest percentage interest in partnership capital determined under paragraph (e)(3)(ii)(B) of this section; and

(*2*) The denominator of which is the partner's percentage interest in that type of QSB stock immediately after the distribution (determined under paragraph (e)(3)(iv) of this section).

(B) *Partner's smallest percentage interest in partnership capital*. A partner's smallest percentage interest in partnership capital is the partner's percentage share of capital determined at the time of the acquisition of the QSB stock as adjusted prior to the time the QSB stock is distributed to the partner to reflect any reduction in the capital of the partner including a reduction as a result of a disproportionate capital contribution by other partners, a disproportionate capital distribution to the partner, or the transfer of a capital interest by the partner, but excluding income and loss allocations.

(C) *QSB stock received in other distributions*. If a partner receives QSB stock in a distribution from the partnership that is not described in paragraph (e)(3)(ii)(A)

of this section, the partner's section 1045 amount realized is the partner's amount realized from the sale of the distributed QSB stock multiplied by the partner's smallest percentage interest in partnership capital determined under paragraph (e)(3)(ii)(B) of this section.

(iii) *Section 1045 adjusted basis*—(A) *QSB stock received in liquidation of partner's interest and in certain nonliquidating distributions*. If a partner receives QSB stock from the partnership in a distribution in liquidation of the partner's interest in the partnership or as part of a series of related distributions by the partnership in which the partnership distributes all of the partnership's QSB stock of a particular type, then the partner's section 1045 adjusted basis is the product of—

(*1*) The partnership's basis in all of the QSB stock of the type distributed (without regard to basis adjustments under section 734(b) or section 743(b), other than basis adjustments described in paragraphs (b)(3)(ii) and (c)(4)(ii) of this section);

(*2*) The partner's smallest percentage interest in partnership capital determined under paragraph (e)(3)(ii)(B) of this section; and

(*3*) The proportion of the distributed QSB stock that was sold by the partner.

(B) *QSB stock received in other distributions*. If a partner receives QSB stock in a distribution from the partnership that is not described in paragraph (e)(3)(iii)(A) of this section, the partner's section 1045 adjusted basis is the product of—

(*1*) The partnership's basis in the QSB stock sold by the partner (without regard to basis adjustments under section 734(b) or section 743(b), other than basis adjustments described in paragraphs (b)(3)(ii) and (c)(4)(ii) of this section); and

(*2*) The partner's smallest percentage interest in partnership capital determined under paragraph (e)(3)(ii)(B) of this section.

(iv) *Partner's percentage interest in distributed QSB stock*. For purposes of this paragraph (e)(3), a partner's percentage interest in a type of QSB stock immediately after a partnership distribution is the value (as of the date of the distribution) of the QSB stock distributed to the partner divided by the value (as of the date of the distribution) of all of that type of QSB stock that was acquired by the partnership.

(v) *QSB stock of the same type*. For purposes of this paragraph (e)(3), QSB stock will be of the same type as the distributed QSB stock if it has the same issuer and the same rights and preferences as the distributed QSB stock and was acquired by the partnership at original issue.

(4) *Distribution of replacement QSB stock to a partner that reduces another partner's interest in the replacement QSB stock*. For purposes of this section, a partner must recognize gain upon a distribution of replacement QSB stock to another partner that reduces the partner's share of the replacement QSB stock held by a partnership. The amount of gain that the partner must recognize is determined based on the amount of gain that the partner would recognize upon a sale of the distributed replacement QSB stock for its fair market value on the date of the distribution but not to exceed the amount that was previously not recognized by the partner under section 1045 with respect to the distributed replacement QSB stock. Any gain recognized by a partner whose interest is reduced must be taken into account in determining the adjusted basis of the partner's interest in the partnership and also taken into account in determining the partnership's adjusted basis in the QSB stock distributed to another partner under paragraph (e)(3) of this section.

(f) *Contribution of QSB stock or replacement QSB stock to a partnership*. Section 721 applies to a contribution of QSB stock to a partnership. Except as provided in section 721(b), any gain that was not recognized by the taxpayer under section 1045 is not recognized when the taxpayer contributes QSB stock to a partnership in exchange for a partnership interest. Stock that is contributed to a partnership is not QSB stock in the hands of the partnership. See *Example 12* of paragraph (i) of this section.

(g) *Definitions.* For purposes of section 1045 and this section, the following terms are defined as follows:

(1) *Qualified small business stock*. The term *qualified small business stock* (QSB stock) has the meaning provided in section 1202(c). The term "QSB stock" does not include an interest in a partnership that purchases or holds QSB stock. See *Example 1* of paragraph (i) of this section.

(2) *Replacement QSB stock*. The term *replacement QSB stock* is any QSB stock purchased within 60 days beginning on the date of a sale of QSB stock.

(3) *Eligible partner*—(i) *In general*. Except as provided in paragraphs (e)(1), (g)(3)(ii), (iii) and (iv) of this section, an eligible partner with respect to QSB stock is a taxpayer other than a C corporation that holds an interest in a partnership on the date the partnership acquires the QSB stock and at all times thereafter for more than 6 months until the partnership sells or distributes the QSB stock.

(ii) *Acquisition by gift or at death*. For purposes of paragraph (g)(3)(i) of this section, a taxpayer who acquires from a partner (other than a C corporation) by gift or at death an interest in a partnership that holds QSB stock is treated as having held the acquired interest in the partnership during the period the partner (other than a C corporation) held the interest in the partnership.

(iii) *Tiered partnership*. For purposes of paragraph (g)(3)(i) of this section, if a partnership (upper-tier partnership) holds an interest in another partnership (lower-tier partnership) that holds QSB stock, then the upper-tier partnership's ownership of the lower-tier partnership is disregarded and each partner of the upper-tier partnership is treated as owning the interest in the lower-tier partnership directly. The partner of the upper-tier partnership is treated as owning the interest in the lower-tier partnership during the period in which both—

(A) The partner of the upper-tier partnership held an interest in the upper-tier partnership; and

(B) The upper-tier partnership held an interest in the lower-tier partnership. See *Examples 3* and *4* of paragraph (i) of this section.

(iv) *Multiple tiers of partnerships*. Principles similar to those described in paragraph (g)(3)(iii) of this section apply where a taxpayer holds an interest in a lower-tier partnership through multiple tiers of partnerships.

(4) *Month(s)*. For purposes of this section, the term *month(s)* means a period commencing on the same numerical day of any calendar month as the day on which the QSB stock is sold and ending with the close of the day preceding the numerically corresponding day of the succeeding calendar month or, if there is no corresponding day, with the last day of the succeeding calendar month.

(h) *Reporting and election rules*—(1) *Time and manner of making election*. A partnership making an election under section 1045 (as described under paragraph (b)(1) of this section) must do so on the partnership's timely filed (including extensions) Federal income tax return for the taxable year during which the sale of QSB stock occurs. A partner making an election under section 1045 (as described under paragraph (c)(1) of this section) must do so on the partner's timely filed (including extensions) Federal income tax return for the taxable year during which the partner's distributive share of the partnership's gain from the sale of the QSB stock is taken into account by such partner under section 706. In addition, a partnership or partner making an election under section 1045 must make such election in accordance with the applicable forms and instructions.

(2) *Purchases, distributions, and sales of QSB stock or replacement QSB stock by partnerships*. A partnership that purchases, distributes to a partner, or sells or exchanges QSB stock or replacement QSB stock must provide information to the Commissioner and to the partnership's partners to the extent provided by the applicable forms and instructions.

(3) *Nonrecognition of gain by eligible partners*. An eligible partner that does not recognize gain under section 1045 must provide information to the Commissioner to the extent provided by the applicable forms and instructions.

(i) *Examples*. The provisions of this section are illustrated by the following examples:

Example 1. Sale of a partnership interest. On January 1, 2008, A, an individual, X, a C corporation, and Y, a C corporation, form PRS, a partnership. A, X, and Y each contribute $250 to PRS and agree to share all partnership items equally. PRS purchases QSB stock for $750 on February 1, 2008. On November 4, 2008, A sells A's interest in PRS for $500, realizing $250 of capital gain. Under paragraph (g)(1) of this section, an interest in a partnership that holds QSB stock is not treated as QSB stock. Therefore, the sale of an interest in a partnership that holds QSB stock is not treated as a sale of QSB stock, and A may not elect to apply section 1045 with respect to A's $250 gain from the sale of A's interest in PRS.

Example 2. Election by partner; replacement by partnership. (i) Assume the same facts as in *Example 1*, except that A does not sell A's interest in PRS. Instead, PRS sells the QSB stock (QSB1 stock) for $1,500 on November 3, 2008. PRS realizes $750 of gain from the sale of the QSB1 stock (none of which is treated as ordinary income) and allocates $250 of gain to each of A, X, and Y. PRS does not make a section 1045 election. On November 30, 2008, A contributes $500 to ABC, a partnership, in exchange for a 10 percent interest in ABC. ABC then purchases QSB stock (QSB2 stock) for $5,000 on December 1, 2008. ABC has no other assets. A makes an election under paragraph (c)(1) of this section and treats A's percentage interest in ABC's QSB2 stock as replacement QSB stock under paragraph (c)(1)(iii) of this section with respect to the $250 gain PRS allocated to A. Under paragraph (c)(3) of this section, A's share of the cost of QSB2 stock purchased by ABC is $500 (A's reasonably expected income and gain with respect to QSB2 stock, or 10 percent multiplied by the cost of the QSB2 stock, $5,000). Under paragraph (c)(1)(iii) of this section, A will not recognize the $250 gain PRS allocated to A, because A's share of the amount realized by PRS, $500 (the total amount realized by the partnership on the sale of the QSB1 stock ($1,500) multiplied by A's share of the gain from the sale of the QSB1 stock ($250) over the total gain realized by the partnership on the sale of the QSB1 stock ($750)), does not exceed A's share of ABC's cost of the QSB2 stock acquired by ABC, $500. Under paragraph (c)(4)(ii) of this section, A must reduce A's share of ABC's basis in the QSB2 stock by $250. Under paragraph (c)(4)(iii) of this section, A must reduce A's basis in A's interest in ABC by $250. Under paragraph (c)(4)(i) of this section, A's basis in A's interest in PRS is increased by $250.

(ii) Assume the same facts as in paragraph (i) of this *Example 2*, except that A does not contribute $500 to ABC in exchange for a partnership interest. Instead, on November 30, 2008, EFG, a partnership in which A has an existing 10 percent partnership interest, purchases QSB stock for $5,000. Under paragraph (c)(1) of this section, A may treat A's 10 percent interest in EFG's QSB stock as replacement QSB stock with respect to the $250 of gain PRS allocated to A.

(iii) Assume the same facts as in paragraph (i) of this *Example 2*, except that ABC owns QSB stock that ABC purchased on November 10, 2008, and ABC does not purchase QSB stock on December 1, 2008. Under paragraph (c)(1) of this section, ABC is not a purchasing partnership with respect to A for the QSB stock ABC purchased on November 10, 2008. A may not treat A's percentage interest in ABC's QSB stock as replacement QSB stock to defer the $250 gain PRS allocated to A, because A acquired its interest in ABC after ABC acquired the QSB stock.

(iv) Assume the same facts as in paragraph (i) of this *Example 2*, except that ABC sells QSB2 stock on July 30, 2009, for $5,000. ABC realizes no gain or loss on the sale of QSB2 stock. A desires to continue to rollover the $250 gain from the sale of QSB1 stock. Under paragraph (c)(2)(ii)(A) of this section, A's share of the amount realized is $500, which was A's share of the amount realized on the prior sale of QSB1 stock. Accordingly, A must elect to apply section 1045 and purchase $500 of replacement QSB stock either directly or through a purchasing partnership to continue to defer the $250 gain from the sale of QSB1 stock.

Example 3. Tiered partnerships; partnership election. (i) On January 1, 2008, A, an individual, and B, an individual, each contribute $500 to UTP, (upper-tier partnership) for equal partnership interests. On February 1, 2008, UTP and C, an individual, each contribute $1,000 to LTP, (lower-tier partnership) for equal partnership interests. On March 1, 2008, LTP purchases QSB stock for $500. On April 1, 2008, D, an individual, joins UTP by contributing $500 to UTP for a 1/3 interest in UTP. On December 1, 2008, LTP sells the QSB stock for $2000. Under paragraph (g)(3)(iii) of this section, A, B, and D are treated as owning an interest in LTP during the period in which each of the partners held an interest in UTP and UTP held an interest in LTP. Therefore, under paragraphs (g)(3)(i) and (iii) of this section, A and B are eligible partners, and D and UTP are not eligible partners with respect to the QSB stock sold by LTP. Under paragraph (g)(3)(i) of this section, C is also an eligible partner with respect to the QSB stock sold by LTP.

(ii) Assume the same facts as in paragraph (i) of this *Example 3*. LTP realizes a gain of $1,500 on the December 1, 2008, sale of QSB stock. LTP allocates $750 of gain to each of UTP and C. UTP, in turn, allocates $250 (of the $750 of gain allocated to UTP) to each of A, B, and D. LTP makes a section 1045 election. On January 1, 2009, LTP purchases replacement QSB stock for $2,000. Under paragraph (b)(5)(ii) of this section, D notifies UTP that it recognizes $250 of gain and UTP notifies LTP. Because A, B, and C are eligible partners with respect to the QSB stock sold by LTP, A and B may each defer $250 of LTP's section 1045 gain and C may defer $750 of LTP's section 1045 gain. LTP must decrease its basis in the replacement QSB stock by the $750 of partnership section 1045 gain that was allocated to C and by $500 of the partnership section 1045 gain that was allocated to UTP. These basis reductions are with respect to UTP (A and B) and C only. Under paragraph (b)(3)(ii)(B) of this section, the basis of UTP's interest in LTP attributable to the LTP's replacement QSB stock must be segregated and allocated to A and B. In addition, A and B each have a $250 negative basis adjustment in their respective interests in UTP. If UTP sells its interest in LTP for $1,250, A and B would each recognize $250 of gain from the sale of the LTP interest. D would not recognize any gain or loss from the sale.

Example 4. Tiered partnerships; partner election. (i) On January 1, 2008, A, an individual, and X, a C corporation, form UTP, a partnership. A and X each contribute $250 to UTP and agree to share all partnership items equally. Also, on January 1, 2008, UTP and Y, a C corporation, form LTP, a partnership. UTP and Y contribute $500 and $250, respectively, to LTP. UTP and Y agree to share all partnership items equally. LTP purchases QSB stock for $750 on February 1, 2008. On November 3, 2008, LTP sells the QSB stock for $1,500. LTP realizes $750 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $250 gain to Y and $500 gain to UTP. Of the $500 gain allocated to UTP from the sale of QSB stock, $250 is allocated to A and $250 is allocated to X. LTP purchases replacement QSB stock (replacement QSB1 stock) for $1,350 on December 15, 2008. LTP does not make an election under section 1045. Under the rules provided in paragraph (c) of this section, A makes an election under section 1045 on its timely filed return for the taxable year for which the distributive share of gain from the sale of QSB stock is taken into account by A under section 706. Under paragraph (c)(1)(iii) of this section, A treats A's interest in replacement QSB1 stock as replacement stock with respect to A's

distributive share of LTP's section 1045 gain. On March 30, 2009, LTP sells replacement QSB1 stock for $1,650. LTP realizes $300 of gain from the sale of replacement QSB1 stock (none of which is treated as ordinary income) and allocates $100 to Y and $200 to UTP.

(ii) Under paragraph (c)(1)(iii) of this section, A must recognize its distributive share of gain from LTP's sale of QSB stock ($250) only to the extent of the greater of A's distributive share of LTP's gain from the sale of QSB stock that is treated as ordinary income ($0) or the amount by which A's share of the amount realized by LTP's sale of QSB stock exceeds A's share of LTP's cost of the replacement QSB1 stock, $50 (1/3rd of $1,500, or $500, minus 1/3rd of $1,350, or $450). Because Y is not an eligible partner of LTP under paragraph (g)(3) of this section, Y must recognize its $250 distributive share of partnership gain from the sale of the QSB stock. Also, X is not an eligible partner under paragraph (g)(3) of this section, and it must recognize its $250 distributive share of gain from UTP attributable to UTP's distributive share of $500 of LTP's gain from the sale of QSB stock.

(iii) Under section 705(a)(1), the adjusted basis of Y's interest in LTP is increased by $250, and the adjusted basis of UTP's interest in LTP is increased by $500. Under section 705(a)(1), the adjusted basis of X's interest in UTP is increased by $250, and the adjusted basis of A's interest in UTP is increased by $250. However, under paragraph (c)(4)(iii) of this section, the adjusted basis of A's interest in UTP is reduced by the $200 of partnership section 1045 gain that was not recognized by A.

(iv) Under paragraph (c)(4)(ii) of this section, the LTP's adjusted basis in replacement QSB1 stock is reduced by the $200 of gain from the sale of QSB stock that is not recognized by A, as a result of A's election under section 1045. A must retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment is made, and dates the stock was acquired. LTP's adjusted basis in the replacement QSB1 stock is maintained without regard to the eligible partner's adjustment provided in paragraph (c)(4)(ii) of this section.

(v) On the sale of replacement QSB1 stock, LTP realizes a gain of $300, $100 of which is allocated to Y and $200 of which is allocated to UTP. UTP allocates $100 of this gain to A. Under paragraph (c)(5) of this section, in determining A's amount recognized upon the sale of replacement QSB1 stock by LTP, A must take into account A's basis adjustment of $200. Accordingly, A recognizes a total gain of $300 upon the sale of replacement QSB1 stock, absent an additional section 1045 election by A or LTP. Under paragraph (c)(4)(iv) of this section, the adjusted basis of A's interest in UTP is increased by $300 under section 705(a)(1).

(vi) Assume the same facts as in paragraph (i) of this *Example 4*, except that UTP sells its entire interest in LTP on March 30, 2009, for $1,200. UTP realizes a gain of $200 on the sale of its interest in LTP ($1,200 amount realized less $1,000 adjusted basis) and allocates $100 of this gain to A. Under paragraph (c)(5) of this section, in determining A's amount recognized upon the sale of UTP's interest in LTP, A must take into account A's basis adjustment of $200. Accordingly, A recognizes a total gain of $300 upon the sale of the interest in LTP. Under paragraph (c)(4)(iv) of this section, the adjusted basis in A's interest in UTP is increased by $300 under section 705(a)(1).

Example 5. Partnership sale of QSB stock and purchase and sale of replacement QSB stock. (i) On January 1, 2008, A, an individual, X, a C corporation, and Y, a C corporation, form PRS, a partnership. A, X, and Y each contribute $250 to PRS and agree to share all partnership items equally. PRS purchases QSB stock for $750 on February 1, 2008. On November 3, 2008, PRS sells the QSB stock for $1,500. PRS realizes $750 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $250 of gain to each of A, X, and Y. PRS purchases replacement QSB stock (replacement QSB1 stock) for $1,350 on December 15, 2008. On its timely filed return for the taxable year during which the sale of the QSB stock occurs, PRS makes an election to apply section 1045. A does not make an election to apply section 1045 with respect to the November 3, 2008, sale of QSB stock. PRS knows that X and Y are C corporations. On March 30, 2009, PRS sells replacement QSB1 stock for $1,650. PRS realizes $300 of gain from the sale of replacement QSB1 stock (none of which is treated as ordinary income) and allocates $100 of gain to each of A, X, and Y. A does not make an election to apply section 1045 with respect to the March 30, 2009, sale of replacement QSB1 stock.

(ii) Under paragraph (b)(1) of this section, the partnership section 1045 gain from the November 3, 2008, sale of QSB stock is $600 ($750 gain less $150 ($1,500 amount realized on the sale of QSB stock less $1,350 cost of replacement QSB1 stock)). This amount must be allocated among the partners in the same proportions as the entire gain from the sale of QSB stock is allocated to the partners, 1/3 ($200) to A, 1/3 ($200) to X, and 1/3 ($200) to Y.

(iii) Because neither X nor Y is an eligible partner under paragraph (g)(3) of this section, X and Y must each recognize its $250 distributive share of partnership gain from the sale of QSB stock. Because A is an eligible partner under paragraph (g)(3) of this section, A may defer recognition of A's $200 distributive share of partnership section 1045 gain. A is not required to separately elect to apply section 1045. A must recognize A's remaining $50 distributive share of the partnership's gain from the sale of QSB stock.

(iv) Under section 705(a)(1), the adjusted bases of X's and Y's interests in PRS are each increased by $250. Under section 705(a)(1) and paragraph (b)(3)(i) of this section, the adjusted basis of A's interest in PRS is not increased by the $200 of partnership section 1045 gain that was not recognized by A, but is increased by A's remaining $50 distributive share of gain.

(v) PRS must decrease its basis in the replacement QSB1 stock by the $200 of partnership section 1045 gain that was allocated to A. This basis reduction is a reduction with respect to A only. PRS then adjusts A's distributive share of gain from the sale of replacement QSB1 stock to reflect the effect of A's basis adjustment under paragraph (b)(3)(ii) of this section. In accordance with the principles of §1.743–1(j)(3), the amount of A's gain from the March 30, 2009, sale of replacement QSB1 stock in which A has a $200 negative basis adjustment equals $300 (A's share of PRS's gain from the sale of replacement QSB1 stock ($100), increased by the amount of A's negative basis adjustment for replacement QSB1 stock ($200)). Accordingly, upon the sale of replacement QSB1 stock, A recognizes $300 of gain, and X and Y each recognize $100 of gain.

(vi) Assume the same facts as in paragraph (i) of this *Example 5*, except that PRS purchases replacement QSB stock (replacement QSB2 stock) on April 15, 2009, for $1,150 and PRS makes an election to apply section 1045 with respect to the March 30, 2009, sale of replacement QSB1 stock. Under paragraph (b)(3)(ii)(A) of this section, PRS' $200 basis adjustment in QSB1 stock relating to the November 3, 2008, sale of QSB stock carries over to the basis adjustment for QSB2 stock. This basis adjustment is an adjustment with respect to A only. The $200 basis adjustment is reduced by A's distributive share of the excess of $500 (the greater of the amount determined under paragraph (b)(1)(i), $0, or (ii) of this section, $500 ($1,650 amount realized on the sale of QSB1 stock less $1,150 cost of replacement QSB2 stock)) over $300 (PRS' gain from the sale of QSB1 stock), or $67 ($200 ($500 minus $300) divided by 3). Under paragraph (b)(3)(ii)(A), A must account for the $67 excess amount that reduces PRS' basis adjustment in QSB2 stock as gain in accordance with §1.743–1(j)(3). Therefore, A now has a $133 negative basis adjustment with respect to replacement QSB2 stock (($200) negative basis adjustment from the November 3, 2008, sale of QSB stock plus $67 positive basis adjustment from the March 30, 2009, sale of QSB1 stock). A also recognizes the $100 of gain allocated by PRS to A from the March 30, 2009, sale of replacement QSB1 stock for total gain recognition of $167 ($100 plus $67).

Example 6. Partnership sale of QSB stock; election by eligible partner; replacement QSB stock purchased by purchasing partnership. (i) Assume the same facts as in *Example 5* except that PRS does not make an election under section 1045 with respect to the sale of either the QSB stock on November 3, 2008, or the QSB1 stock on March 30, 2009. However, A makes an election under section 1045 with respect to the sale of QSB stock and treats the purchase of QSB1 stock on December 15, 2008, by PRS, as the purchase of replacement QSB stock. Additionally, A makes an election under section 1045 with respect to the sale of QSB1 stock and treats the purchase of QSB2 stock on April 15, 2009, by PRS, as the purchase of replacement QSB stock.

(ii) A's distributive share of gain from the November 3, 2008, sale of QSB stock is $250 (A's 1/3 interest in $750 of total PRS gain). Under paragraph (c)(1)(iii) of this section, A must recognize only $50 of A's distributive share of PRS' gain of $250, that is the excess of A's share of the amount realized on the sale of QSB stock, or $500 (the total amount realized by PRS on the sale of QSB stock ($1,500) multiplied by A's share of the gain from the sale of QSB stock ($250) over the total gain realized by PRS on the sale of QSB stock ($750)), minus A's share of PRS' cost of QSB1 stock, or $450 (1/3 of $1,350). Under section 705(a)(1) and paragraph (c)(4)(i) of this section, A's adjusted basis in its interest in PRS is increased by $250. However, under paragraph (c)(4)(iii) of this section, because PRS is a purchasing partnership, A's adjusted basis of its interest in PRS is then reduced by the deferred gain of $200. Also under paragraph (c)(4)(ii) of this section, PRS' adjusted basis in QSB1 stock is reduced by the gain not recognized of $200

and A must take into account such adjusted basis in computing A's income, gain, loss or deduction with respect to QSB1 stock. A must retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment is made, and dates the stock was acquired.

(iii) A's distributive share of gain from the March 30, 2009, sale of QSB1 stock is $100 (A's 1/3 interest in $300 of total PRS gain) and under paragraph (c)(5) of this section, A must take into account A's $200 basis adjustment with respect to the QSB1 stock that was sold. Accordingly, A's total gain from the sale of QSB1 stock is $300. Under paragraph (c)(1)(iii) of this section, A must recognize only $167 of A's total gain of $300, that is, the excess of A's share of the amount realized on the sale of QSB1 stock, or $550 (the total amount realized by PRS on the sale of QSB1 stock ($1,650) multiplied by A's share of the gain from the sale of QSB1 stock ($100) over the total gain realized by PRS on the sale of QSB1 stock ($300)) minus A's share of PRS' cost of QSB2 stock, or $383 (1/3 of $1,150). Under section 705(a)(1), A's adjusted basis in A's interest in PRS is increased by A's $100 distributive share of gain from the sale of QSB1 stock. Under paragraph (c)(4)(iv) of this section, A's adjusted basis of A's interest in PRS is increased by the additional $67 of gain recognized under paragraph (c)(5) of this section. Also, under paragraph (c)(4)(ii) of this section, PRS' adjusted basis in QSB2 stock is reduced by the gain not recognized of $133 ($300 minus $167) and A must take into account such adjusted basis in computing A's income, gain, loss or deduction with respect to QSB2 stock. A must retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment is made, and dates the stock was acquired.

Example 7. Partnership sale of QSB stock and partner purchase of replacement QSB stock. (i) Assume the same facts as in paragraph (i) of *Example 5*, except that PRS does not make an election under section 1045 with respect to the sale of the QSB stock and does not purchase replacement QSB stock. On November 30, 2008, A, an eligible partner under paragraph (g)(3) of this section, purchases replacement QSB stock for $500. A elects pursuant to paragraph (c) of this section to apply section 1045 on A's timely filed return for the taxable year that A is required to include A's distributive share of PRS' gain from the sale of the QSB stock.

(ii) Under paragraph (c)(2) of this section, A's share of the amount realized from PRS' sale of the QSB stock is $500 (the total amount realized by the partnership on the sale of the QSB stock ($1,500) multiplied by A's share of the gain from the sale of the QSB stock ($250) over the total gain realized by the partnership on the sale of the QSB stock ($750)). Because A purchased, within 60 days of PRS' sale of the QSB stock, replacement QSB stock for a cost equal to A's share of the partnership's amount realized on the sale of the QSB stock, and because A made an election pursuant to paragraph (c) of this section to apply section 1045, A defers recognition of A's $250 distributive share of gain from PRS' sale of the QSB stock. Under section 705(a)(1) and paragraph (c)(4)(i) of this section, the adjusted basis of A's interest in PRS is increased by $250. Under paragraph (c)(4)(ii) of this section, A's adjusted basis in the replacement QSB stock is $250 ($500 cost minus $250 nonrecognition amount).

Example 8. Partial replacement by partnership; partial replacement by partner. (i) On January 1, 2008, A, an individual, and X, a C corporation, form PRS, a partnership. A and X each contribute $500 to PRS and agree to share all partnership items equally. PRS purchases QSB stock on February 1, 2008, for $1,000 and subsequently sells the QSB stock on January 31, 2010, for $3,000. PRS realizes $2,000 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $1,000 of gain to each of A and X. On February 10, 2010, PRS purchases replacement QSB stock for $2,200. On March 20, 2010, A purchases replacement QSB stock for $400. PRS makes an election to apply section 1045 under paragraph (b)(1) of this section with respect to the partnership section 1045 gain from the sale of QSB stock and A does not opt out of PRS' section 1045 election under paragraph (b)(4) of this section. Also, A makes an election under paragraph (c)(1) of this section with respect to the remaining gain from the sale of the QSB stock.

(ii) Under paragraph (b)(1) of this section, partnership section 1045 gain is $1,200 ($2,000 less $800 ($3,000 amount realized on the sale of the QSB stock minus $2,200 cost of the replacement QSB stock)). This amount is allocated among the partners in the same proportions as the entire gain from the sale of the QSB stock is allocated to the partners, 1/2 to A ($600), and 1/2 to X ($600). Because A is an eligible partner, A defers recognition of A's $600 distributive share of partnership section 1045 gain.

(iii) A also made an election under section 1045 and purchased, within 60 days of PRS' sale of the QSB stock, replacement QSB stock for $400. Therefore, under paragraph (c)(1) of this section, A may defer a portion of A's distributive share of the remaining gain from the partnership's sale of the QSB stock. A must recognize that remaining gain to the extent that A's share of the amount realized by PRS on the sale of the QSB stock (excluding the cost of the QSB stock that was replaced by PRS) exceeds the cost of the replacement QSB stock purchased by A during the 60-day period following the sale of the QSB stock. The amount realized by PRS on the sale of the QSB stock (excluding the cost of the QSB stock that was replaced by PRS) is $800 ($3,000 minus $2,200). Under paragraph (c)(2) of this section, A's share of that amount realized is $400 ($1,000 (A's share of the realized gain from the sale of the QSB stock) / $2,000 (PRS total realized gain from the sale of the QSB stock) multiplied by $800). Because the replacement QSB stock purchased by A cost $400, A defers recognition of all of the remaining gain from the sale of the QSB stock.

(iv) The adjusted basis of A's interest in PRS is not increased by the $600 gain that was not recognized pursuant to paragraph (b)(1) of this section, but is increased by the $400 gain that was not recognized pursuant to paragraph (c)(1) of this section. See paragraphs (b)(3)(i) and (c)(4)(i) of this section. PRS must decrease its basis in the replacement QSB stock by the $600 of partnership section 1045 gain that was allocated to A. See paragraph (b)(3)(ii) of this section. A must decrease A's basis in the replacement QSB stock purchased by A by the $400 not recognized pursuant to paragraph (c)(1) of this section. See paragraph (c)(4)(ii) of this section.

Example 9. Change in partner's interest in partnership while partnership holds QSB stock. (i) On January 1, 2008, A, an individual, and X, a C corporation, form PRS, a partnership. A and X each contribute $500 to PRS and agree to share all partnership items equally. PRS purchases QSB stock on February 1, 2008, for $1,000. On August 2, 2008, A sells a 25 percent interest in PRS to Z. On July 10, 2009, A repurchases the 25 percent interest from Z for $500. PRS makes a timely election under section 754 for the 2008 taxable year. Under section 743(b), A has a positive basis adjustment of $250. On January 31, 2011, PRS sells the QSB stock for $3,000. PRS realizes $2,000 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $1,000 of gain to each of A and X. On February 10, 2010, PRS purchases replacement QSB stock for $3,000. PRS makes an election to apply section 1045 under paragraph (b)(1) of this section with respect to the partnership section 1045 gain from the sale of QSB stock.

(ii) Of the $2,000 of realized gain from the sale of the QSB stock, PRS allocates $1,000 to A and $1,000 to X. However, A has a positive basis adjustment of $250 under section 743(b) as a result of the purchase of the 25 percent interest in PRS from Z; therefore, A's share of the gain is reduced to $750. Because A is an eligible partner under paragraph (g)(3) of this section, A may defer recognition of A's distributive share of gain from the sale of the QSB stock subject to the nonrecognition limitation described in paragraph (d) of this section. The smallest percentage interest that A held in PRS capital during the time that PRS held the QSB stock is 25 percent. Under the nonrecognition limitation, A may not defer more than 25 percent of the partnership gain realized from the sale of the QSB stock (determined without regard to any basis adjustment under section 734(b) or section 743(b), other than a basis adjustment described in paragraph (b)(3)(ii) of this section). Because the partnership's realized gain determined without regard to A's basis adjustment under section 743(b) is $2,000, A may defer recognition of $500 (25 percent of $2,000) of the gain from the sale of the QSB stock. A must recognize the remaining $250 of that gain.

Example 10. Sale by partner of QSB stock received in a liquidating distribution. (i) On January 1, 2008, A, an individual, and X, a C corporation, form PRS, a partnership. A and X each contribute $1,500 to PRS and agree to share all partnership items equally. PRS purchases QSB stock on February 1, 2008, for $3,000. On May 1, 2008, when the QSB stock has appreciated in value to $4,000, A contributes $1,000 to PRS, increasing A's interest in PRS capital to 60 percent. On June 1, 2011, when the QSB stock is still worth $4,000, PRS makes a liquidating distribution of $3,000 worth of QSB stock to A. Under section 732, A's basis in the distributed QSB stock is $2,500. A sells the QSB stock on August 4, 2011, for $6,000, realizing a gain of $3,500 (none of which is treated as ordinary income). A purchases replacement QSB stock on August 30, 2011, for $5,500, and makes an election under section 1045 with respect to the August 4, 2011, sale of QSB stock.

(ii) A is an eligible partner under paragraph (g)(3) of this section. Therefore, under paragraph (e)(1) of this section, A is treated as having acquired the distributed QSB stock in the same manner as PRS and as

having held the QSB stock since February 1, 2008, its original issue date. Because A purchased, within 60 days of A's sale of the QSB stock, replacement QSB stock, A is eligible to defer a portion of A's gain from the sale of the QSB stock. A must recognize gain, however, to the extent that A's amount realized on the sale of the QSB stock, $6,000, exceeds the cost of the replacement QSB stock purchased by A during the 60-day period beginning on the date of the sale of the QSB stock, $5,500. Accordingly, A must recognize $500 of the gain from the sale of the QSB stock. A defers recognition of the remaining $3,000 of gain to the extent that such gain does not exceed the distribution nonrecognition limitation under paragraph (e)(3) of this section.

(iii) Under paragraph (e)(3)(i) of this section, A's nonrecognition limitation with respect to the sale of the QSB stock is A's section 1045 amount realized with respect to the stock, reduced by A's section 1045 adjusted basis with respect to the stock. A's amount realized from the sale is the product of A's amount realized from the sale, $6,000; and a fraction—

(*1*) The numerator of which is A's smallest percentage interest in PRS capital with respect to such stock, 50 percent; and

(*2*) The denominator of which is A's percentage interest in that type of partnership QSB stock immediately after the distribution, 75 percent (the value of the stock distributed to A, $3,000, divided by the value of all QSB stock of that type acquired by PRS, $4,000).

(iv) Therefore, A's section 1045 amount realized is $4,000 ($6,000 multiplied by 50/75). Because PRS distributed the QSB stock to A in liquidation of A's interest in PRS, A's section 1045 adjusted basis is the product of PRS' basis in all of the QSB stock of the type distributed, $3,000; A's smallest percentage interest in PRS capital with respect to QSB stock of the type distributed, 50 percent; and the percentage of the distributed QSB stock that was sold by A, 100 percent. Therefore, A's section 1045 adjusted basis is $1,500 (the product of $3,000, 50 percent, and 100 percent)) and A's nonrecognition limitation amount on the sale of the QSB stock is $2,500 ($4,000 section 1045 amount realized minus $1,500 section 1045 adjusted basis). Accordingly, A defers recognition of $2,500 of the remaining $3,000 gain from the sale of the QSB stock and must recognize $500 of the remaining $3,000 gain. Accordingly, A's total gain recognized from the sale of the QSB stock is $1,000.

(v) A's basis in the replacement QSB stock is $3,000 (cost of the replacement QSB stock, $5,500, reduced by the gain not recognized under section 1045, $2,500).

Example 11. Sale by partner of QSB stock received in a nonliquidating distribution. (i) The facts are the same as in *Example 10*, except that, on June 1, 2011, PRS distributes only $2,000 of the QSB stock to A, reducing A's interest in PRS capital from 60 percent to 33 percent. PRS' basis in the distributed QSB stock is $1,500. On November 1, 2011, A sells for $2,500 the QSB stock distributed by PRS to A and purchases, within 60 days of the date of sale of the QSB stock, replacement QSB stock for $2,500. A makes a timely election to apply section 1045 with respect to A's sale of the distributed QSB stock.

(ii) Under section 732, A's basis in the distributed QSB stock is $1,500. Therefore, A realizes a gain on the sale of the distributed QSB stock of $1,000. Because A made an election to apply section 1045 to the sale, and because A purchased, within 60 days of A's sale of the QSB stock, replacement QSB stock at a cost equal to the amount realized on the sale of the distributed QSB stock, A defers recognition of the gain from the sale of the QSB stock to the extent that such gain does not exceed the distribution nonrecognition limitation.

(iii) Under paragraph (e)(3) of this section, the nonrecognition limitation with respect to A's sale of the QSB stock is A's section 1045 amount realized reduced by A's section 1045 adjusted basis. Because PRS did not distribute all of the particular type of QSB stock and the distribution of the QSB stock to A was not in liquidation of A's interest in PRS, under paragraph (e)(3)(ii)(C) of this section A's section 1045 amount realized is $1,250 (A's amount realized from the sale of the distributed QSB stock, $2,500, multiplied by A's smallest percentage interest in PRS capital with respect to such stock, 50 percent). Under paragraph (e)(3)(iii)(B) of this section, A's section 1045 adjusted basis is the product of the partnership's basis in the QSB stock sold by the partner, $1,500, and A's smallest percentage interest in the partnership capital with respect to such stock, 50 percent. Therefore, A's section 1045 adjusted basis is $750 (50 percent of $1,500), and A's nonrecognition limitation amount on the sale of the QSB stock is $500 ($1,250 section 1045 amount realized minus $750 section 1045 adjusted basis). As this amount is less than the amount of gain that A is eligible to defer under section 1045, $1,000, A defers recognition of only $500 of the gain from the sale of the QSB stock. A must recognize the remaining $500 of that gain.

(iv) A's basis in the replacement QSB stock is $2,000 (cost of the replacement QSB stock, $2,500, reduced by the gain not recognized under section 1045, $500).

Example 12. Contribution of replacement QSB stock to a partnership. (i) On January 1, 2008, A, an individual, B, an individual, and X, a C corporation, form PRS, a partnership. A, B, and X each contribute $250 to PRS and agree to share all partnership items equally. On February 1, 2008, PRS purchases QSB stock for $750. PRS sells the QSB stock on November 3, 2008, for $1,050. PRS realizes $300 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $100 of gain to each of its partners. PRS informs the partners that it does not intend to make an election under section 1045 with respect to the sale of the QSB stock. Each partner's share of the amount realized from the sale of the QSB stock is $350. On November 30, 2008, A, an eligible partner within the meaning of paragraph (g)(3) of this section, purchases replacement QSB stock for $350 and makes a section 1045 election under paragraph (c)(1) of this section. Subsequently, A transfers the replacement QSB stock to ABC, a partnership, in exchange for an interest in ABC.

(ii) Because A purchased within 60 days of PRS's sale of the QSB stock, replacement QSB stock for a cost equal to A's share of the partnership's amount realized on the sale of the QSB stock, and because A made a valid election to apply section 1045 with respect to A's share of the gain from PRS's sale of the QSB stock, A does not recognize A's $100 distributive share of the gain from PRS's sale of the QSB stock. Before the contribution of the replacement QSB stock to ABC, A's adjusted basis in the replacement QSB stock is $250 ($350 cost minus $100 nonrecognition amount). A does not recognize gain upon the contribution of QSB stock to ABC under section 721(a). Upon the contribution of the replacement QSB stock to ABC, A's basis in the ABC partnership interest is $250, and ABC's basis in the replacement QSB stock is $250. However, the replacement QSB stock does not qualify as QSB stock in ABC's hands. Neither A nor ABC will be eligible to defer gain under section 1045 on a subsequent sale of the replacement QSB stock.

(j) *Effective/applicability date—In general.* This section applies to sales of QSB stock on or after August 14, 2007.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101 paragraph (b) is amended by adding in numerical order, §1.1045–1, to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1045–1	1545–1893
* * * * *	

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

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

(Filed by the Office of the Federal Register on August 13, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 14, 2007, 72 F.R. 45346)

Approved August 2, 2007.

Part III. Administrative, Procedural, and Miscellaneous

Information Reporting by Organizations That Receive Charitable Contributions of Certain Motor Vehicles, Boats, and Airplanes

Notice 2007–70

SECTION 1. PURPOSE

This notice provides information on where to file a completed Form 1098–C, *Contributions of Motor Vehicles, Boats, and Airplanes*, an information form used by a donee organization to report a contribution of a qualified vehicle with a claimed value of more than $500, for calendar years ending on or after December 31, 2008. This notice changes where to file a completed Form 1098–C as described in Section 3 of Notice 2006–1, 2006–1 C.B. 347.

SECTION 2. BACKGROUND

Notice 2006–1, 2006–1 C.B. 347, provides guidance on the reporting requirements under § 170(f)(12)(D) of the Internal Revenue Code, which apply to any donee organization that receives a contribution of a qualified vehicle after December 31, 2004, the claimed value of which is more than $500. Notice 2006–1, Section 3, provides that if a donee organization receives a contribution of a qualified vehicle, with a claimed value of more than $500, after December 31, 2004, the donee organization is required to provide a contemporaneous written acknowledgment to the donor. Notice 2006–1 specifies that the donee organization may use a completed Form 1098–C, *Contributions of Motor Vehicles, Boats, and Airplanes*, for the contemporaneous written acknowledgment. The notice also specifies that the Form 1098–C along with Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, be filed with the Internal Revenue Service Center, Ogden, UT 84201–0027.

SECTION 3. WHERE TO FILE A FORM 1098–C, CONTRIBUTIONS OF MOTOR VEHICLES, BOATS, AND AIRPLANES

All Forms 1098–C, *Contributions of Motor Vehicles, Boats, and Airplanes*, along with Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, filed after December 31, 2007, must be filed with the Internal Revenue Service Center, Kansas City, MO 64999. The Internal Revenue Service Center at Ogden remains the location for Form 1098–C filed on or before December 31, 2007. Future changes to the filing location for Form 1098–C will be announced and placed in the instructions to Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*.

The filing instructions for Form 1098–C in Section 3 of Notice 2006–1, 2006–1 C.B. 347, are hereby modified.

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is Carolyn Ibok of Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this notice, contact Carolyn Ibok at (202) 283–8923 (not a toll-free call).

Qualified Transportation Fringes

Notice 2007–76

The purpose of this notice is to delay the effective date of Revenue Ruling 2006–57, 2006–47 I.R.B. 911. Revenue Ruling 2006–57 provides guidance to employers on the use of smartcards, debit or credit cards, or other electronic media to provide qualified transportation fringes under Internal Revenue Code §§ 132(a)(5) and 132(f). Treasury and the IRS have become aware that certain transit systems may need additional time to modify their technology and make it compatible with the requirements for vouchers set forth in Revenue Ruling 2006–57. Therefore, the ruling's effective date, which was set for January 1, 2008, is delayed to January 1, 2009. Nevertheless, employers and employees may rely on Revenue Ruling 2006–57 with respect to transactions occurring prior to January 1, 2009. The principal author of this notice is Michael R. Skutley of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this notice, contact Mr. Skutley at (202) 622–6040 (not a toll-free call).

Determination of Housing Cost Amounts Eligible for Exclusion or Deduction for 2007

Notice 2007–77

SECTION 1. PURPOSE

This notice provides adjustments to the limitation on housing expenses for purposes of section 911 of the Internal Revenue Code (Code) for specific locations for 2007. These adjustments are made on the basis of geographic differences in housing costs relative to housing costs in the United States.

SECTION 2. BACKGROUND

Section 911(a) of the Code allows a qualified individual to elect to exclude from gross income the foreign earned income and housing cost amount of such individual. Section 911(c)(1) defines the term "housing cost amount" as an amount equal to the excess of (A) the housing expenses of an individual for the taxable year to the extent such expenses do not exceed the amount determined under section 911(c)(2), over (B) 16 percent of the exclusion amount (computed on a daily basis) in effect under section 911(b)(2)(D) for the calendar year in which such taxable year begins ($70.44 per day for 2007, or $85,700 for the full year), multiplied by the number of days of that taxable year within the applicable period described in section 911(d)(1). The applicable period is the period during which the individual

meets the tax home requirement of section 911(d)(1) and either the *bona fide* residence requirement of section 911(d)(1)(A) or the physical presence requirement of section 911(d)(1)(B). Assuming that the entire taxable year of a qualified individual is within the applicable period, the section 911(c)(1)(B) amount for 2007 is $13,712 ($85,700 x .16).

Section 911(c)(2)(A) of the Code limits the housing expenses taken into account in section 911(c)(1)(A) to an amount equal to (i) 30 percent (adjusted as may be provided under the Secretary's authority under section 911(c)(2)(B)) of the amount in effect under section 911(b)(2)(D) for the calendar year in which the taxable year of the individual begins, multiplied by (ii) the number of days of that taxable year within the applicable period described in section 911(d)(1). Thus, under this general limitation, a qualified individual whose entire taxable year is within the applicable period is limited to maximum housing expenses of $25,710 ($85,700 x .30) in 2007.

Section 911(c)(2)(B) of the Code authorizes the Secretary to issue regulations or other guidance to adjust the percentage under section 911(c)(2)(A)(i) based on geographic differences in housing costs relative to housing costs in the United States. Pursuant to this authority, the Internal Revenue Service (IRS) and the Treasury Department published Notice 2006–87, 2006–43 I.R.B. 766, and Notice 2007–25, 2007–12 I.R.B. 760, to provide adjustments to the limitation on housing expenses for 2006 for qualified individuals incurring housing expenses in countries with high housing costs relative to housing costs in the United States.

SECTION 3. TABLE OF ADJUSTED LIMITATIONS FOR 2007

The following table provides adjusted limitations on housing expenses (in lieu of the otherwise applicable limitation of $25,710) for 2007.

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Argentina	Buenos Aires	120.27	43,900
Australia	Canberra	70.68	25,800
Australia	Melbourne	72.60	26,500
Australia	Perth	109.59	40,000
Austria	Vienna	78.97	28,824
Bahamas, The	Nassau	136.16	49,700
Bahrain	Bahrain	120.55	44,000
Barbados	Barbados	103.29	37,700
Belgium	Antwerp	98.90	36,100
Belgium	Brussels	137.53	50,200
Belgium	Gosselies	98.90	36,100
Belgium	Hoogbuul	98.90	36,100
Belgium	Mons	98.90	36,100
Belgium	SHAPE/Chievres	98.90	36,100
Bermuda	Bermuda	197.26	72,000
Bosnia-Herzegovina	Sarajevo	74.52	27,200
Brazil	Brasilia	101.64	37,100
Brazil	Rio de Janeiro	96.16	35,100
Brazil	Sao Paolo	127.40	46,500
Canada	Calgary	109.04	39,800
Canada	Dartmouth	92.88	33,900
Canada	Edmonton	83.01	30,300
Canada	Halifax	92.88	33,900
Canada	London/Ontario	79.18	28,900
Canada	Montreal	153.97	56,200
Canada	Ottawa	118.90	43,400

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Canada	Toronto	126.03	46,000
Canada	Vancouver	122.19	44,600
Canada	Victoria	92.33	33,700
Canada	Winnipeg	80.00	29,200
Chile	Santiago	96.71	35,300
China	Beijing	134.62	49,137
China	Hong Kong	313.15	114,300
China	Shanghai	156.17	57,001
Colombia	Bogota	148.22	54,100
Colombia	All cities other than Bogota and Barranquilla	123.01	44,900
Costa Rica	San Jose	71.78	26,200
Dominican Republic	Santo Domingo	110.96	40,500
Ecuador	Guayaquil	84.38	30,800
Ecuador	Quito	83.56	30,500
France	Garches	238.90	87,200
France	Le Havre	105.48	38,500
France	Lyon	149.32	54,500
France	Marseille	139.73	51,000
France	Montpellier	123.84	45,200
France	Paris	238.90	87,200
France	Sevres	238.90	87,200
France	Suresnes	238.90	87,200
France	Versailles	238.90	87,200
Germany	Babenhausen	116.97	42,700
Germany	Bad Aibling	99.73	36,400
Germany	Bad Nauheim	93.42	34,100
Germany	Baumholder	106.58	38,900
Germany	Berlin	143.29	52,300
Germany	Birkenfeld	106.58	38,900
Germany	Boeblingen	127.40	46,500
Germany	Butzbach	91.51	33,400
Germany	Darmstadt	116.99	42,700
Germany	Erlangen	74.25	27,100
Germany	Frankfurt am Main	122.19	44,600
Germany	Friedberg	93.42	34,100
Germany	Fuerth	74.25	27,100
Germany	Garmisch-Partenkirchen	101.10	36,900
Germany	Geilenkirchen	80.27	29,300

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Germany	Gelnhausen	126.58	46,200
Germany	Germersheim	88.77	32,400
Germany	Giebelstadt	101.40	37,000
Germany	Giessen	91.51	33,400
Germany	Grafenwoehr	75.89	27,700
Germany	Hanau	126.58	46,200
Germany	Hannover	87.40	31,900
Germany	Heidelberg	116.71	42,600
Germany	Idar-Oberstein	106.58	38,900
Germany	Ingolstadt	125.75	45,900
Germany	Kaiserslautern, Landkreis	130.41	47,600
Germany	Kitzingen	101.40	37,000
Germany	Leimen	116.71	42,600
Germany	Ludwigsburg	127.40	46,500
Germany	Mainz	143.84	52,500
Germany	Mannheim	116.71	42,600
Germany	Munich	125.75	45,900
Germany	Nellingen	127.40	46,500
Germany	Neubruecke	106.58	38,900
Germany	Nuernberg	74.25	27,100
Germany	Ober Ramstadt	116.99	42,700
Germany	Oberammergau	101.10	36,900
Germany	Pirmasens	130.41	47,600
Germany	Rheinau	116.71	42,600
Germany	Schwabach	74.25	27,100
Germany	Schwetzingen	116.71	42,600
Germany	Seckenheim	116.71	42,600
Germany	Sembach	130.41	47,600
Germany	Stuttgart	127.40	46,500
Germany	Wertheim	101.40	37,000
Germany	Wiesbaden	143.84	52,500
Germany	Wuerzberg	101.40	37,000
Germany	Zirndorf	74.25	27,100
Germany	Zweibrueken	130.41	47,600

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Germany	All cities other than Augsburg, Babenhausen, Bad Aibling, Bad Kreuznach, Bad Nauheim, Baumholder, Berchtesgaden, Berlin, Birkenfeld, Boeblingen, Bonn, Bremen, Bremerhaven, Butzbach, Cologne, Darmstadt, Delmenhorst, Duesseldorf, Erlangen, Flensburg, Frankfurt am Main, Friedberg, Fuerth, Garlstedt, Garmisch-Partenkirchen, Geilenkirchen, Gelnhausen, Germersheim, Giebelstadt, Giessen, Grafenwoehr, Grefrath, Greven, Gruenstadt, Hamburg, Hanau, Handorf, Hannover, Heidelberg, Heilbronn, Herongen, Idar-Oberstein, Ingolstadt, Kaiserslautern, Landkreis, Kalkar, Karlsruhe, Kerpen, Kitzingen, Koblenz, Leimen, Leipzig, Ludwigsburg, Mainz, Mannheim, Moenchen-Gladbach, Muenster, Munich, Nellingen, Neubruecke, Noervenich, Nuernberg, Ober Ramstadt, Oberammergau, Osterholz-Scharmbeck, Pirmasens, Rheinau, Rheinberg, Schwabach, Schwetzingen, Seckenheim, Sembach, Stuttgart, Twisteden, Wahn, Wertheim, Wiesbaden, Worms, Wuerzburg, Zirndorf and Zweibrueken.	103.29	37,700
Greece	Athens	94.25	34,400
Greece	Argyroupolis	91.23	33,300
Greece	Elefsis	94.25	34,400
Greece	Ellinikon	94.25	34,400
Greece	Mt. Hortiatis	91.23	33,300
Greece	Mt. Parnis	94.25	34,400
Greece	Mt. Pateras	94.25	34,400
Greece	Nea Makri	94.25	34,400
Greece	Perivolaki	91.23	33,300
Greece	Piraeus	94.25	34,400

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Greece	Souda Bay (Crete)	72.88	26,600
Greece	Tanagra	94.25	34,400
Greece	Thessaloniki	91.23	33,300
Guatemala	Guatemala City	103.01	37,600
Holy See, The	Holy See, The	159.18	58,100
Hungary	Budapest	89.04	32,500
India	Mumbai	156.19	57,011
India	New Delhi	73.75	26,920
Indonesia	Jakarta	103.49	37,776
Ireland	Dublin	80.55	29,400
Ireland	Limerick	80.00	29,200
Ireland	Shannon Area	80.00	29,200
Italy	Catania	78.63	28,700
Italy	Genoa	103.29	37,700
Italy	Gioia Tauro	85.48	31,200
Italy	La Spezia	103.29	37,700
Italy	Leghorn	99.45	36,300
Italy	Milan	237.53	86,700
Italy	Naples	131.23	47,900
Italy	Pisa	99.45	36,300
Italy	Pordenone-Aviano	109.59	40,000
Italy	Rome	159.18	58,100
Italy	Sardinia	81.37	29,700
Italy	Sigonella	78.63	28,700
Italy	Turin	118.63	43,300
Italy	Verona	75.89	27,700
Italy	Vicenza	110.68	40,400
Italy	All cities other than Avellino, Brindisi, Catania, Florence, Gaeta, Genoa, Gioia Tauro, La Spezia, Leghorn, Milan, Mount Vergine, Naples, Nettuno, Pisa, Pordenone-Aviano, Rome, Sardinia, Sigonella, Turin, Verona and Vicenza.	91.23	33,300
Jamaica	Kingston	112.88	41,200
Japan	Akashi	73.70	26,900
Japan	Atsugi	93.15	34,000
Japan	Camp Zama	93.15	34,000
Japan	Chiba-Ken	93.15	34,000

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Japan	Fussa	93.15	34,000
Japan	Gifu	80.00	29,200
Japan	Gotemba	75.07	27,400
Japan	Haneda	93.15	34,000
Japan	Kanagawa-Ken	93.15	34,000
Japan	Komaki	80.00	29,200
Japan	Machida-Shi	93.15	34,000
Japan	Nagoya	103.52	37,786
Japan	Okinawa Prefecture	123.56	45,100
Japan	Osaka-Kobe	145.30	53,036
Japan	Sagamihara	93.15	34,000
Japan	Saitama-Ken	93.15	34,000
Japan	Sasebo	73.70	26,900
Japan	Tachikawa	93.15	34,000
Japan	Tokyo	234.79	85,700
Japan	Tokyo-to	99.73	36,400
Japan	Yokohama	131.23	47,900
Japan	Yokosuka	113.42	41,400
Japan	Yokota	93.15	34,000
Korea	Camp Carroll	77.53	28,300
Korea	Camps Market	179.18	65,400
Korea	Chinhae	83.01	30,300
Korea	Chunchon	76.99	28,100
Korea	Colbern	179.18	65,400
Korea	K–16	179.18	65,400
Korea	Kimhae	86.03	31,400
Korea	Kimpo Airfield	179.18	65,400
Korea	Kwangju	82.19	30,000
Korea	Mercer	179.18	65,400
Korea	Munsan	75.62	27,600
Korea	Osan AB	93.42	34,100
Korea	Pusan	86.03	31,400
Korea	Pyongtaek	93.42	34,100
Korea	Seoul	179.18	65,400
Korea	Suwon	179.18	65,400
Korea	Taegu	97.53	35,600
Korea	Tongduchon	75.62	27,600
Korea	Uijongbu	106.85	39,000
Korea	Waegwan	77.53	28,300

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Korea	All cities other than Ammo Depot #9, Camp Carroll, Camps Market, Changwon, Chinhae, Chunchon, Colbern, K–16, Kimhae, Kimpo Airfield, Kunsun, Kwangju, Mercer, Munsan, Osan AB, Pusan, Pyongtaek, Seoul, Suwon, Taegu, Tongduchon, Uijongbu, and Waegwan.	87.40	31,900
Kuwait	Kuwait City	166.85	60,900
Kuwait	All cities other than Kuwait City	149.59	54,600
Luxembourg	Luxembourg	130.68	47,700
Macedonia	Skopje	96.99	35,400
Malaysia	Kuala Lumpur	131.50	48,000
Malaysia	All cities other than Kuala Lumpur	92.33	33,700
Malta	Malta	108.22	39,500
Mexico	Hermosillo	91.23	33,300
Mexico	Mazatlan	81.92	29,900
Mexico	Mexico City	116.16	42,400
Mexico	Monterrey	108.49	39,600
Mexico	All cities other than Ciudad Juarez, Cuernavaca, Guadalajara, Hermosillo, Matamoros, Mazatlan, Merida, Metapa, Mexico City, Monterrey, Nogales, Nuevo Laredo, Tapachula, Tijuana, Tuxtla Gutierrez, Veracruz.	103.84	37,900
Netherlands	Amsterdam	144.93	52,900
Netherlands	Aruba	98.63	36,000
Netherlands	Brunssum	90.14	32,900
Netherlands	Eygelshoven	90.14	32,900
Netherlands	Hague, The	163.29	59,600
Netherlands	Heerlen	90.14	32,900
Netherlands	Hoensbroek	90.14	32,900
Netherlands	Hulsberg	90.14	32,900
Netherlands	Kerkrade	90.14	32,900
Netherlands	Landgraaf	90.14	32,900
Netherlands	Maastricht	90.14	32,900
Netherlands	Papendrecht	114.52	41,800

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Netherlands	Rotterdam	114.52	41,800
Netherlands	Schaesburg	90.14	32,900
Netherlands	Schinnen	90.14	32,900
Netherlands	Schiphol	144.93	52,900
Netherlands	Ypenburg	163.29	59,600
Netherlands	All cities other than Amsterdam, Aruba, Brunssum, Coevorden, Eygelshoven, The Hague, Heerlen, Hoensbroek, Hulsberg, Kerkrade, Landgraaf, Maastricht, Margraten, Papendrecht, Rotterdam, Schaesburg, Schinnen, Schiphol, and Ypenburg.	83.29	30,400
New Zealand	Auckland	97.81	35,700
New Zealand	Wellington	92.60	33,800
Nicaragua	Managua	87.12	31,800
Norway	Oslo	83.76	30,573
Norway	Stavanger	96.44	35,200
Norway	All cities other than Oslo and Stavanger.	98.08	35,800
Panama	Panama City	88.22	32,200
Peru	Lima	74.79	27,300
Philippines	Cavite	98.63	36,000
Philippines	Manila	98.63	36,000
Poland	Poland	72.33	26,400
Portugal	Alverca	145.48	53,100
Portugal	Lajes Field	71.78	26,200
Portugal	Lisbon	145.48	53,100
Qatar	Doha	95.30	34,786
Russia	Moscow	249.04	90,900
Russia	Saint Petersburg	113.70	41,500
Russia	Sakhalin Island	212.33	77,500
Russia	Vladivostok	212.33	77,500
Russia	Yekaterinburg	129.86	47,400
Rwanda	Kigali	86.30	31,500
Saudi Arabia	Jeddah	84.02	30,667
Saudi Arabia	Riyadh	84.02	30,667
Singapore	Singapore	155.34	56,700
South Africa	Pretoria	110.14	40,200

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Spain	Barcelona	108.49	39,600
Spain	Madrid	107.67	39,300
Spain	Rota	92.60	33,800
Spain	Valencia	111.51	40,700
Switzerland	Bern	139.45	50,900
Switzerland	Geneva	194.25	70,900
Switzerland	Zurich	107.45	39,219
Switzerland	All cities other than Bern, Geneva and Zurich.	90.14	32,900
Taiwan	Taipei	122.42	44,685
Thailand	Bangkok	100.27	36,600
Turkey	Ankara	89.04	32,500
Turkey	Elmadag	89.04	32,500
Turkey	Izmir-Cigli	86.58	31,600
Turkey	Manzarali	89.04	32,500
Turkey	Yamanlar	86.58	31,600
Ukraine	Kiev	89.98	32,844
United Arab Emirates	Abu Dhabi	84.07	30,687
United Arab Emirates	Dubai	116.31	42,452
United Kingdom	Basingstoke	112.60	41,099
United Kingdom	Bath	112.33	41,000
United Kingdom	Bracknell	170.14	62,100
United Kingdom	Bristol	106.03	38,700
United Kingdom	Cambridge	117.81	43,000
United Kingdom	Caversham	202.19	73,800
United Kingdom	Cheltenham	128.22	46,800
United Kingdon	Chicksands	72.60	26,500
United Kingdom	Croughton	105.75	38,600
United Kingdom	Fairford	108.77	39,700
United Kingdom	Farnborough	141.92	51,800
United Kingdom	Felixstowe	123.29	45,000
United Kingdom	Gibraltar	122.24	44,616
United Kingdom	Harrogate	119.18	43,500
United Kingdom	High Wycombe	170.14	62,100
United Kingdom	Kemble	108.77	39,700
United Kingdom	Lakenheath	150.96	55,100
United Kingdom	Liverpool	106.30	38,800
United Kingdom	London	213.15	77,800
United Kingdom	Loudwater	143.84	52,500

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
United Kingdom	Menwith Hill	119.18	43,500
United Kingdom	Mildenhall	150.96	55,100
United Kingdom	Oxfordshire	105.75	38,600
United Kingdom	Plymouth	105.75	38,600
United Kingdom	Portsmouth	105.75	38,600
United Kingdom	Reading	170.14	62,100
United Kingdom	Rochester	109.32	39,900
United Kingdom	Southampton	121.10	44,200
United Kingdom	Surrey	132.61	48,402
United Kingdom	Waterbeach	120.27	43,900
United Kingdon	West Byfleet	72.33	26,400
United Kingdom	Wiltshire	113.97	41,600
United Kingdom	All cities other than Basingstoke, Bath, Belfast, Birmingham Bracknell, Bristol, Brough, Bude, Cambridge, Caversham, Chelmsford, Cheltenham, Chicksands, Croughton, Dunstable, Edinburgh, Edzell, Fairford, Farnborough, Felixstowe, Ft. Halstead, Glenrothes, Greenham Common, Harrogate, High Wycombe, Hythe, Kemble, Lakenheath, Liverpool, London, Loudwater, Menwith Hill, Mildenhall, Nottingham, Oxfordshire, Plymouth, Portsmouth, Reading, Rochester, Southampton, Surrey, Waterbeach, Welford, West Byfleet, and Wiltshire.	104.93	38,300
Venezuela	Caracas	156.16	57,000
Vietnam	Hanoi	128.22	46,800

EFFECTIVE DATE

This notice is effective for taxable years beginning on or after January 1, 2007.

DRAFTING INFORMATION

The principal author of this notice is Paul J. Carlino of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Carlino at (202) 622–3840 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also: Part I, Sections 704(c); 1.704–3(e)(3).)

Rev. Proc. 2007–59

SECTION 1. PURPOSE

The purpose of this revenue procedure is to permit certain partnerships to aggregate gains and losses from an expanded class of qualified financial assets for purposes of making reverse section 704(c) allocations under § 1.704–3(e)(3).

SECTION 2. BACKGROUND

01. To prevent the shifting of tax consequences among partners with respect to precontribution gain or loss, section 704(c) requires partnerships to allocate income, gain, loss, and deductions with respect to property contributed by a partner so as to take into account any variation between the adjusted tax basis of the property and

its fair market value at the time of the contribution. These allocations must be made using a reasonable method that is consistent with the purpose of section 704(c). Section 1.704–3(a)(6) provides that similar rules apply to differences between book value and tax basis that are created by a revaluation of partnership assets pursuant to § 1.704–1(b)(2)(iv)(f) (reverse section 704(c) allocations).

02. Section 1.704–3(a)(2) provides that section 704(c) allocations are generally made on a property-by-property basis. Therefore, built-in gains and losses from different items of contributed or revalued property generally cannot be aggregated.

03. Section 1.704–3(e)(3) provides a special rule that allows securities partnerships to make reverse section 704(c) allocations on an aggregate basis. Specifically, § 1.704–3(e)(3)(i) provides that, for purposes of making reverse section 704(c) allocations, a securities partnership may aggregate built-in gains and losses from qualified financial assets using any reasonable approach that is consistent with the purpose of section 704(c).

04. Section 1.704–3(e)(3)(iii)(A) provides that a partnership is a securities partnership if the partnership is either a management company or an investment partnership, and the partnership makes all of its book allocations in proportion to the partners' relative book capital accounts (except for reasonable special allocations to a partner that provides management services or investment advisory services to the partnership).

05. Section 1.704–3(e)(3)(iii)(B)(1) provides that a partnership is a management company if it is registered with the Securities and Exchange Commission as a management company under the Investment Company Act of 1940, as amended (15 U.S.C. 80a).

06. Section 1.704–3(e)(3)(iii)(B)(2) provides that a partnership is an investment partnership if (1) on the date of each capital account restatement, the partnership holds qualified financial assets that constitute at least 90 percent of the fair market value of the partnership's non-cash assets; and (2) the partnership reasonably expects, as of the end of the first taxable year in which the partnership adopts an aggregate approach under § 1.704–3(e)(3), to make revaluations at least annually.

07. Section 1.704–3(e)(3)(ii)(A) provides that a qualified financial asset is any personal property (including stock) that is actively traded. Actively traded means actively traded as defined in § 1.1092(d)–1 (defining actively traded property for purposes of the straddle rules). In addition, under § 1.704–3(e)(3)(ii)(B), for management companies, qualified financial assets also include the following, even if not actively traded: shares of stock in a corporation; notes, bonds, debentures, or other evidences of indebtedness; interest rate, currency, or equity notional principal contracts; evidences of an interest in, or derivative financial instruments in, any security, currency, or commodity, including any option, forward or futures contract, or short position; or any similar financial instrument.

08. Sections 1.704–3(e)(3)(iv) and (v) describe two methods of making reverse section 704(c) allocations on an aggregate basis that are generally reasonable, the partial netting and the full netting approaches, respectively.

09. Section 1.704–3(a)(10) provides that an allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse section 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

10. Section 1.704–3(e)(4) provides in relevant part that the Commissioner may, by published guidance or by letter ruling, permit: (1) aggregation of properties other than assets described in paragraphs (e)(2) and (e)(3) of § 1.704–3; (2) partnerships other than securities partnerships to aggregate gain and loss from qualified financial assets; and (3) aggregation of qualified financial assets for purposes of making section 704(c) allocations in the same manner as that described in paragraph (e)(3) of § 1.704–3.

SECTION 3. DEFINITIONS

01. *Qualified Partnerships.* For purposes of this revenue procedure, a partnership is a Qualified Partnership if it satisfies the following requirements: (1) the partnership makes all of its book allocations in proportion to the partners' relative book capital accounts (except for reasonable special allocations to a partner that provides management services or investment advisory services to the partnership); (2) the partnership reasonably expects, as of the end of the first taxable year in which the partnership adopts an aggregate approach under this revenue procedure, to make revaluations of qualified financial assets at least four times annually; (3) on the date of each capital account restatement during the taxable year, the partnership holds qualified financial assets that constitute at least 90 percent of the partnership's non-cash assets; (4) the partnership reasonably expects, as of the first day of each taxable year for which the partnership seeks to aggregate under this revenue procedure, that the partnership (a) will have at least 10 unrelated partners at all times during the taxable year; and (b) will make at least 200 trades of qualified financial assets during the taxable year, the aggregate value of which will comprise at least 50% of the book value of the partnership's assets (including cash) as of the first day of the taxable year; and (5) the application of the aggregation method to reverse section 704(c) allocations under this revenue procedure is not made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability. For purposes of this paragraph, partners are treated as related if they are related within the meaning of sections 267(b) or 707(b).

02. *Qualified financial assets.* Solely for purposes of this revenue procedure, qualified financial assets are (1) those assets described in § 1.704–3(e)(3)(ii)(A) and (B); (2) any interest in a partnership that is traded on an established securities market or readily tradable on a secondary market or the substantial equivalent thereof within the meaning of § 1.7704–1(c); and (3) any interest owned by the partnership (the upper-tier partnership) in a partnership (the lower-tier partnership) that represents it is a securities partnership or a Qualified Partnership, provided that such interest is (i) less than 10 percent of the capital and profits of the lower-tier partnership and that the upper-tier partnership does not actively or

materially participate in the management or operations of the lower-tier partnership; and (ii) less than 5 percent of the total book value of the upper-tier partnership's assets (including cash) as of the first day of the taxable year.

SECTION 4. APPLICATION

01. *Automatic permission to aggregate qualified financial assets.* Permission is hereby granted to any Qualified Partnership as defined in this revenue procedure to aggregate built-in gains and losses from qualified financial assets for purposes of making reverse section 704(c) allocations under § 1.704–3(e)(3). Pursuant to § 1.704–3(e)(3)(i), once a partnership adopts an aggregate approach under this revenue procedure, that partnership must apply the same aggregate approach to all of its qualified financial assets for all taxable years in which the partnership qualifies as a Qualified Partnership. However, a partnership may choose not to aggregate all of the partnership's qualified financial assets provided that such qualified assets do not exceed in the aggregate 30 percent of the book value of the partnership's non-cash assets at the time any such qualified financial assets is acquired.

02. *Subsequent failure to qualify as a Qualified Partnership*. A Qualified Partnership that adopts an aggregate approach under this revenue procedure and subsequently fails to qualify as a Qualified Partnership must make reverse section 704(c) allocations on an asset-by-asset basis after the date of disqualification. The partnership, however, is not required to disaggregate the book gain or book loss from qualified asset revaluations before the date of disqualification when making reverse section 704(c) allocations on or after the date of disqualification.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning on or after October 1, 2007. However, taxpayers may apply this revenue procedure to taxable years beginning after December 31, 2005.

SECTION 6. REQUEST FOR COMMENTS

.01 *Comments Requested*. The Treasury and IRS request comments on the appropriateness of the factors used to define Qualified Partnerships and qualified financial assets. Additionally, comments are requested on whether additional factors should be considered in defining Qualified Partnerships and qualified financial assets. The Treasury and the IRS also request comments as to whether additional guidance regarding the aggregation of qualified financial assets for purposes of making reverse section 704(c) allocations is appropriate or necessary.

.02 *Submission of Comments*. Written comments may be submitted to the Office of Associate Chief Counsel (Passthroughs & Special Industries), Attention: Jonathan E. Cornwell (Revenue Procedure 2007–59), CC:PSI:B01, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to *notice.comments@irscounsel.treas.gov*. Please include "Revenue Procedure 2007–59" in the subject line of any electronic communications. Comments will be available for public inspection and copying.

SECTION 7. DRAFTING INFORMATION

The principal authors of this revenue procedure are Jonathan E. Cornwell and Steven A. Schmoll of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, contact Mr. Cornwell or Mr. Schmoll at (202) 622–3050 (not a toll-free call).

Section 807.—Rules for Certain Reserves (Also §§ 805, 812, 832.)

Rev. Proc. 2007–61

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor under which an insurance company subject to tax under subchapter L of the Internal Revenue Code is not required to take into account any portion of the increase for the taxable year in policy cash values of life insurance contracts described in § 264(f)(4)(A) (I-COLI Contracts) for purposes of applying the insurance company proration rules in §§ 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5).

SECTION 2. BACKGROUND

.01 *Insurance company proration rules*. (1) To clearly reflect income, an insurance company is allowed to deduct increases in certain insurance reserves reflecting the company's obligations to policyholders. Like other taxpayers, an insurance company may receive tax-favored income, such as tax-exempt interest, intercorporate dividends, and the inside build-up under life insurance contracts. Because a portion of the reserve increase can be viewed as funded by tax-favored income, the insurance company proration rules require that tax-favored income be prorated between the insurance company and its policyholders. *See* §§ 807(a) and (b) (requiring that a life insurance company's deductible reserves be reduced by the "policyholders' share" of certain tax-favored income) and § 832(b)(5)(B) (requiring that a property and casualty insurance company's deductible additions to reserves be reduced by 15 percent of tax-favored income). *See also* § 805(a)(4) (generally limiting a life insurance company's deduction for dividends received to the "company's share" of the dividends); § 812 (setting forth the methodology for determining the company's share and the policyholder's share).

(2) Prior to 1997, the tax-favored investment income items taken into account under the insurance company proration rules were tax-exempt interest and intercorporate dividends. In the Taxpayer Relief Act of 1997, 1997–4 C.B. (Vol. 1) 165–69 ("1997 Act"), Congress amended §§ 807(a)(2), 807(b)(1), 805(a)(4), 812(d)(1), and 832(b)(5) to take into account "the increase for the taxable year in policy cash values . . . of life insurance policies and annuity and endowment *contracts to which section 264(f) applies*." (Emphasis added.) *See* § 1084(b) of the 1997 Act. The legislative history explained:

> [T]he rules reducing certain deductions for losses incurred, in the case of property and casualty companies, and reducing reserve deductions or dividends received deductions of life insurance companies, are modified to take into account the increase in the cash values

of life insurance policies or annuity or endowment contracts held by insurance companies.

H. R. Rep. No. 105–220, 105th Cong., 1st Sess. 588 (1997), 1997–4 (Vol. 2) C.B. 2058.

.02 *Contracts to which § 264(f) applies.* The IRS and the Treasury Department have become aware of questions concerning the interpretation of the phrase "contracts to which § 264(f) applies." For example, it may be argued that § 264(f) does not "apply" to contracts described in § 264(f)(4)(A) (*i.e.*, contracts covering 20-percent owners, officers, directors and employees) because those contracts are excepted from the disallowance rule of § 264(f)(1). Alternatively, it may be argued that the § 264(f)(4)(A) exception applies only for purposes of the disallowance rule of § 264(f)(1) and that other provisions of § 264(f) continue to "apply" to contracts covering 20-percent owners, officers, directors and employees. *See, e.g.,* § 264(f)(4)(C).

SECTION 3. SCOPE

This revenue procedure applies to I-COLI Contracts covering no more than 35 percent of the total aggregate number of the individuals described in § 264(f)(4)(A) at any time during the taxable year.

SECTION 4. SAFE HARBOR

For purposes of applying the insurance company proration rules in §§ 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5), an insurance company is not required to take into account any portion of the increase for the taxable year in the policy cash values (within the meaning of section 805(a)(4)) of I-COLI contracts to which this revenue procedure applies pending the publication of additional guidance. Arrangements involving such contracts, however, remain subject to challenge by the IRS under other provisions of the tax law, including judicial doctrines such as the business purpose doctrine.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective September 11, 2007. If, in response to comments, additional guidance is published interpreting the phrase "contracts to which section 264(f) applies," such guidance will apply prospectively.

SECTION 6. REQUEST FOR COMMENTS

.01 Comments are requested concerning the need for additional guidance in this area. Specifically, comments are requested regarding the existence of any non-tax regulatory rules or other requirements that limit an insurance company's ability to invest in I-COLI Contracts and the effect of any experience rating, inter-insurance, reciprocal, or reinsurance arrangement on transactions involving I-COLI Contracts. In addition, the IRS would welcome comments on the operation of arrangements involving I-COLI Contracts.

.02 Comments should be submitted by December 31, 2007. Comments may be submitted by mail addressed to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044, Attn. CC:PA:LPD:PR (Rev. Proc. 2007–61), Room 5205; by hand delivery (Monday through Friday between the hours of 8:00 a.m. through 4:00 p.m.) addressed to: Courier's Desk, Internal Revenue Service, Attn.: CC:PA:LPD:PR (Rev. Proc. 2007–61), Room 5205, 1111 Constitution Avenue, NW, Washington, DC 20224; or by email addressed to: *Notice.Comments@irscounsel.treas.gov.* Commentators should include the identification number of the publication (Rev. Proc. 2007–61) in both the email subject line and the body of the comment. All materials submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Stephen D. Hooe and John E. Glover of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Messrs. Hooe or Glover (202) 622–3900 (not a toll-free call).

Part IV. Items of General Interest

Exclusions From Gross Income of Foreign Corporations; Correction

Announcement 2007–79

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document contains corrections to notice of proposed rulemaking by cross-reference to temporary regulations (REG–138707–06, 2007–32 I.R.B. 342) that were published in the **Federal Register** on Monday, June 25, 2007 (72 FR 34650) modifying final regulations issued under section 883(a) and (c) of the Internal Revenue Code, relating to income derived by foreign corporations from the international operation of ships or aircraft.

FOR FURTHER INFORMATION CONTACT: Patricia A. Bray, (202) 622–3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking by cross-reference to temporary regulations that are the subject of this correction are under section 883 (a) and (c) of the Internal Revenue Code.

Need for Correction

As published, notice of proposed rulemaking by cross-reference to temporary regulations (REG–138707–06) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the proposed regulations (REG–138707–06), which was the subject of FR Doc. E7–12037, is corrected as follows:

1. On page 34650, column 2, in the preamble, under the paragraph heading "*Paperwork Reduction Act*", line 1 of the fourth paragraph, the language "Whether the proposed collection of" is corrected to read "Whether the proposed collections of".

2. On page 34650, column 2, in the preamble, under the paragraph heading "*Paperwork Reduction Act*", line 2 of the fifth paragraph, the language "associated with the proposed collection" is corrected to read "associated with the proposed collections".

3. On page 34651, column 1, in the preamble, under the paragraph heading "*Comments and Public Hearing*", line 7, the language "and Treasury Department specifically" is corrected to read "and the Treasury Department specifically".

4. On page 34651, column 2, in the preamble, under the paragraph heading "*Drafting Information*", line 5, the language "personnel from the IRS and Treasury" is corrected to read "personnel from the IRS and the Treasury".

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

(Filed by the Office of the Federal Register on August 10, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 13, 2007, 72 F.R. 45199)

Foundations Status of Certain Organizations

Announcement 2007–82

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:

21st Century Inventions, Inc., St. Louis, MO
39 East, Inc., Newport News, VA
99 Wayz 2 Win Foundation, Inc., Atlanta, GA
A1 Credit Counseling, Inc., Fort Smith, AR
Academy of Martial Arts Foundation, Inc., Scarsdale, NY
Act Today Foundation, Las Vegas, NV
ADCO Development Corporation, Commerce City, CO
Advocates for Better Health, Inc., San Diego, CA
African American Free Loan Corp., Cleveland Heights, OH
Afro Charity, Inc., St. Paul, MN
AJ's Helping Hand, Lansing, MI
Alferdaws Islamic Center, Oakhurst, NJ
All Neighborhood Group Home, Inc., Jakin, GA
Allen-Lee Community Development Corporation, Columbus, OH
Alpha Gardens Community Development Corporation, Burgaw, NC
Alta Housing Corporation, Granbury, TX
American-Russian Education Assc., Inc., Scarsdale, NY
American Tae Kwon Do Foundation, Sherwood, OR
Angels International, Inc., Rockville, MD
Animal Advocacy and Relief Foundation, Encino, CA
Arizona Children First Shelter, Inc., Chandler, AZ
Artemis, Inc., Santa Fe, NM
ASJ, Inc., Hartford, CT
Assist by Knight, Inc., Philadelphia, PA
Autism Family Services of New Jersey, Inc., Trenton, NJ
B & H Financial Educators, Inc., Arvada, CO
Barnabas Bar Petra, Inc., Fayetteville, NC
Baseball in Africa, Inc., Shrewsbury, MA
Basketball Services Unlimited, Houston, TX
Black Heritage Rider, Inc., Piscataway, NJ

Boundless Development Corporation, Memphis, TN
Brazilian Arts Foundation, West Hollywood, CA
Building Young Leaders, Inc., Tulsa, OK
California Street Performers Association, Richmond, CA
Call Kyle, Inc., Hamilton Square, NJ
Castle Center, Inc., Hazelton, PA
Centro De Restauracion Jesus Manantial De Vida, Inc., Manati, PR
Challenging Minds, Carson, CA
Challenging the Arts, North Richland Hills, TX
Changing Lives at Home, Inc., Baltimore, MD
Charity Horse Adoption & Rescue Mission, Tomball, TX
Charlene's Turtle Sanctuary, Carrollton, TX
Cherish the Child Academy, Hackettstown, NJ
Cherokee Heights Community Development Corporation, Macon, GA
Child Safety Exchange, Torrance, CA
Childrens of the Light Academy, Wichita, KS
Christian Education Network, Inc., Lexington, KY
Christian Life Services, Inc., Philadelphia, PA
Christopher's Guests, Pittsburgh, PA
Chosen Generation, Fort Myers, FL
Church of the Simple Faith, Inc., Aubrey, TX
Citizens for Santo, Inc., Santo, TX
Coalition of Multi Ethnic Partnership and Support Services B, Plainview, NY
Coccon, Inc., Charleston, WV
Come Back to Eden, Inc., Gresham, OR
Community Counseling Services of North Carolina, Wilmington, NC
Community Energy Foundation, Tyler, TX
Community Housing Administration, Columbia, SC
Community Transitional Services and Resources, Los Angeles, CA
Community Voices in Action, Inc., Beaumont, TX
Connecticut Habilitation Centers, Colchester, CT
Connie and Priscilla Mack Foundation, Washington, DC
Covenant Medical Transporters, Inc., Birmingham, AL
Cowboys for Kids, Inc., Rhinebeck, NY
Creating Academic and Social Excellence Youth Development Program, Inc., Cleveland, OH
Creative Biomedical Research Institute, Philadelphia, PA
Crime Victims Advocacy Council, Lansing, MI
Crisis Counseling Center, Bakersfield, CA
Cunningham Lifesafety Education Center, Inc., Denver, CO
Current Elijah Ministries, Inc., The Woodlands, TX
Cyber Anthropology, Chevy Chase, MD
Cyber-Sight Foundation, Inc., Indianapolis, IN
D. R. Johnson Ministries, Centennial, CO
Dare to be Different of the Bay Area, Alameda, CA
Design Workshop Foundation, Aspen, CO
Designer Sewing Tech Center, Chicago, IL
Dewdrop Foundation, Inc., Mableton, GA
Divine Works, Inc., Tallahassee, FL
DKY Developers Association, Mokena, IL
Downtown Miamisburg, Inc., Miamisburg, OH
End Times Storm Ministries, Inc., Oklahoma City, OK
Energy Master Planning Institute, Inc., Silver Spring, MD
Estate and Wealth Strategies Institute at Michigan State University, Sarasota, FL
Evans Christian Learning Center, Inc., Columbus, MS
Evening of Prayer CEDC, Charleston, SC
Excel Youth Foundation, Irwindale, CA
Exsousia Ministries, Inc., Tulsa, OK
Fairview Community Development Corporation, Inc., Birmingham, AL
Faithful Women of God—Paws Octave, Elkton, MD
Family Service Organization, New York, NY
Family Support Center of New Jersey, Inc., Trenton, NJ
First Step Transitional Living Foundation, Los Angeles, CA
Foundation for Evidence-Based Medicine Education, Orange, CA
Foxmore Care, Inc., Corona, NY
Franklin Concept Group, Inc., Philadelphia, PA
Free for All Outreach Mission, Inc., Newton, GA
Freedom West Development Corporation, Rockford, IL
Friends of Compton Creek, Compton, CA
Friends of River Park, Inc., Ellijay, GA
Friends of the Mohegans, Inc., Greenfield Pk, NY
G F F Community Development Corporation, Inc., Kalamazoo, MI
Game Conservation International, Fort Worth, TX
Genesis Full Life, San Antonio, TX
George Graff Westchester-Putman Building Trades Scholarship Fund, Elmsford, NY
Gerry and Franca Mulligan Foundation, Inc., Westport, CT
Get on the Bus of Christ, Inc., Beaumont, TX
Global Relief Assistance, Inc., Beltsville, MD
Glory To God Mission, La Crescenta, CA
Go Community Organization, Inc., Chicago, IL
Golden Gate, Lake City, SC
Grace & Mercy Christian Shelter, Woodville, MS
Grace Foundation, Langley, WA
GracePoint America, Inc., Norcross, GA
Greater Bethel Development Corporation, Charlotte, NC
Greater St. Paul Educational Center, Port Allen, LA
Greater Works, Inc., Atlanta, GA
Green Door, Inc., Miami, FL
Greenwise Alliance, Inc., Annapolis, MD
Guided Endeavors, Inc., Mount Vernon, NY
Gunga Coleman-Helen Hunter Centers for Success, West Hills, CA
Haggai Community Services, Culver City, CA
Haitian American Professionals Coalition, Inc., Fort Lauderdale, FL
Hammond Heights, Inc., North Augusta, SC
Hamptons Artillery, Centre Hall, PA
Harold B. Rhodes Music Foundation, Pasadena, CA
Heavens Angel Paws, Lakewood, CA
Helping Animals Lives Organization, Kerens, TX
Helping Hand Mission, Chicago, IL
Helpnow, Inc., Frederick, MD
Historic Royal Palaces, Inc., Washington, DC
Home Away From Home II, Little Rock, AR
Homeward Bound Outreach, Stuttgart, AR
Hope Factory, Inc., Smithfield, RI
Hour of Restoration & Community Development Corporation, Cheneyville, LA

IFF Foundation for Philanthropy, Irvine, CA
Iluminadas Performing Arts School and Educational Services, Inc., St. Paul, MN
Imua Transit Services, Honolulu, HI
In Depth Ministries, Inc., Houston, TX
In Line With the Word Ministries, Inc., Tallahassee, FL
Information Integrity Foundation, Naperville, IL
Institute for At Risk Children, Alexandria, VA
Institute for Research on Learning Technology Visions, Inc., Menands, NY
Institute for the Healing Heart Foundation, Houston, TX
Jackson Community Center for the Deaf, Jackson, MS
Jackson Youth League, Jackson, MO
Jeto Productions, Inc., Pine Bluff, AR
Jetta's Track Club, Inc., Bergensfield, NJ
Joetta Clark-Diggs Sports Foundation, Inc., Hillsborough, NJ
John B. McLendon Foundation, Inc., Roswell, GA
JRT Productions, Inc., Starruca, PA
Kealakehe Ahupua'a 2020, Kailua-Kona, HI
Khal-Khai, Inc., Warrensville Heights, OH
Khocolate Keepsakes II Childrens Literacy Museum, Irving, TX
Kids 101, Inc., Eugene, OR
Kingdom Foundation, Somerset, KY
Kingdom Kids Child Placing Agency, Lancaster, TX
Konkel Scholarship Foundation, Inc., Walsh, CO
Legal Clinic and Counseling Center, Inc., Alexandria, LA
Lifestyle Changes, Inc., Missouri City, TX
Lighthouse Core Development Corporation, South Orange, NJ
Lithonia Development Corp., Inc., Lithonia, GA
Little Rock Community Development Corp., Selma, AL
Logansport Health Education Center, Inc., Logansport, IN
London Bridges Kids Foundation, Powder Springs, GA
M B International Refugee Center, Orlando, FL
Make it Public, Inc., San Francisco, CA
Making a Difference in the Community, Inc., Atlanta, GA
Medieval Properties, Incorporated, Lakewood, CO
Michigan Dominators Softball Club, Clinton, MI
Michigan National Organization for Women Foundation, Inc., East Lansing, MI
Millennium Hills Development Group, Inc., Murfreesboro, TN
Mind Star, Inc., San Diego, CA
Minnesota AG Network, Mahtomedi, MN
Morenci Area Community Center, Morenci, MI
Mother Nature's Axle-Economic Development and Support, Milwaukee, WI
Motivational Centers, Brooklyn, NY
Mt. Olive Housing, Inc., Myrtle Beach, SC
Museum of Pop Culture, Redwood City, CA
MYGPA.ORG, Atlanta, GA
NAALA National Association for the Advancement of Living Artists, Houston, TX
National 12 Rounds Mentoring Program, Inc., Bowie, MD
National Committee for History of Art, Inc., Los Angeles, CA
Natural Health Research Institute, San Diego, CA
Natures Creations, Inc., Borden, IN
Neily Peach Happy Home, Willingboro, NJ
New City Community Development Corporation, New Orleans, LA
New Covenant Christian Outreach, Kemo, MO
New Covenant Community Education Corporation, Dallas, TX
Next Chance Recovery Center of Atlanta, Inc., Atlanta, GA
Nita's Private Outreach Home, Legrange, CA
North Florence Ministries of the Holy Spirit, Inc., Florence, SC
NP Leadership Collaborative, Birmingham, MI
Nu-Light Economic Development Corporation, Houston, TX
Oakland Wrestling Club, Oakland, NJ
Oasis of Hope Ministries, Jefferson, TX
One Spirit One World, Westlake Village, CA
Operation Educate, Highland Park, MI
Optimal Health Quest, Inc., Baltimore, MD
Orphan Charity, Costa Mesa, CA
Our Children's Hope, Inc., Flanders, NJ
Outreach International, Inc., Branford, CT
Pagedale Community Association, St. Louis, MO
Pairadocs Community Development Corp., Dallas, TX
Panhandle Sports Medicine Association, Amarillo, TX
Patterson/Horton Retreat Center & Youth Home, Franklinton, LA
Peace Patrol Program, Inc., Missouri City, TX
Pearls of Wisdom, Yarnell, AZ
Peer Plus Education & Training Advocates, Chicago, IL
People Helping People Help Themselves, Salt Lake City, UT
People on the Rise Community Economic Development Corporation, Plainfield, NJ
People With Pride, Incorporated, Ontario, CA
P H Smith, Houston, TX
Pleasant Grove Community Development Service Center, Inc., Fairfield, AL
Positive Focus Foundation, Inc., Washington, DC
Pride of Wisconsin Farms, Inc., Elroy, WI
Progressive Care Systems, Inc., St. Clair Shores, MI
Projects for Positive Change, Roseville, CA
Radiology Research Fund, Eugene, OR
RE-1J Foundation, Inc., Holyoke, CO
Recognizing All Cultures Equally, Inc., Portsmouth, VA
Recovering Pharmacists Network of Florida, Inc., Longwood, FL
Regional Collection Education Foundation, Inc., Marietta, OH
Restore Trust, Longville, LA
Rosslyn Academy International, Inc., Trout Run, PA
Ryan Stoller Fund for Acute Head Trauma Patients, Inc., Perrysburg, OH
SAAF Group, Inc., Birmingham, AL
Safety First for Kids, Detroit, MI
San Diego Foundation for Recovery, San Diego, CA
Sapintia Culture and Education Foundation, Bellevue, WA
Save The Rain Forests Foundation, Las Vegas, NV
Saving Noahs Generation, Inc., Kansas City, MO
Seafaring College, Inc., Sarasota, FL
Second Chance for Teens, Incorporated, Baltimore, MD
Seeds of Salvation Christian Ministry, Elk Grove, CA

Service to Mankind Foundation, Inc., Jasper, GA
Shango, Inc., Center for the Study of African American Art and Culture, Dayton, OH
Skills Development for Self Reliance, Marietta, GA
South Central Training & Research Consortium, Los Angeles, CA
Sports Resource Program, Rancho Palos Verdes, CA
Springfield Tigers, Inc., Springfield, IL
Starfestival, Lexington, MA
Strong Women of God, Inc., Baldwin, FL
Suburban Chamber of Commerce Foundation, Willow Grove, PA
Support Teen Outreach Program, Doylestown, PA
Sword of Splendor International Ministry, Inc., Bronx, NY
Tarae Simone Family Services, Inc., Bellflower, CA
TCR Children's Services, East Palo Alto, CA
Teen Action Program, Los Angeles, CA
Texas Prostate Cancer Coalition, Houston, TX
TJ Family Enterprise, Inc., Mokena, IL
To Kindle Spirit A Not For Profit Corporation, Annandale, VA
Transcom Community Development Corp., Houston, TX
Tree of Life Economic Development, Inc., Birmingham, AL
Trost Living Charities, Orlando, FL
TS August, Reston, VA
Turning Point Educational Experience, Spring Hill, TN
Tyler County Ministers Union, Chester, TX
Union Valley Outreach Ministries, Inc., Wynne, AR
United Christian Children's Fund, Tukwila, WA
Venture Capital & Loan, Inc., Mount Pleasant, MI
Victory Resource Institute, Springfield, MO
Vocational Education and Careers Centers, Riverdale, GA
WCI Educational Foundation, Asheville, NC
Westerville Cats Baseball Club, Cumberland, MD
Will Power-Power, Houston, TX
William and Sylvia Development Corporation, Philadelphia, PA
Willis Center for Personal Growth and Development, Incorporated, Inglewood, CA
Women in Transition, Inc., Baltimore, MD
Work Life Initiatives, Inc., West Chester, PA
Working Together as One Production, Humble, TX
Workshops Unlimited, Inc., Royal Palm Beach, FL
Zapotlan Project, Inc., Argyle, TX
Zara' Ministries, Belleville, IL
Zoe Group Outreach, Norcross, GA

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.

Exclusions From Gross Income of Foreign Corporations; Correction

Announcement 2007–83

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to final and temporary regulations (T.D. 9332, 2007–32 I.R.B. 300) that were published in the **Federal Register** on Monday, June 25, 2007 (72 FR 34600) relating to the exclusion from gross income of income derived by certain foreign corporations engaged in the international operation of ships or aircraft.

DATES: The correction is effective August 13, 2007.

FOR FURTHER INFORMATION CONTACT: Patricia A. Bray, (202) 622–3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final and temporary regulations that are the subject of this correction are under section 883 of the Internal Revenue Code.

Need for Correction

As published, final and temporary regulations (T.D. 9332) contain an error that may prove to be misleading and is in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendment:

PART 1 — INCOME TAXES

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

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

Par. 2. Section 1.883–1 is amended by revising paragraph (h)(3) to read as follows:

§ 1.883–1 Exclusion of income from the international operation of ships or aircraft.

* * * * *

(h) * * *

(3) For further guidance, see the entry for § 1.883–1T(h)(3).

* * * * *

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

(Filed by the Office of the Federal Register on August 10, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 13, 2007, 72 F.R. 45159)

Payout Requirements for Type III Supporting Organizations That are Not Functionally Integrated

Announcement 2007–87

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: This document describes rules that the Treasury Department and the IRS anticipate proposing, in a notice of proposed rulemaking, regarding the payout requirements for Type III supporting organizations that are not functionally integrated, the criteria for determining whether a Type III supporting organization is functionally integrated, the modified requirements for Type III supporting organizations that are organized as trusts, and the requirements regarding the type of information a Type III supporting organization must provide to its supported organization(s) to demonstrate that it is responsive to its supported organization(s). Sections 1241 and 1243 of the Pension Protection Act of 2006 amended the law with respect to Type III supporting organizations prompting a need to revise the Treasury Regulations regarding the four matters mentioned above. These new requirements and criteria would apply to Type III supporting organizations as defined under sections 509(a)(3)(B)(iii) and 4943(f)(5) of the Internal Revenue Code (Code). This document also invites comments from the public regarding the proposed payout requirement and the proposed criteria for qualifying as functionally integrated. All materials submitted will be available for public inspection and copying.

DATES: Written or electronic comments must be submitted by October 31, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–155929–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–155929–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, D.C., or sent electronically via the Federal eRulemaking Portal at http://*www.regulations.gov/* (IRS REG–155929–06).

FOR FURTHER INFORMATION CONTACT: Concerning submissions, Richard A. Hurst at (202) 622–2949 (TDD Telephone) and his e-mail address is *Richard.A.Hurst@irscounsel.treas.gov*; concerning the proposed rules, Philip T. Hackney or Michael B. Blumenfeld at (202) 622–6070 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (2006) (PPA), amended the requirements that an organization exempt from tax under section 501(c)(3) of the Code must meet to qualify as a Type III supporting organization under section 509(a)(3) of the Code. This advanced notice of proposed rulemaking describes the rules that the Treasury Department and the IRS expect to propose to implement the new qualification requirements for Type III supporting organizations enacted by Congress and solicits comments from the public.

Public Charities versus Private Foundations

Under section 509(a), an organization described in section 501(c)(3) is a private foundation unless it meets the requirements of section 509(a)(1), (2), (3), or (4). Organizations described in section 501(c)(3) that meet the requirements of section 509(a)(1), (2), (3), or (4) are referred to as public charities.

Private foundations, which are generally divided into two categories, operating and non-operating, depending on the type of activity in which the foundation engages, are subject to a different set of requirements than those applicable to public charities. Sections 4940 through 4948 impose various restrictions and excise taxes on private foundations along with their disqualified persons and foundation managers, that are generally not applicable to public charities. Furthermore, more stringent deduction limitations apply to contributions made to private non-operating foundations than apply to contributions to public charities. For example, under section 170(b)(1)(A), an individual who makes a cash contribution to a public charity may deduct up to fifty percent of his or her contribution base (a modified adjusted gross income amount) in the year of his or her contribution, while the same contribution to a private non-operating foundation would be limited to thirty percent of the individual's contribution base under section 170(b)(1)(B). In addition, deductions for contributions of certain appreciated property to a private non-operating foundation are limited to the contributor's basis in the property under section 170(e)(1)(A), while the same contribution to a public charity could result in a deduction based on the property's fair market value under section 170(e)(1)(B)(ii).

Supporting Organizations

Public charities that meet the requirements of section 509(a)(3) are known as supporting organizations. To be classified as a supporting organization, an organization must satisfy an organizational test, an operational test, a relationship test, and a disqualified person control test. The organizational and operational tests require that the organization be organized and at all times thereafter operated exclusively for the benefit of, to perform the functions of, or to conduct the purposes of one or more publicly supported organizations described in section 509(a)(1) or (2). The relationship test requires that the organization be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. Finally, the disqualified person control test requires that the organization not be controlled directly or indirectly by certain disqualified persons.

Relationship Test

Treasury Regulation (Treas. Reg.) § 1.509(a)–4(f)(2) sets forth three structural or operational relationships a supporting organization is permitted to have with its supported organization(s). Each supporting organization must have one of the three types of relationships with the organization(s) it supports to be a supporting organization described in section 509(a)(3) of the Code. The purpose of the relationship requirement is to ensure that a supporting organization has a sufficiently close tie to one or more publicly supported organizations such that the supporting organization will be accountable to a broader public constituency.

A supporting organization that is operated, supervised or controlled by one or more publicly supported organizations is commonly known as a Type I supporting organization. The relationship a Type I supporting organization has with its supported organization(s) is comparable to that of a parent-subsidiary relationship. A supporting organization supervised or controlled in connection with one or more publicly supported organizations is commonly known as a Type II supporting organization. The relationship a Type II supporting organization has with its supported organization(s) is comparable to a brother-sister corporate relationship. A supporting organization that is operated in connection with one or more publicly supported organizations is commonly known as a Type III supporting organization.

Qualification Requirements for Type III Supporting Organizations Prior to Enactment of the Pension Protection Act

In general, Treas. Reg. § 1.509(a)–4(i)(1) requires an organization to meet a "responsiveness test" and an "integral part test" to satisfy the relationship requirement for a Type III supporting organization.

Responsiveness Test: General Rule. Treas. Reg. § 1.509(a)–4(i)(2)(i) provides that an organization is "considered to meet the 'responsiveness test' if the organization is responsive to the needs or demands of" its publicly supported organizations. Treas. Reg. § 1.509(a)–4(i)(2)(ii) provides that a supporting organization may demonstrate responsiveness to its publicly supported organization(s) if: (1)(a) one or more of its officers, directors, or trustees are elected or appointed by the officers, directors, trustees, or membership of its publicly supported organization(s), (b) one or more members of the governing bodies of its publicly supported organization(s) are also officers, directors, or trustees of, or hold other important offices in, the supporting organization, or (c) the officers, directors, or trustees of the supporting organization maintain a close, continuous working relationship with the officers, directors, or trustees of its publicly supported organization(s); and (2) by reason of such arrangement, the officers, directors, or trustees of its publicly supported organization(s) have a significant voice in the investment policies of the supporting organization, the timing and the manner of making grants, the selection of the grant recipients by the supporting organization, and otherwise directing the use of the income or assets of the supporting organization.

In addition, with respect to an organization that was supporting a publicly supported organization before November 20, 1970, Treas. Reg. § 1.509(a)–4(i)(1)(ii) provides that additional facts and circumstances, such as a historic and continuing relationship between the supporting organization and its supported organization(s), may be taken into account, in addition to the factors described in the general responsiveness test above, to establish compliance with the responsiveness test.

Responsiveness Test: Charitable Trusts. Before enactment of the PPA, one way of satisfying the responsiveness test, under Treas. Reg. § 1.509(a)–4(i)(2)(iii), required that (1) the supporting organization be a charitable trust under state law, (2) each publicly supported organization that the trust supports be named as a beneficiary under the charitable trust's governing instrument, and (3) each beneficiary organization have the power to enforce the trust and compel an accounting under State law. As described below, this method of satisfying the responsiveness test was effectively removed by the PPA.

Integral Part Test. Treas. Reg. § 1.509(a)–4(i)(3)(i) provides that a supporting organization is required to establish that "it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides." Treas. Reg. § 1.509(a)–4(i)(3)(ii) and (iii) sets forth two alternative ways to meet the integral part test. The first method is typically referred to as the "but for" test. In this advance notice of proposed rulemaking, the second method of meeting the integral part test will be referred to as the "attentiveness" test.

Integral Part Test, Alternative I: the "but for" test. Under Treas. Reg. § 1.509(a)–4(i)(3)(ii) the "but for" test is satisfied if "the activities engaged in [by the supporting organization] for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations, and, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves."

Integral Part Test, Alternative II: the "attentiveness" test. The "attentiveness" test, under Treas. Reg. § 1.509(a)–4(i)(3)(iii), requires a supporting organization to (1) make payments of substantially all of its income to or for the use of one or more publicly supported organizations, (2) provide enough support to one or more publicly supported organizations to insure the attentiveness of such organizations to the operations of the supporting organization, and (3) pay a substantial amount of the total support of the supporting organization to those publicly supported organizations that meet the attentiveness requirement. Rev. Rul. 76–208, 1976–1 C.B. 161, (see § 601.601(d)(2) of this chapter), provides that the phrase "substantially all of its income" in Treas. Reg. § 1.509(a)–4(i)(3)(iii) means at least 85 percent of its adjusted net income.

PPA Amendments to Qualification Requirements for Type III Supporting Organizations

The PPA amended the qualification requirements for Type III supporting organizations, modifying both the integral part test and the responsiveness test.

Sections 1241 and 1243 of the PPA enacted Code sections 509(f) and 4943(f)(5).

These provisions define the term Type III supporting organization and distinguish between functionally integrated and non-functionally integrated Type III supporting organizations. These two new categories appear to reflect the distinction drawn in the Treasury Regulations between those organizations that meet the integral part test by meeting the "but for" test and those that meet the integral part test by meeting the "attentiveness" test.

In conformity with existing Treasury Regulations, new section 4943(f)(5)(A) defines a Type III supporting organization as a supporting organization that is operated in connection with one or more section 509(a)(1) or (2) organizations. New section 4943(f)(5)(B) defines a functionally integrated Type III supporting organization as a Type III supporting organization that is not required under regulations established by the Secretary to make payments to supported organizations due to the activities of the organization related to performing the functions of, or carrying out the purposes of, such supported organizations. Although this language appears similar to the "but for" prong of the integral part test, the Staff of the Joint Committee on Taxation in its technical explanation of the provision notes that there is "concern that the current regulatory standards for satisfying the integral part test not by reason of a payout [*i.e.*, the existing "but for" test] are not sufficiently stringent to ensure that there is a sufficient nexus between the supporting and supported organizations." See Staff of the Joint Committee on Taxation, *Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006* (JCX–38–06) at 360 n. 571, August 3, 2006 (Technical Explanation). In particular, the Technical Explanation states that in revising the Type III supporting organization regulations the Secretary "shall strengthen the standard for qualification as [a Type III supporting] organization that is not required to pay out." *Id.*

Section 1241(d)(1) of the PPA directed the Secretary to promulgate new regulations on the payments required by Type III supporting organizations that are not functionally integrated. Section 1241(d)(1) of the PPA provides that such regulations shall require non-functionally integrated Type III supporting organizations to make distributions of a "percentage of either income or assets to supported organizations (defined in new section 509(f)(3) of [the] Code) in order to ensure that a significant amount is paid" to their supported organizations. The Technical Explanation notes that there is concern that merely requiring a Type III supporting organization to pay out substantially all of its net income (as under the "attentiveness" prong of the integral part test) does not necessarily result in significant distributions to publicly supported organizations relative to the value of the assets held by the Type III supporting organization and "as compared to amounts paid out by nonoperating private foundations." See Technical Explanation at 360 n. 571.

Section 1241(c) of the PPA modified the responsiveness test as it applies to charitable trusts. Effectively, section 1241(c) provides that having each organization that the trust supports be a publicly supported organization named as a beneficiary under the trust's governing instrument and establishing that each beneficiary organization has the power to enforce the trust and compel an accounting is no longer sufficient to satisfy the responsiveness test as provided in Treas. Reg. § 1.509(a)–4(i)(2)(iii). The Technical Explanation states that a Type III supporting organization organized as a trust must now "establish to the satisfaction of the Secretary, that it has a close and continuous relationship with the supported organization such that the trust is responsive to the needs or demands of the supported organization." Technical Explanation at 362. Under section 1241(e)(2)(A) of the PPA, trusts that operated in connection with a publicly supported organization on August 17, 2006, have until August 17, 2007 to satisfy the modified responsiveness test under Treas. Reg. 1.509(a)–4(i)(2)(ii). For other trusts, the provision was effective on August 17, 2006.

Finally, section 1241(b) added section 509(f)(1)(A), which contains another requirement for Type III supporting organizations. The provision requires a Type III supporting organization to provide each of its supported organizations with "such information as the Secretary may require to ensure that such organization is responsive to the needs or demands of the supported organization."

As described in this advanced notice of proposed rulemaking, the Treasury Department and the IRS intend to propose regulations that provide (1) the payout requirements for Type III supporting organizations that are not functionally integrated, (2) the criteria for determining whether a Type III supporting organization is functionally integrated, (3) the modified responsiveness test for Type III supporting organizations that are organized as charitable trusts, and (4) the type of information a Type III supporting organization will be required to provide to its supported organization(s) to demonstrate that it is responsive.

Explanation of Provisions

Summary of Proposed Criteria for Qualifying as a Type III Supporting Organization

The Treasury Department and the IRS expect that all Type III supporting organizations will be required to meet the responsiveness test under Treas. Reg. § 1.509(a)–4(i)(2)(ii). In addition, it is expected that Type III supporting organizations that are functionally integrated will be required to meet: (A) the "but for" test in existing Treas. Reg. § 1.509(a)–4(i)(3)(ii); (B) an expenditure test that will resemble the qualifying distributions test for private operating foundations; and (C) an assets test that will resemble the alternative assets test for private operating foundations. Finally, it is expected that a Type III supporting organization that is not functionally integrated will be required to meet a payout requirement equal to the qualified distribution requirement of a private non-operating foundation. In addition, there will be a limit on the number of publicly supported organizations a non-functionally integrated Type III supporting organization may support. These proposed criteria for qualifying as a Type III supporting organization will replace the integral part test in the existing regulations. These provisions are explained in more detail below.

Definition of Functionally Integrated Type III Supporting Organization and

the Applicability of Private Operating Foundation Rules

Private operating foundations under section 4942(j)(3) share strong similarities with Type III functionally integrated supporting organizations under section 4943(f)(5)(B) in that both are expected to be directly engaged in the active conduct of charitable activities rather than only making grants to, or for the use of, charitable organizations. The Code and Treasury Regulations provide extensive rules used to determine whether a private foundation is a private operating foundation. See section 4942(j)(3) and Treas. Reg. § 53.4942(b). The Treasury Department and the IRS believe that these rules provide a useful model for developing standards to determine whether a Type III supporting organization is functionally integrated, and that adoption of similar rules under section 4943(f)(5)(B) will further the Congressional purpose articulated in the Technical Explanation of strengthening the nexus between a functionally integrated Type III supporting organization and the publicly supported organization(s) it supports.

To qualify as a private operating foundation under section 4942(j)(3), an organization must satisfy a qualifying distributions test and one of three alternative tests described below. Under the qualifying distributions test, a private operating foundation must make qualifying distributions "directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated," equal to substantially all (at least 85 percent) of the lesser of its adjusted net income or its minimum investment return. Under section 4942(e)(1), the minimum investment return is equal to 5 percent of the excess of (A) the aggregate fair market value of all the foundation's assets other than those used (or held for use) directly in carrying out the organization's exempt purpose over (B) the acquisition indebtedness with respect to such assets. Under Treas. Reg. § 53.4942(b)–1(b)(1), a qualifying distribution directly for the active conduct of activities constituting the foundation's exempt purpose is a distribution that is used by the foundation itself to carry out its exempt activities rather than paid to other organizations to help them carry out their exempt activities.

In addition, a private operating foundation must meet one of three alternative tests: an assets test, an endowment test or a support test. The assets test, under section 4942(j)(3)(B)(i) and Treas. Reg. § 53.4942(b)–2(a), requires that substantially more than half (at least 65 percent) of the assets of an operating foundation must be devoted directly to the private operating foundation's exempt purpose activities, or to functionally related businesses (see section 4942(j)(4)), or both, or are stock of a corporation controlled by, and substantially all (at least 85 percent) of the assets of which are devoted to, the foundation. The endowment test, under Treas. Reg. § 53.4942(b)–2(b), requires a foundation to make qualifying distributions directly for the active conduct of its exempt activities in an amount not less than two thirds of its minimum investment return. The support test, under Treas. Reg. § 53.4942(b)–2(c), is satisfied if substantially all (85 percent) of a foundation's support (other than gross investment income) is normally received from the general public and from five or more exempt organizations that are not related to each other or the recipient foundation, if the foundation does not normally receive more than 25 percent of its support from any one such exempt organization; and if the foundation does not normally receive more than 50 percent of its support from gross investment income.

Description of the Proposed Functionally Integrated Test

The Treasury Department and the IRS anticipate that the proposed regulations will define the term functionally integrated Type III supporting organization as a Type III supporting organization that meets: (A) the "but for" test in existing Treas. Reg. § 1.509(a)–4(i)(3)(ii); (B) an expenditure test consistent with section 4942(j)(3)(A); and (C) an assets test consistent with section 4942(j)(3)(B)(i). It is expected that the expenditure test will require a functionally integrated Type III supporting organization to use substantially all of the lesser of (a) its adjusted net income or (b) five percent of the aggregate fair market value of all its assets (other than assets that are used, or held for use, directly in supporting the charitable programs of the supported organizations) directly for the active conduct of activities that directly further the exempt purposes of the organizations it supports. The assets test will require the organization to devote at least 65 percent of the aggregate fair market value of all its assets directly for the active conduct of activities that directly further the exempt purposes of the organizations it supports. The Treasury Department and the IRS believe that requiring functionally integrated Type III supporting organizations to satisfy the expenditure and assets tests, in addition to the "but for" test, will be stronger than the existing integral part test and ensure a sufficient nexus between a supporting organization and the organization(s) it supports. These tests also will ensure that a sufficient amount is being dedicated directly to the active conduct of activities that further the exempt purposes of publicly supported organizations.

The term "adjusted net income" is expected to have substantially the same meaning as that term has in section 4942(f) and Treas. Reg. § 53.4942(a)–2(d). The valuation of assets is expected to be determined in a manner similar to the rules under section 4942(e)(2) and Treas. Reg. § 53.4942(a)–2(c)(4).

The Treasury Department and the IRS also intend that certain Type III supporting organizations that oversee or facilitate the operation of an integrated system that includes one or more charities and that may be unable to satisfy the "direct active conduct" and "directly further" requirements of the expenditure and assets tests, such as certain hospital systems, will be classified as functionally integrated in the proposed regulations if they satisfy the existing "but for" test.

The proposed regulations will not permit a functionally integrated Type III supporting organization to qualify as functionally integrated by using the endowment or support tests that are available to private operating foundations as alternatives to the proposed assets test. Because the endowment test is similar to the expenditure test, the Treasury Department and the IRS believe that the endowment test would not provide sufficient additional assurances of a tight nexus between a functionally integrated supporting organization and its supported organizations. Furthermore the support test, which focuses on sources of support received by a private foundation rather than on its activities, ap-

pears to be inapplicable to the functionally integrated concept. By requiring at least 65 percent of the value of all assets of each functionally integrated supporting organization to be devoted directly for the active conduct of the activities of its supported organizations, the proposed assets test is intended to ensure that the connection between the supporting and supported organizations is significant.

Payout Requirement for Type III Supporting Organizations that are not Functionally Integrated

In establishing a payout requirement for non-functionally integrated Type III supporting organizations, the Treasury Department and the IRS expect to follow the framework of the existing section 4942 qualifying distribution regulations applicable to private non-operating foundations. Private non-operating foundations have operated under these qualifying distribution regulations for many years. The Treasury Department and the IRS believe these rules are appropriate for Type III grant-making organizations, and would further the Congressional purpose articulated in the Technical Explanation of ensuring that, as compared to amounts paid out by private non-operating foundations, significant amounts are being paid to supported organizations even if the supporting organization's assets produce little or no income.

A private non-operating foundation is required under section 4942 to make certain qualifying distributions or pay an excise tax. A private non-operating foundation is generally liable for this excise tax under section 4942(a) and (b) if it does not make qualifying distributions each year equal to its minimum investment return. The minimum investment return is five percent of the aggregate fair market value of all the foundation's assets other than those used (or held for use) directly in carrying out the organization's exempt purpose over the acquisition indebtedness with respect to such assets. Qualifying distributions under section 4942(g) are generally those distributions (including reasonable and necessary administrative expenses) paid to accomplish charitable purposes.

Description of the Proposed Payout Rule

The Treasury Department and the IRS anticipate that the proposed regulations will (A) require a non-functionally integrated Type III supporting organization to meet a payout requirement and (B) limit the number of publicly supported organizations a non-functionally integrated Type III supporting organization may support.

The payout requirement will call for a Type III supporting organization that is not functionally integrated to distribute annually to or for the use of its supported organizations an amount equal to at least five percent of the aggregate fair market value of all its assets (other than assets that are used, or held for use, directly in supporting the charitable programs of its supported organizations). Additionally, the Treasury Department and the IRS are concerned that a supporting organization's relationship with and accountability to its supported organizations is diminished as the number of its supported organizations increases. Accordingly, except for organizations in existence on or before the date the regulations are proposed, it is expected that the proposed regulations will also provide that non-functionally integrated Type III supporting organizations will be limited to supporting no more than five publicly supported organizations. An organization in existence on or prior to the date regulations are proposed may support more than five supported organizations only if the organization distributes at least 85 percent of its total required payout amount to, or for the use of, publicly supported organizations to which the supporting organization is responsive pursuant to Treas. Reg. § 1.509(a)–4(i)(2)(ii). The anticipated proposed payout rules are intended to ensure that a non-functionally integrated Type III supporting organization has a tight nexus with its supported organization(s).

The Treasury Department and the IRS recognize that requiring an existing Type III supporting organization that supports more than five supported organizations to provide 85 percent of its total required payout to those supported organizations to which it is responsive may affect existing donee relationships. The Treasury Department and the IRS solicit comments on whether transitional rules are needed with respect to this proposed limitation regarding distributions to supported organizations.

The valuation of assets for purposes of the payout requirement is expected to be determined in a manner similar to that under section 4942(e)(2) and Treas. Reg. § 53.4942(a)–2(c)(4). The proposed distribution rules will be similar to the distribution rules under section 4942. It is expected that amounts paid by an organization to accomplish the exempt purposes of its supported organizations will be considered as distributed to or for the use of its supported organization(s).

Responsiveness Test

Except as explained below with respect to charitable trusts, the Treasury Department and the IRS do not expect to modify the responsiveness test. Thus, all Type III supporting organizations will be expected to meet the responsiveness test under Treas. Reg. § 1.509(a)–4(i)(2)(ii). Accordingly, a Type III supporting organization will be expected to demonstrate the necessary relationship between its officers, directors or trustees and those of its supported organization(s), and further show that this relationship results in the officers, directors or trustees of its supported organization(s) having a significant voice in the operations of the supporting organization.

Responsiveness Test for Charitable Trusts

Consistent with section 1241(c) of the PPA, discussed in the Background section above, the proposed regulations will provide that charitable trusts must satisfy the responsiveness test under Treas. Reg. § 1.509(a)–4(i)(2)(ii). Thus, for instance, a trust would be expected to show that its trustees have a close, continuous working relationship with the officers, directors, or trustees of the publicly supported organization(s) it supports and that through such relationship the officers, directors or trustees of its publicly supported organization(s) have a significant voice in the operations of the supporting organization. Comments are requested with respect to potential transition relief given that the statute directs that this modified test apply as of August 17, 2007 to trusts already in existence on the date of enactment of the PPA.

Requirement to Provide Supported Organizations with Information Regarding Responsiveness

The proposed regulations will provide rules for the form, content and timing of the information Type III supporting organizations are required to provide their supported organization(s) under section 509(f)(1)(A). The Treasury Department and the IRS solicit comments as to what information the Secretary should require a Type III supporting organization to provide to each of its supported organizations to ensure that such supporting organization is responsive to the needs or demands of its supported organization(s).

Consequences for Failing to Satisfy the Proposed Tests

The proposed regulations will clarify that an organization that would otherwise be classified as a Type III supporting organization, but either does not establish that it is functionally integrated or does not satisfy the payout requirement for non-functionally integrated organizations in a taxable year, will be classified as a private foundation for such taxable year and all subsequent taxable years until it terminates its private foundation status under section 507. The Treasury Department and the IRS solicit comments on how the requirements for a private foundation termination under section 507 should apply in these circumstances.

Transitional Issues

Implementation of the new qualification requirements for Type III supporting organizations enacted in the PPA will raise transitional issues for certain organizations. For instance, an organization that currently qualifies as a Type III supporting organization by meeting the attentiveness prong of the integral part test might be prohibited by its current governing instrument from distributing capital or corpus, thus preventing it from being able to satisfy the new payout requirement for non-functionally integrated Type III supporting organizations without a change to such instrument. The Treasury Department and the IRS invite comments regarding potential transition rules for supporting organizations in existence as of the date of enactment of the PPA that will provide such organizations a reasonable opportunity to amend their governing instruments or make other changes to comply with the law as amended by the PPA.

Proposed Effective Date

Except as otherwise noted, the Treasury Department and the IRS anticipate that these new proposed rules for Type III supporting organizations would apply to taxable years with respect to each organization beginning after the date these rules are published in the Federal Register as final or temporary regulations.

Request for Comments

Before the notice of proposed rulemaking is issued, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying.

Drafting Information

The principal authors of this advance notice of proposed rulemaking are Philip T. Hackney and Michael B. Blumenfeld, Office of the Chief Counsel (Tax-exempt and Government Entities), however, other personnel from the IRS and the Treasury Department participated in its development.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 1, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 2, 2007, 72 F.R. 42335)

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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