Internal Revenue bulletin

Bulletin No. 2012-25
June 18, 2012

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2012–17, page 1018.

Interest in a money market fund as a cash item for REITs. This ruling provides guidance to real estate investment trusts (REITs) on the treatment of income derived from an investment in a money market fund for purposes of the REIT asset tests under section 856(c)(4) of the Code. The ruling holds that a REIT's investment in a money market fund is an investment in "cash or cash items" for purposes of section 856(c)(4)(A).

REG–142561–07, page 1020.

Agency for a consolidated group. Proposed regulations under section 1502 of the Code clarify that the agent for the consolidated group that becomes either a partnership or an entity that is disregarded from its owner for Federal income tax purposes remains as the agent for the group. Another change is that in situations where the agent for the group may no longer continue to be the agent for the group, the regulations provide, under most circumstances, that the continuing agent for the group will be automatically determined by a default selection.

REG–141075–09, page 1028.

Section 83 addresses the income tax consequences of property transferred in connection with the performance of services. Proposed regulations under section 83 of the Code clarify the definition of a substantial risk of forfeiture under regulations section 1.83–3(c)(1). The regulations also update the regulations under section 1.83–3 to incorporate the holdings of Revenue Ruling 2005–48, 2005–2 C.B. 259, which address the substantial risk of forfeiture created by liability under section 16(b) of the Securities Exchange Act of 1934.

EMPLOYEE PLANS

REG–141075–09, page 1028.

Section 83 addresses the income tax consequences of property transferred in connection with the performance of services. Proposed regulations under section 83 of the Code clarify the definition of a substantial risk of forfeiture under regulations section 1.83–3(c)(1). The regulations also update the regulations under section 1.83–3 to incorporate the holdings of Revenue Ruling 2005–48, 2005–2 C.B. 259, which address the substantial risk of forfeiture created by liability under section 16(b) of the Securities Exchange Act of 1934.

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

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

Proposed regulations clarify the definition of a substantial risk of forfeiture under section 1.83–3 and update the regulations under section 1.83–3 to incorporate the holdings in Revenue Ruling 2005–48, 2005–2 C.B. 259, which address the substantial risk of forfeiture created by liability under section 16(b) of the Securities Exchange Act of 1934. See REG-141075-09, page 1028.

Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856–2: Limitations.

Interest in a money market fund as a cash item for REITs. This ruling provides guidance to real estate investment trusts (REITs) on the treatment of income derived from an investment in a money market fund for purposes of the REIT asset tests under section 856(c)(4) of the Code. The ruling holds that a REIT's investment in a money market fund is an investment in "cash or cash items" for purposes of section 856(c)(4)(A).

Rev. Rul. 2012–17

ISSUE

If a real estate investment trust (REIT) holds shares in a money market fund, are those shares "cash items" for purposes of section 856(c)(4)(A) of the Internal Revenue Code?

FACTS

R has elected to be taxed as a REIT under subchapter M of Chapter 1 of the Code. During the first quarter of its 2011 taxable year, *R* purchased shares of *F*, a money market fund. *F* is subject to regulation under the Investment Company Act of 1940, 15 U.S.C. 80a–1, *et seq*. (1940 Act), and complies with the requirements of Rule 2a–7 under the 1940 Act, as amended in 2010. At the close of the first quarter of its 2011 taxable year, 20 percent of the value of *R*'s total assets for purposes of section 856(c)(4) was represented by securities that are neither Government securities, real estate assets within the meaning of section 856(c)(5)(B), nor cash or cash items; 7 percent was represented by the shares in *F*; and 73 percent was represented by assets that are real estate assets.

LAW AND ANALYSIS

Section 856(c)(4)(A) provides that at the close of each quarter of its taxable year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities (the "75 percent value test"). Section 856(c)(4)(B) provides, in relevant part, that at the end of each quarter of a taxable year, not more than 25 percent of the value of a REIT's total assets may be represented by securities (other than those includible under section 856(c)(4)(A)). Section 856(c)(4)(B) further provides (with certain exceptions) that not more than 5 percent of the REIT's total assets may be represented by securities of any one issuer, and that a REIT may not hold securities possessing more than 10 percent of the total voting power or value of the outstanding securities of a single issuer. The term "cash and cash items" is not defined in the Code. Section 856(c)(5)(F) provides that all terms that are not defined in section 856(c)(5) shall have the same meaning as when used in the 1940 Act.

The term "cash item" is not defined in either the 1940 Act or the regulations under the 1940 Act. However, with respect to the issue addressed by this revenue ruling, the staff of the Division of Investment Management at the Securities and Exchange Commission (SEC) has issued a no-action letter that is directly on point. *See* Willkie Farr & Gallagher, SEC No-Action Letter, IM Ref. No. 2000 10 24 1124, File No. 132–3 (October 23, 2000), viewable at *http://www.sec.gov/divisions/investment/noaction/2000/willkiefarrgallagher102300.pdf* (hereinafter, "the SEC No-Action Letter"). The Division of Investment Management generally permits a third party to rely on no-action letters issued to other persons to the extent that the third party's facts and circumstances are substantially similar to those described in the underlying request for the letter.[1]

At issue in the SEC No-Action Letter was whether an issuer:

> ... may treat money market fund shares as "cash items," and not as investment securities and adjusted investment securities ..., for purposes of determining whether the issuer is an investment company as defined in section 3(a)(1)(C) of the Investment Company Act of 1940 ... and rule 3a–l thereunder, respectively.

SEC No-Action Letter at 1. Section 3(a)(1)(C) of the 1940 Act defines the term "investment company" to mean any issuer which is engaged generally in the business of investing in securities and "owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and *cash items*) on an unconsolidated basis" (emphasis added). Investment Company Act Rule 3a–1, which was adopted by the SEC in 1981, generally provides that notwithstanding section 3(a)(1)(C) of the 1940 Act, an issuer will be deemed not to be an investment company if, among other things, no more than 45 percent of the value of the issuer's total assets (exclusive of Government securities and cash items) consists of certain specified classes of securities.

The SEC No-Action Letter concluded that the SEC Division of Investment Management would not object if an issuer calculated the amount of its investment securities without including the money market

[1] An SEC Policy Statement provides that "[i]n general, only the party or parties requesting a no-action letter or interpretive position may rely on the no-action or interpretive letter, and they may rely on the position with regard only to the specific facts addressed in the letter." The Policy Statement further states, however, that "[t]he Division of Investment Management generally permits third parties to rely on no-action and interpretive letters to the extent that the third party's facts and circumstances are substantially similar to those described in the underlying request for a no-action or interpretive letter." Informal Guidance Program for Small Entities, Investment Company Act, Release No. IC–22587, 62 Fed. Reg. 15604, 15606 (SEC, April 12, 1997) at n.20.

fund shares. The SEC staff stated in the letter,

> [T]he essential qualities of a cash item for purposes of section 3(a)(1)(C) and rule 3a–1...[are] a high degree of liquidity and a relative safety of principal. In our view, money market fund shares have these same qualities because of the specific regulatory requirements with which money market funds must comply.

SEC No-Action Letter at 6. The SEC No-Action Letter further noted that "treating money market fund shares [as a cash item] provides operating companies with appropriate flexibility in managing their cash holdings." SEC No-Action Letter at 7.

The conclusion reached in the SEC No-Action Letter is not inconsistent with the language of section 856(c)(4)(A) or its underlying legislative history.

HOLDINGS

R's shares in *F* are described in section 856(c)(4)(A), which includes "cash and cash items (including receivables)." *R*, therefore, satisfies the 75 percent value test under section 856(c)(4)(A). In addition, as an investment that is includible under subparagraph (A) of section 856(c)(4), *R*'s shares in *F* are not treated as investments in securities for purposes of section 856(c)(4)(B).

The conclusions in this revenue ruling are predicated on provisions of nontax law applicable to money market funds. *See* Rev. Proc. 89–14, § 7.01(6), 1989–1 C.B. 814, 815.

DRAFTING INFORMATION

The principal author of this revenue ruling is Jonathan D. Silver of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact Jonathan D. Silver at (202) 622–3930 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Regulations Revising Rules Regarding Agency for a Consolidated Group

REG–142561–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the regulations regarding the agent for an affiliated group that files a consolidated return (consolidated group). The proposed regulations provide guidance concerning the identity and authority of the agent for the consolidated group (agent for the group). These proposed regulations affect all consolidated groups. This document also invites comments from the public regarding these proposed regulations.

DATES: Written or electronic comments and a request for a public hearing must be received by August 28, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–142561–07), room 5205, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–142561–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–142561–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Gerald B. Fleming at (202) 622–7770 or Richard M. Heinecke at (202) 622–7930; concerning submissions of comments or a request for a public hearing, Funmi Taylor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review and approval under OMB approval number 1545–1699 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

Comments on the collection of information should be sent 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, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:M:S, Washington, DC 20224. Comments on the collection of information should be received by July 30, 2012.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the collection will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information in the proposed regulations are in §1.1502–77(c)(3), (c)(4), (c)(5), and (f)(3).

The proposed regulations provide that an entity that is the agent for the group, upon becoming the default successor, is required to notify the Commissioner in writing (under procedures prescribed by the Commissioner), in accordance with §1.1502–77(c)(3), that it is the default successor.

The proposed regulations under §1.1502–77(c)(4) further provide that, when the agent for the group designates an agent for the group under circumstances in which the agent for the group's existence terminates without a default successor, the agent for the group must notify the Commissioner in writing (under procedures prescribed by the Commissioner) of the designation and provide an agreement executed by the designated entity acknowledging that it will serve as the agent for the group. If the designated entity was not itself a member of the group during the consolidated return year because the designated entity is a successor of a member of the group for the consolidated return year, the agent for the group must furnish a statement by the designated entity acknowledging that it is or will be primarily liable for the tax as a successor of a member.

The proposed regulations at §1.1502–77(c)(5) require a designated substitute agent to give notice to each member of the group when the Commissioner has designated a substitute agent for the group.

Under §1.1502–77(f)(3), if an entity ceases to be a member of a group, such entity may file a written notice of that fact with the Commissioner and request a copy of the notice of deficiency with respect to the Federal income tax for a consolidated return year during which the entity was a member, or a copy of any notice and demand for payment of such deficiency, or both.

The collections of information are required to obtain a benefit, for example, to identify a substitute agent for the group. The likely respondents are business or other for-profit institutions.

The burden for the collection of information in §1.1502–77(c)(3), (c)(4), (c)(5), and (f)(3) is as follows:

Estimated total annual reporting burden: 200 hours.

Estimated average annual burden per respondent: 2 hours.

Estimated number of respondents: 100.

Estimated annual frequency of responses: On occasion.

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.

Background

This document proposes amendments to 26 CFR part 1 under section 1502 of the Internal Revenue Code of 1986 (Code). Section 1.1502–77 provides the existing regulations concerning the agent for a group and the designation of a new agent to act for the group. Section 1.1502–77 was promulgated in 2002 in T.D. 9002, 2002–2 C.B. 120 (June 28, 2002) (67 FR 43538), and supplemented by T.D. 9255, 2006–1 C.B. 741 (71 FR 13001) (March 14, 2006) and T.D. 9343, 2007–2 C.B. 533 (72 FR 40066) (July 23, 2007) (each providing authority to replace the common parent as agent where the parent is a foreign entity). Subsequent to 2002, the IRS and Treasury Department issued other regulations, §§1.856–9, 1.1361–4(a)(6), and 301.7701–2(c)(2)(iii), which provide that an entity treated as disregarded from its owner for Federal income tax purposes is not disregarded for purposes of its tax liability for periods during which it was not disregarded. These proposed regulations conform to the subsequent guidance by permitting a non-corporate entity to be agent for the group.

These proposed regulations provide greater certainty as to which entity will be the substitute agent for the group by identifying a default successor agent for the group. Under the proposed regulations, an entity (whether foreign or domestic) is a default successor if it becomes the single entity primarily liable, pursuant to applicable law (including, for example, by operation of a state or Federal merger statute), for the tax liability of the former agent of the group upon the termination of the agent's existence. (The determination of tax liability is made without regard to §1.1502–1(f)(4) or §1.1502–6(a)). When the agent for the group terminates under applicable law and there is no default successor, the agent for the group may designate a substitute agent.

Furthermore, as discussed under "Explanation of Provisions" the proposed amendments clarify and supplement the existing regulations to address other issues that have arisen. This notice of proposed rulemaking also requests comments with respect to several issues that the proposed amendments do not address.

Explanation of Provisions

1. *Overview*

These proposed regulations generally retain the rules, concepts and examples from the existing regulations regarding the agent for a consolidated group. However, the rules, concepts and examples from the existing regulations have been renumbered, restructured and revised to provide greater clarity. Examples in the final regulations also have been modified to reflect the more limited circumstances in which an agent may be selected by the IRS or the former agent. In addition, when these proposed regulations are adopted, the IRS plans to issue contemporaneous guidance in a revenue procedure superseding Rev. Proc. 2002–43, 2002–2 C.B. 99, (see §601.601(d)(2)(ii)(*b*) of this chapter). Rev. Proc. 2002–43 provides instructions regarding all communications relating to the determination of a substitute agent to act on behalf of a consolidated group. In general, it is anticipated that the instructions in the superseding revenue procedure will update Revenue Procedure 2002–43 to reflect the rules in the adopted regulations.

2. *Automatic Designation of a Default Successor Agent*

Under the existing regulations, a common parent that is going out of existence may designate its successor, another member of the group, or a group member's successor entity as the substitute agent for the group. In practice, the terminating common parent, when it has designated a substitute agent at all, has generally designated its successor rather than another member as the substitute agent.

The proposed regulations provide that the terminating agent's default successor automatically becomes the agent for the group. The former agent cannot designate an agent if there is a default successor, and the IRS can replace a default successor only in limited circumstances. See §1.1502–77(c)(5). If the agent for the group has no default successor, the agent for the group may designate an entity that was a member of the group for the consolidated return year or a successor of such member. Narrowing the option to designate the agent for the group is consistent with the pattern of choices exhibited by taxpayers under the existing regulations and minimizes the difficulties that arise when a terminating agent fails to designate a substitute. In the rare cases in which an entity serving as agent terminates its existence without having a default successor, the IRS and Treasury Department expect that fact generally will be clear. Accordingly, IRS and taxpayers can readily identify situations in which a new agent must be designated. Furthermore, having the default successor become the substitute agent is the intuitively appropriate choice because it is generally consistent with the handling of tax matters involving non-consolidated entities and non-consolidated taxes.

A default successor must notify the IRS in writing (under procedures prescribed by the IRS) that it is the default successor. Until the IRS receives such notification, any notice of deficiency or other communication mailed to the predecessor agent for the group, even if no longer in existence, is considered as having been properly mailed to the agent for the group, and the IRS is not required to act on any communication (including, for example, a claim for refund) submitted on behalf of the group by any person (including the default successor) other than the predecessor agent for the group.

3. *Entities That Can Be an Agent for the Group*

In general, §1.1502–77(e) provides that the common parent, as agent for the group, ceases to be the agent for the group if its existence terminates under applicable law, if it becomes an entity disregarded from its owner for Federal tax purposes, or if it becomes an entity that is reclassified as a partnership for Federal tax purposes.

When the existing regulations were adopted in 2002, there was no direct guidance concerning whether the party liable for a disregarded entity's Federal taxes with respect to periods before it becomes disregarded should be the disregarded entity or its owner. Section 1.1502–77(e)

generally precludes the common parent from continuing to serve as the agent for the group if it becomes a disregarded entity or partnership. Subsequent regulatory amendments provided that an entity treated as disregarded from its owner for Federal income tax purposes (whether a single member eligible entity, a Qualified Real Estate Investment Trust Subsidiary or a Qualified Subchapter S Subsidiary) is not disregarded for purposes of its tax liability for taxable periods during which it was not disregarded. See T.D. 9183, 2005–1 C.B. 754 (70 FR 9220) (February 25, 2005), as supplemented in T.D. 9462, 2009–42 I.R.B. 504 (74 FR 46903) (September 14, 2009) and T.D. 9553, 2011–48 I.R.B. 806 (76 FR 66181) (October 26, 2011). Thus, such an entity, rather than its owner, is the party liable for the taxes arising in taxable periods before the entity became disregarded.

These proposed regulations include disregarded entities and partnerships among the entities capable of serving as substitute agents for prior years. Accordingly, the transformation or merger of a common parent into a disregarded entity or partnership after the taxable year of the return generally will result in the disregarded entity or partnership becoming the agent for the group. Because the entity that was formerly a corporation serving as the agent for the group is no longer treated as a corporation for Federal income tax purposes after the change in its classification, it will not be a continuing member of a consolidated group in future periods. Nevertheless, the continuing or successor juridical entity is the agent for the group for prior periods. This result will obtain whether the change in classification is effectuated by a merger under state law, a conversion under state law, or a tax election.

4. *TEFRA Partnerships*

Section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 324) (TEFRA) provides that the tax treatment of partnership items shall be determined at the partnership level. These TEFRA provisions are in sections 6221 through 6234. A partner in a TEFRA partnership is subject to the provisions of sections 6221 through 6234. In general, the IRS will deal with the tax matters partner (TMP) regarding specified matters for the partners in a TEFRA partnership.

The existing regulations at §1.1502–77(a)(6)(iii) provide that "[t]he Commissioner generally will deal directly with any member in its capacity as a partner of a [TEFRA] partnership" but also permits the Commissioner to deal with the common parent, as agent for the group, if requested to do so in accordance with the provisions of §301.6223(c)–1(b). This provision was intended to facilitate IRS audits of TEFRA partnerships by permitting the IRS TEFRA audit team to deal with a member-partner without the involvement of the agent for the group. However, these rules have created some confusion, especially with respect to the execution of consents to extend the statute of limitations and settlement agreements in connection with TEFRA audits.

Subject to enumerated exceptions in (f)(2)(iii) (relating to a member's actions as TMP and the Commissioner's discretion to deal directly with the member-partner), section 1.1502–77(f)(2)(iii)(A) provides that the agent for the group is the agent for any matter related to a TEFRA partnership in which a member is a partner. Consistent with this general rule, these proposed regulations would delete the provision of the existing regulations that the common parent, as agent for the group, will not act as agent for a member that is a partner in a TEFRA partnership for purposes of executing a settlement agreement under section 6224(c). The proposed regulations also clarify that only the agent for the group can extend the statute of limitations with respect to items other than the items of the TEFRA partnership. Section 1.1502–77(g), *Example 11*.

5. *Commissioner's Affirmative Approval*

The existing regulations at §1.1502–77(d)(1)(i)(A) and (d)(1)(ii) provide that any designation of the substitute agent for the group must be approved by the Commissioner. The IRS is aware of having denied this approval only in the very limited circumstance in which the designation was not made in accordance with the regulations. Because the IRS would deny approval only infrequently, the proposed regulations do not require IRS approval of the designation of an agent for the group by the terminating agent. This proposed change will enhance efficiency and save resources. However, the proposed regulations retain the requirement that a terminating agent must notify the IRS in writing (under procedures prescribed by the IRS) of the designation of the agent for the group so that IRS records will reflect the identity of the agent for the group.

The proposed regulations also provide several limited circumstances in which the IRS may designate or replace the agent for the group, either on its own initiative or at the request of other members. The IRS will not, however, have the ability to replace a domestic default successor under circumstances in which it could not replace the common parent.

6. *Foreign Entity*

Under the existing regulations, a substitute agent is required to be a domestic entity for Federal income tax purposes. However, the existing regulations also provide that the Commissioner may designate another domestic member of the group to act as the agent for the group (a domestic substitute agent) if the common parent is an entity created or organized under the laws of a foreign country and is treated as a domestic corporation by reason of section 7874 (or regulations under that section) or a section 953(d) election (a foreign common parent). This rule recognizes that foreign agents may present unique logistical issues, and provides the Commissioner full discretion to replace a foreign agent should those issues arise.

Although a foreign entity may raise practical difficulties in certain cases, the IRS and Treasury realize that a foreign entity, especially a default successor, may have the best access to information relating to prior consolidated return years. Furthermore, the IRS and Treasury believe that it is important for a consolidated group to have, to the greatest extent practicable, an entity that is authorized to act on its behalf to enable the group to communicate with the IRS and to ensure that the group can timely meet its compliance obligations (for example, file a timely final return if the group terminates). The IRS and Treasury also believe that the interests of the government and taxpayers are best served by a rule that clearly identifies the group's agent. Balancing special logistical issues

and the importance of continual agency, the proposed regulations do not preclude a foreign entity from being the agent for the consolidated group. However, the IRS retains discretion to replace a foreign entity that is an agent for a consolidated group.

7. *Agency does not Include any Winding Up Period After Dissolution*

These proposed regulations also provide that an entity cannot serve as the agent for the group during any winding up period that follows its dissolution.

The existing regulations predicate agency on the continued existence of the corporation under applicable law. Questions have arisen as to what actions can be performed by a dissolved entity that has a "winding up" period following its dissolution. In many states, a dissolved corporation or entity may continue to perform certain acts after its dissolution to wind up its affairs. The duration of such a winding up period and the scope of the permissible actions vary from jurisdiction to jurisdiction. To resolve questions about whether a dissolved entity may be the agent for the remaining members of the consolidated group during the winding up period, these proposed regulations provide that an entity that has dissolved or otherwise ceased to exist under applicable law can no longer be the agent for the group, irrespective of any winding up period under applicable law.

8. *The Agent for the Group's Failure to Fulfill its Duties With Respect to the Consolidated Group*

These proposed regulations include no new mechanism to address situations in which the agent for the group fails to fulfill its duties on behalf of the members of the consolidated group, for example by not filing a return, not requesting a refund, or not cooperating with an examination. Under those circumstances, the members might not be able to accurately file or determine their Federal tax liability or obtain their refunds. The government might have difficulty determining which, if any, member is entitled to a refund, forcing it to interplead all potential claimants in any such refund case.

The IRS and Treasury Department request comments on whether and how to implement a mechanism whereby the subsidiary members can request that the IRS designate another member of the group to be the agent when the common parent or substitute agent does not discharge its obligations as agent. Comments should consider under what circumstances and how this mechanism might be invoked to ensure that it is narrowly applied.

9. *Possible Resignation of the Agent for the Group*

Under the existing regulations, a common parent, as agent for the group, remains the agent for the group for consolidated return years for which it was the common parent of the group. Only a termination of the common parent under applicable law will result in either the successor becoming the default substitute agent or an agent being designated for the group. The proposed regulations do not provide a mechanism for an existing agent to resign and limit the ability of the agent to displace its obligations transactionally by mandating the designation of any default successor. The Treasury Department and the IRS are considering whether, and under what circumstances, the regulations should allow an agent for the group to resign as the agent, and invite comments on this issue.

Proposed Effective/Applicability Date

The amendments to §1.1502–77 are proposed to apply to consolidated return years beginning on or after the date final regulations are published in the **Federal Register.** The current rules of §1.1502–77 continue to apply with respect to consolidated return years beginning before the effective date of final regulations. Those regulations are proposed to be republished as §1.1502–77B.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12666, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily will affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger entities. 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, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS.

The Treasury Department and the IRS request comments on all aspects of the proposed rules. In addition, comments are requested on the treatment in the proposed regulations of entities that become disregarded as entities separate from their owners or classified as partnerships for Federal tax purposes.

All comments that are submitted by the public will be available for public inspection and copying at *http://www.regulations.gov* or upon request. A public hearing may be scheduled if requested in writing by any person who timely submits comments. If a public hearing is scheduled, notice of the date, time and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Richard M. Heinecke, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and the Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.1502–77 also issued under 26 U.S.C. 1502 and 6402(j). * * *

Section 1.1502–77A also issued under 26 U.S.C. 1502 and 6402(j). * * *

Section 1.1502–77B also issued under 26 U.S.C. 1502 and 6402(j). * * *

Par. 2. Section 1.338–1 is amended by removing the language "section 1.1502–77(e)(4)" in the last sentence of paragraph (b)(2)(viii) and adding the language "section 1.1502–77(c)(8)" in its place.

Par. 3. Section 1.1502–41A, paragraph (c) heading is revised to read as follows:

* * * * *

(c) *Effective/applicability dates*. * * *

Par. 4. Section 1.1502–77 is redesignated as section 1.1502–77B and added immediately following newly designated section 1.1502–77B the undesignated center heading and revised paragraph (h)(1)(i) to read as follows:

Section 1.1502–77B Agent for the group applicable for consolidated return years beginning on or after June 28, 2002, and before [the date final regulations are published in the ***Federal Register***].

REGULATIONS APPLICABLE TO TAXABLE YEARS BEGINNING ON OR AFTER JUNE 28, 2002, AND BEFORE [THE DATE FINAL REGULATIONS ARE PUBLISHED IN THE **FEDERAL REGISTER**]

* * * * *

(h) *Effective/Applicability date*—(1) *Application*—(i) *In general*. This section applies to taxable years beginning on or after June 28, 2002, and before [the date final regulations are published in the **Federal Register**].

* * * * *

Par. 5. New section 1.1502–77 is added to read as follows:

§1.1502–77 Agent for the group.

(a) *Agent for the group*. Except as provided in paragraphs (e) and (f)(2) of this section, one entity (the agent for the group) is the sole agent that is authorized to act in its own name regarding all matters relating to the Federal income tax liability for the consolidated return year for each member of the group and any successor or transferee of a member (and any subsequent successors and transferees thereof). The common parent during the consolidated return year to which the matter relates or such other entity as is provided in paragraph (c) of this section is the agent for the group. Agency for the group is established for each consolidated return year and is not affected by the status or membership of the group in later years. Thus, for as long as it remains in existence under applicable law and is not replaced under paragraph (c)(5)(i)(C) of this section, a corporation or entity that is the agent for the group for a particular consolidated return year remains the agent for the group for that year regardless of whether one or more subsidiaries later cease to be members of the group, whether the group files a consolidated return for any subsequent year, whether the agent for the group ceases to be the agent for the group or a member of the group in any subsequent year, or whether the group continues pursuant to §1.1502–75(d) with a new common parent in any subsequent year.

(b) *Definitions*. The following definitions apply for purposes of this section only—

(1) *Successor*. A *successor* is an individual or entity (including a disregarded entity) that is primarily liable, pursuant to applicable law (including, for example, by operation of a state or Federal merger statute), for the tax liability of a corporation which was a member of the group but is no longer in existence under applicable law. The determination of tax liability is made without regard to §1.1502–1(f)(4) or §1.1502–6(a). (For inclusion of a successor in references to a subsidiary or member, see paragraph (b)(5)(iii) of this section.)

(2) *Entity*. The term *entity* includes any corporation, limited liability company or partnership formed under any state, Federal, or foreign jurisdiction. The term entity includes a disregarded entity. The term entity does not include an entity during any winding up period if the entity's existence has terminated pursuant to the law under which it is organized.

(3) *Disregarded entity*. The term *disregarded entity* includes any of the following types of entities disregarded as separate from their owners—

(i) Qualified real estate investment trust subsidiaries (within the meaning of section 856(i)(2));

(ii) Qualified subchapter S subsidiaries (within the meaning of section 1361(b)(3)(B)); and

(iii) Single owner eligible entities (within the meaning of Treas. Reg. §301.7701–3).

(4) *Default successor*. A successor to the agent for the group is the default successor if it is an entity (whether domestic or foreign) that is the sole successor to the agent for the group. A partnership is treated as a sole successor with primary liability notwithstanding that one or more partners may also be primarily liable by virtue of being partners.

(5) *Member or subsidiary*. All references to a member or subsidiary for a consolidated return year include—

(i) Each corporation that was a member of the group during any part of such year (except that any reference to a subsidiary does not include the common parent);

(ii) Each corporation whose income was included in the consolidated return for such year, notwithstanding that the tax liability of such corporation should have been computed on the basis of a separate return, or as a member of another consolidated group, under the provisions of §1.1502–75; and

(iii) Except as indicated otherwise, a successor of any of the foregoing corporations.

(c) *Identity of the agent for the group*—(1) *In general*. Except as otherwise provided in this section, the common parent or its default successor, if any, is the agent for the group. Any entity that is an agent pursuant to this paragraph (c) acts as agent for the group to the same extent and subject to the same limitations as are applicable to the common parent.

(2) *New common parent after a group structure change*. If the group continues in existence with a new common parent under the principles of §1.1502–75(d) during a consolidated return year, the common parent at the beginning of the year is the agent for the group through the date of the §1.1502–75(d) transaction, and the new common parent becomes the agent for

the group beginning the day after the transaction, at which time the new common parent becomes the agent for the group with respect to the entire consolidated return year (including the period through the date of the transaction) and the former common parent is no longer the agent for that year.

(3) *Notification by default successor*. A default successor must notify the Commissioner in writing (under procedures prescribed by the Commissioner) that it is the default successor. Until the Commissioner receives such notification—

(i) Any notice of deficiency or other communication mailed to the predecessor agent for the group, even if no longer in existence, is considered as having been properly mailed to the agent for the group; and

(ii) The Commissioner is not required to act on any communication (including, for example, a claim for refund) submitted on behalf of the group by any person (including the default successor) other than the predecessor agent for the group.

(4) *Designation by terminating agent*. (i) Prior to the termination of its existence without a default successor, the agent for the group may designate an entity described in paragraph (c)(4)(ii) of this section to act as agent for the group, effective upon its termination.

(ii) The terminating agent for the group may designate as agent for the group, for any consolidated return year for which it is the agent for the group—

(A) Any corporation that was a member of the group during any part of the consolidated return year, or

(B) Any successor of such a corporation or of the agent for the group that is an entity (whether domestic or foreign), including an entity that will become a successor at the time that the agent for the group's existence terminates.

(iii) The agent for the group must notify the Commissioner in writing (under procedures prescribed by the Commissioner) of the designation and provide an agreement executed by the designated entity acknowledging that it will serve as the agent for the group, and, if the designated entity was not itself a member of the group during the consolidated return year (because the designated entity is a successor of a member of the group for the consolidated return year), a statement by the designated entity acknowledging that it is or will be primarily liable for the tax as a successor of a member.

(iv) If the agent for the group 's existence terminates without there being a default successor, and it has not designated an entity to act as agent for the group in its place pursuant to this paragraph (c)(4)—

(A) Any notice of deficiency or other communication mailed to the agent for the group, even if no longer in existence, is considered as having been properly mailed to the agent for the group; and

(B) The Commissioner is not required to act on any communication (including, for example, a claim for refund) submitted on behalf of the group by any person.

(5) *Designation by the Commissioner*. (i) The Commissioner may, at any time, with or without a request from any member of the group, designate an entity described in paragraph (c)(4)(ii) of this section to act as the agent for the group if—

(A) The agent for the group's existence terminates without there being a default successor and no designation is made under paragraph (c)(4) of this section;

(B) The Commissioner believes that the agent for the group or its default successor exists but such entity has not responded to the Commissioner's notices sent to the last known address on file for the entity or any notices left at the usual place of business for such entity; or

(C) The agent for the group is or becomes a foreign entity as a result of any action or transaction (including, for example, a continuance into a foreign jurisdiction).

(ii) The Commissioner will notify the designated entity in writing of its designation, and the designation is effective upon receipt by the designated entity of such notice. The designated entity must give notice of the designation to each member of the group during any part of the consolidated return year, but a failure by the designated entity to notify any such member of the group does not invalidate the designation.

(iii) At the request of any member, the Commissioner may, but is not required to, replace an agent for the group previously designated under this paragraph (c)(5) with another entity described in paragraph (c)(4)(ii) of this section.

(iv) If the Commissioner replaces the agent for the group pursuant to this paragraph (c)(5), the replaced agent for the group ceases to be the agent after the Commissioner designates another agent.

(6) *Successors to designated agents*. The designation of an agent for the group under paragraph (c)(4) or paragraph (c)(5) of this section includes its default successors, if any.

(7) *Purported agent for the group*. If any entity files a consolidated return, or takes any other action related to the tax liability for the consolidated return year, purporting to be the agent for the group but is subsequently determined not to have been the agent for the group with respect to the claimed group, that entity is treated, to the extent necessary to avoid prejudice to the Commissioner, as if it were the agent for the group.

(8) *Section 338 transactions*. Notwithstanding section 338(a)(2), a target corporation for which an election is made under section 338 is not deemed to terminate for purposes of this section.

(d) *Examples of matters subject to agency*. With respect to any consolidated return year for which it is the agent for the group—

(1) The agent for the group makes any election (or similar choice of a permissible option) that is available to a subsidiary in the computation of its separate taxable income, and any change in an election (or similar choice of a permissible option) previously made by or for a subsidiary, including, for example, a request to change a subsidiary's method or period of accounting;

(2) All correspondence concerning the income tax liability for the consolidated return year is carried on directly with the agent for the group;

(3) The agent for the group files for all extensions of time, including extensions of time for payment of tax under section 6164, and any extension so filed is considered as having been filed by each member;

(4) The agent for the group gives waivers, gives bonds, and executes closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, is considered as having also been given or executed by each member;

(5) The agent for the group files claims for refund, and any refund is made directly to and in the name of the agent for the group and discharges any liability of the

Government to any member with respect to such refund;

(6) The agent for the group takes any action on behalf of a member of the group with respect to a foreign corporation including, for example, elections by, and changes to the method of accounting of, a controlled foreign corporation in accordance with §1.964–1(c)(3);

(7) Notices of claim disallowance are mailed only to the agent for the group, and the mailing to the agent for the group is considered as a mailing to each member;

(8) Notices of deficiencies are mailed only to the agent for the group (except as provided in paragraph (f)(3) of this section), and the mailing to the agent for the group is considered as a mailing to each member;

(9) Notices of final partnership administrative adjustment under section 6223 with respect to any partnership in which a member of the group is a partner may be mailed to the agent for the group, and, if so, the mailing to the agent for the group is considered as a mailing to each member that is a partner entitled to receive such notice (for other rules regarding partnership proceedings, see paragraph (f)(2)(iii) of this section);

(10) The agent for the group files petitions and conducts proceedings before the United States Tax Court, and any such petition is considered as also having been filed by each member;

(11) Any assessment of tax may be made in the name of the agent for the group, and an assessment naming the agent for the group is considered as an assessment with respect to each member; and

(12) Notice and demand for payment of taxes is given only to the agent for the group, and such notice and demand is considered as a notice and demand to each member.

(e) *Matters reserved to subsidiaries*. Except as provided in this paragraph (e) and paragraph (f)(2) of this section, no subsidiary has authority to act for or to represent itself in any matter related to the tax liability for the consolidated return year. The following matters, however, are reserved exclusively to each subsidiary—

(1) The making of the consent required by §1.1502–75(a)(1);

(2) Any action with respect to the subsidiary's liability for a Federal tax other than the income tax imposed by chapter 1 of the Internal Revenue Code (Code) (including, for example, employment taxes under chapters 21 through 25 of the Code, and miscellaneous excise taxes under chapters 31 through 47 of the Code);

(3) The making of an election under section 936(e); and

(4) The making of an election to be treated as a Domestic International Sales Corporation under §1.992–2.

(f) *Dealings with members*. (1) *Identifying members in notice of a lien*. Notwithstanding any other provisions of this section, any notice of a lien, any levy or any other proceeding to collect the amount of any assessment, after the assessment has been made, must name the entity from which such collection is to be made.

(2) *Direct dealing with a member*—(i) *Several liability*. The Commissioner may, upon issuing to the agent for the group written notice that expressly invokes the authority of this provision, deal directly with any member of the group with respect to its liability under §1.1502–6 for the consolidated tax of the group, in which event such member has sole authority to act for itself with respect to that liability. However, if the Commissioner believes or has reason to believe that the existence of the agent for the group has terminated, he may, if he deems it advisable, deal directly with any member with respect to that member's liability under §1.1502–6.

(ii) *Information requests*. The Commissioner may, upon issuing to the agent for the group written notice, request information relevant to the consolidated tax liability from any member of the group. However, if the Commissioner believes or has reason to believe that the existence of the agent for the group has terminated, he may request such information from any member of the group.

(iii) *Members as partners in partnerships subject to the provisions of sections 6221 through 6234*.

(A) Except as otherwise provided in this paragraph (f)(2)(iii), the general rule of paragraph (a)(1) of this section applies to make the agent for the group the agent for any subsidiary member that for any part of the consolidated return year is a partner in a partnership subject to the provisions of sections 6221 through 6234 of the Code (as originally enacted by the Tax Equity and Fiscal Responsibility Act of 1982 and subsequently amended) and the accompanying regulations (TEFRA partnership).

(B) Any subsidiary or any disregarded entity owned by a subsidiary that is designated as tax matters partner of a TEFRA partnership will act in its own name and perform its responsibilities under sections 6221 through 6234 and the accompanying regulations without requiring any action by the agent for the group (but see paragraph (d)(9) of this section regarding the mailing of a final partnership administrative adjustment to the agent for the group).

(C) The Commissioner may at any time communicate directly with a subsidiary or a disregarded entity owned by a subsidiary that is a partner in a TEFRA partnership whenever the Commissioner determines that such direct communication will facilitate the conduct of an examination, appeal or settlement with respect to the partnership.

(3) *Copy of notice of deficiency to entity that has ceased to be a member of the group*. A subsidiary that ceases to be a member of the group during or after a consolidated return year may file a written notice of that fact with the Commissioner and request a copy of any notice of deficiency with respect to the tax for a consolidated return year during which it was a member, or a copy of any notice and demand for payment of such deficiency, or both. Such filing does not limit the scope of the agency of the agent for the group provided for in this section. Any failure by the Commissioner to comply with such request does not limit the subsidiary's tax liability under §1.1502–6.

(g) *Examples*. Unless otherwise indicated, all entities are domestic and are calendar year taxpayers. For none of the tax years at issue does the Commissioner exercise the authority under paragraph (f)(2) of this section to deal with any member separately. Any surviving entity in a merger is either a successor as described in paragraph (b)(1) of this section, or a default successor as described in (b)(4) of this section, as the case may be. The following examples illustrate the principles of this section:

Example 1. Disposition of all group members where the agent for the group remains the agent. As of January 1 of Year 1, P, a domestic corporation, is the common parent and agent for the P consolidated group, consisting of P and its two subsidiary corporations, S and S–1. P files consolidated returns for the P group in Years 1 and 2. On December 31 of Year

1, P sells all the stock of S–1 to X. On December 31 of Year 2, P distributes all the stock of S to P's shareholders. P files a separate return for Year 3. Although the consolidated group terminates after Year 2 and P is no longer the common parent nor the agent for the group in years after Year 2, P remains the agent for the P group for Years 1 and 2. For as long as P remains in existence, P is the agent for the P group under paragraph (a) of this section for Years 1 and 2.

Example 2. Acquisition of the agent for the group by another group where the agent for the group remains the agent. The facts are the same as in *Example 1*, except on January 1 of Year 3, all of the outstanding stock of P is acquired by Y, a domestic corporation that is the common parent and agent for the group of the Y consolidated group. P thereafter joins in the Y group consolidated return as a member of the Y group. Although P is a member of the Y group in Year 3 and subsequent periods, P remains the agent for the P group for Years 1 and 2. For as long as P remains in existence, P is the agent for the P group under paragraph (a) of this section for Years 1 and 2.

Example 3. Reverse triangular merger of the agent for the group where the agent for the group remains the agent. (i) As of January 1 of Year 1, P, a domestic corporation that is the common parent and agent for the P consolidated group consisting of P and its two subsidiary corporations, S and S–1. P files consolidated returns for the P group in Years 1 and 2. On March 1 of Year 3, W–1, a domestic subsidiary corporation of W, a domestic corporation, merges into P, in a reverse triangular merger described in section 368(a)(1)(A) and (a)(2)(E). P survives the merger with W–1. The transaction constitutes a reverse acquisition under §1.1502–75(d)(3)(i) because P's shareholders receive more than 50 percent of W's stock in exchange for all of P's stock.

(ii) Because the transaction constitutes a reverse acquisition, the P group is treated as remaining in existence with W as its common parent and agent for the group. Under paragraph (a) of this section, P remains the agent for the P group for Years 1 and 2, even though the P group continues with W as its new common parent pursuant to §1.1502–75(d)(3)(i). Before March 2 of Year 3, P is the agent for the P group for Year 3. Beginning on March 2 of Year 3, W becomes the agent for the P group with respect to all of Year 3 (including the period through March 1) and subsequent consolidated return years. Thus, for as long as P remains in existence, P is the agent for the P group under paragraph (a) of this section for Years 1 and 2.

Example 4. Reverse triangular merger of the agent for the group—subsequent spinoff of agent for the group where the agent for the group remains the agent. The facts are the same as in *Example 3*, except that on April 1 of Year 4, in a transaction unrelated to the March 1, Year 3 reverse acquisition, P distributes the stock of its subsidiaries S and S–1 to W, and W then distributes the stock of P to the W shareholders. Beginning on March 2 of Year 3, W becomes the agent for the P group with respect to Year 3 (including the period through March 1) and subsequent consolidated return years. Although P is no longer a member of the P group after the Year 4 spinoff, P remains the agent for the P group under paragraph (a) of this section for Years 1 and 2. For as long as P remains in existence, P is the agent for the P group under paragraph (a) of this section for Years 1 and 2.

Example 5. Qualified stock purchase and section 338 election where the agent for the group remains the agent. As of January 1 of Year 1, P, a domestic corporation, is the common parent and agent for the P consolidated group consisting of P and its two subsidiary corporations, S and S–1. P files consolidated returns for the P group in Years 1 and 2. On March 31 of Year 2, V, a domestic corporation, purchases the stock of P in a qualified stock purchase (within the meaning of section 338(d)(3)), and V makes a timely election pursuant to section 338(g) with respect to P. Although section 338(a)(2) provides that P is treated as a new corporation as of the beginning of the day after the acquisition date for purposes of subtitle A, paragraph (c)(8) of this section provides that P's existence is not deemed to terminate for purposes of this section notwithstanding the general rule of section 338(a)(2). Therefore, new P remains the agent for the P group for Year 1 and the period ending March 31 of Year 2 (short Year 2) regardless of the election under section 338(g).

Example 6. Change in the agent for the group's Federal income tax classification to a partnership and the resulting partnership continues as the agent for the group. (i) P, a State M limited liability partnership with two partners, makes an initial entity classification election to be an association taxable as a corporation for Federal income tax purposes. P is the common parent and agent for the P consolidated group consisting of P and its two subsidiary corporations, S and S–1. P files consolidated returns for the P group in Years 1 through 5. On January 1 of Year 6, P elects pursuant to Treas. Reg. §301.7701–3(c) to be treated as a partnership. P remains in existence under applicable law.

(ii) The P group terminates and P is no longer the common parent of a consolidated group after its election to be treated as a partnership for Federal income tax purposes. Because P remains in existence under applicable law, P is the agent for the P group under paragraph (a) of this section for Years 1 through 5. The results would be the same if P merged into a foreign partnership because the foreign partnership would be P's default successor and agent for the P group for Years 1 through 5. See paragraphs (b)(4) and (c)(1) of this section.

Example 7. Forward triangular merger of agent for the group—successor as default successor. As of January 1 of Year 1, P, a domestic corporation, is the common parent and agent for the P consolidated group consisting of P and its two subsidiary corporations, S and S–1. P files consolidated returns for the P group in Years 1 and 2. On January 1 of Year 3, P merges with and into Z–1 corporation, a subsidiary of Z corporation, in a forward triangular merger described in section 368(a)(1)(A) and (a)(2)(D). The transaction constitutes a reverse acquisition under §1.1502–75(d)(3)(i) because P's shareholders receive more than 50 percent of Z's stock in exchange for all of P's stock. Z–1, the corporation that survives the merger and the successor of P, is the default successor for the P group for Years 1 and 2. Although Z is the new common parent and agent for the P group (which continues pursuant to §1.1502–75(d)(3)(i)) for years after the merger, P may not designate Z, S or S–1 as the agent for Years 1 or 2 because Z–1 is P's default successor and the agent for the P group for Years 1 and 2. See paragraphs (b)(4) and (c)(1) of this section.

Example 8. Merger of the agent for the group into a disregarded entity in exchange for stock of owner in a transaction qualifying as a reorganization under section 368(a)(1)(F) where successor is the default successor. (i) As of January 1 of Year 1, P, a domestic corporation, is the common parent and agent for the P consolidated group consisting of P and its two subsidiary corporations, S and S–1. P files a consolidated return for the P group in Year 1. On January 1 of Year 2, the shareholders of P form Y, a State M corporation. On the same date, Y forms Y–1, a State M limited liability company that is a disregarded entity (within the meaning of paragraph (b)(3) of this section) for Federal income tax purposes, and P merges into Y–1. In the merger, the P shareholders receive all of the Y stock. For Federal income tax purposes, Y is treated as succeeding to P in a transaction qualifying under section 368(a)(1)(F), and the P group continues under Treas. Reg. §1.1502–75(d)(2) with Y as the common parent and agent for the group for Year 2.

(ii) In Year 4, the IRS seeks to extend the period of limitations on assessment with respect to Year 1 of the P consolidated group. As a result of the January 1, Year 2 merger, Y–1 is P's default successor and the agent for the P group for Year 1. See paragraphs (b)(4) and (c)(1) of this section. Therefore, Y–1 is the only party that can sign the extension with respect to the P group for Year 1.

(iii) In Year 5, the IRS seeks to extend the period of limitations on assessment with respect to Year 1 of the P group and Year 2 of the Y group (formerly the P group). Y–1 remains as the default successor to P for Year 1 and therefore is the only party that can sign the extension with respect to the P group for Year 1. Furthermore, because the merger transaction qualified as a reorganization under section 368(a)(1)(F), the P group remains in existence with Y as the common parent. Therefore, Y is the agent for the group for Year 2 and is the only party that can sign the extension with respect to the Y group for that year. See paragraphs (a) and (c)(1) of this section.

Example 9. Designation of agent where there is no default successor. (i) P is a corporation formed under the laws of State X. Fifty percent of its stock is owned at all times by A, an individual, and 50 percent by BCD, a partnership. On January 1 of Year 1, P forms two subsidiary corporations, S and T. P files consolidated returns for the P group beginning in Year 1. On November 30 of Year 3, P dissolves under X law. Under X law, A and BCD are primarily liable for the Federal income tax liability of dissolved corporation P. State X law allows the officers of a dissolved corporation to perform certain actions incident to the winding up of its affairs after its dissolution, including the filing of tax returns.

(ii) Upon its dissolution, there is no default successor to P because there are two successors. Prior to its dissolution on November 30 of Year 3, P may designate an agent for the P group for Years 1 and 2 and the short taxable year ending on November 30 of Year 3, to be effective upon P's dissolution. P may designate S or T (because they are members of the former group) or BCD (because it is an entity that is a successor to P). P cannot designate A because A is not an entity. The officers of P cannot designate an agent for the P group after P dissolves on November 30 of Year 3, notwithstanding the winding up provisions of State X law. Accordingly, P should designate an

agent prior to its dissolution to ensure that there is an agent for the group authorized to file the short Year 3 consolidated return. If P does not designate an agent prior to dissolution, the Commissioner may designate an agent from among S, T or BCD, upon their request or otherwise. If any of S, T, A or BCD realizes that P has dissolved without designating an agent for the group, it should request a designation of an agent by the Commissioner as soon as possible.

Example 10. Fraudulent conveyance of assets. As of January 1 of Year 1, P, a domestic corporation, is the common parent and agent for the P consolidated group consisting of P and its two subsidiary corporations, S and S–1. On March 15 of Year 2, P files a consolidated return that includes the income of S and S–1 for Year 1. On December 1 of Year 2, S–1 transfers assets having a fair market value of $ 100x to U in exchange for $10x. This transfer of assets for less than fair market value constitutes a fraudulent conveyance under applicable state law. On March 1 of Year 5, P executes a waiver extending to December 31 of Year 6 the period of limitations on assessment with respect to the group's Year 1 consolidated return. On February 1 of Year 6, the Commissioner issues a notice of deficiency to P asserting a deficiency of $ 30x for the P group's Year 1 consolidated tax liability. P does not file a petition for redetermination in the Tax Court, and the Commissioner makes a timely assessment against the P group. P, S and S–1 are all insolvent and are unable to pay the deficiency. On February 1 of Year 8, the Commissioner sends a notice of transferee liability to U, which does not file a petition in the Tax Court. On August 1 of Year 8, the Commissioner assesses the amount of the P group's deficiency against U. Under section 6901(c), the Commissioner may assess U's transferee liability within one year after the expiration of the period of limitations against the transferor S–1. By operation of section 6213(a) and 6503(a), the issuance of the notice of deficiency to P and the expiration of the 90-day period for filing a petition in the Tax Court have the effect of further extending by 150 days the P group's limitations period on assessment from the previously extended date of December 31 of Year 6 to May 30 of Year 7. Pursuant to paragraph (a) of this section, the waiver executed by P on March 1 of Year 5 to extend the period of limitations on assessment to December 31 of Year 6 and the further extension of the P group's limitations period to May 30 of Year 7 (by operation of sections 6213(a) and 6503(a)) have the derivative effect of extending the period of limitations on assessment of U's transferee liability to May 30 of Year 8. By operation of section 6901(f), the issuance of the notice of transferee liability to U and the expiration of the 90-day period for filing a petition in the Tax Court have the effect of further extending the limitations period on assessment of U's liability as a transferee by 150 days, from May 30 of Year 8 to October 27 of Year 8. Accordingly, the Commissioner may send a notice of transferee liability to U at any time on or before May 30 of Year 8 and assess the unpaid liability against U at any time on or before October 27 of Year 8. The result would be the same even if S–1 ceased to exist before March 1 of Year 5, the date P executed the waiver.

Example 11. Consent to extend the statute of limitations for a partnership where a member of the consolidated group is a partner of such partnership subject to the provisions of sections 6221 through 6234 and the tax matters partner is not a member of the group. (i) P, a domestic corporation, is the common parent and agent for the P consolidated group consisting of P and its two subsidiary corporations, S and S–1. The P group has a November 30 fiscal year end and P files consolidated returns for the P group for the years ending November 30, Year 1 and November 30, Year 2. S–1 is a partner in the PRS partnership which is subject to the provisions of sections 6221 through 6234. PRS has a calendar year end and A, an individual, is the tax matters partner of the PRS partnership. PRS files a partnership return for the year ending December 31, Year 1. On January 10, Year 5, A, as the tax matters partner for the PRS partnership, executes a consent to extend the period for assessment of partnership items of PRS for all partners, and the Service co-executes the consent on the same day for the year ending December 31, Year 1.

(ii) A's consent to extend the statute of limitations for the partnership items of PRS partnership for the year ending December 31, Year 1, extends the statute of limitations with respect to the partnership items for all members of the P group, including P, S and S–1 for the consolidated return year ending November 30, Year 2. This is because S–1 is a partner in the PRS partnership for which A, the tax matters partner for the PRS partnership, consents to extend the statute of limitations for the year ending December 31, Year 1. However, under paragraph (f)(2)(iii), such agreement with respect to the statute of limitations for the PRS partnership for the year ending December 31, Year 1 does not obviate the need to obtain a consent from P, the agent for the P consolidated group, to extend the statute of limitations for the P consolidated group for the P group's consolidated return years ending November 30, Year 1 and November 30, Year 2 regarding any items other than partnership items or affected items of the PRS partnership.

Example 12. Contacting subsidiary member in order to facilitate the conduct of an examination, appeal or settlement where a member of the consolidated group is a partner of a partnership subject to the provisions of sections 6221 through 6234. (i) P, a domestic corporation, is the common parent and agent for the P consolidated group consisting of P and its two subsidiary corporations, S and S–1. The P group has a November 30 fiscal year end, and P files consolidated returns for the P group for the years ending November 30, Year 1 and November 30, Year 2. S–1 is a partner in the PRS partnership which is subject to the provisions of sections 6221 through 6234. PRS has a calendar year end and A, an individual, is the tax matters partner of the PRS partnership. PRS files a partnership return for the year ending December 31, Year 1. The Commissioner, on January 10, Year 4, in the course of an examination of the PRS partnership for the year ending December 31, Year 1, seeks to obtain information in the course of that examination in order to resolve the audit.

(ii) Because the direct contact with a subsidiary member of a consolidated group that is a partner in a partnership subject to the provisions under sections 6221 through 6234 may facilitate the conduct of an examination, appeal or settlement, the Commissioner, under paragraph (f)(2)(iii) of this section, may communicate directly with either S–1, P or A regarding the PRS partnership without breaking agency pursuant to paragraph (f)(2)(i) of this section. However, if the Commissioner were instead seeking to execute a settlement agreement with respect to S–1 as a partner with respect to its liability as a partner in PRS partnership, P would need to execute such settlement agreement for all members of the group including the partner subsidiary.

(i) [Reserved]

(j) *Cross-reference*. For further rules applicable to groups that include insolvent financial institutions, see §301.6402–7 of this chapter.

(k) *Effective/applicability date*. The rules of this section apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Steven T. Miller,
Deputy Commissioner for
Services and Enforcement.

(Filed by the Office of the Federal Register on May 29, 2012, 8:45 a.m., and published in the issue of the Federal Register for May 30, 2012, 77 F.R. 31786)

Notice of Proposed Rulemaking

Property Transferred in Connection with the Performance of Services Under Section 83

REG–141075–09

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to property transferred in connection with the performance of services under section 83 of the Internal Revenue Code (Code). These proposed regulations affect certain taxpayers who received property transferred in connection with the performance of services.

DATES: Written or electronic comments must be received by August 28, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–141075–09), 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–141075–09), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov/* (IRS REG–141075–09).

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, Thomas Scholz or Dara Alderman at (202) 622–6030 (not a toll-free number); concerning submissions of comments, and/or to request a hearing, Oluwafunmilayo (Fumni) Taylor, at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 83(a) of the Internal Revenue Code (Code) provides that if, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of (1) the fair market value of the property (determined without regard to lapse restrictions) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over (2) the amount (if any) paid for such property, is included in the gross income of the service provider in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture. Section 83(c)(1) provides that the rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual.

Section 1.83–3(c)(1) provides that, for purposes of section 83 and the regulations, whether a risk of forfeiture is substantial or not depends upon the facts and circumstances. Section 1.83–3(c)(1) further provides that a substantial risk of forfeiture exists where rights in property that are transferred are conditioned, directly or indirectly, upon the future performance (or refraining from performance) of substantial services by any person, or the occurrence of a condition related to a purpose of the transfer, and the possibility of forfeiture is substantial if such condition is not satisfied. Illustrations provided in §1.83–3(c)(2) of the regulations demonstrate when a substantial risk of forfeiture will be considered to exist.

In addition to providing that a person's rights in property are subject to a substantial risk of forfeiture if conditioned upon the future performance of substantial services by any individual, the legislative history indicates that the drafters intended that "in other cases the question of whether there is a substantial risk of forfeiture depends upon the facts and circumstances." H.R. Rep. No. 91–413 (Pt. 1), 91st Cong., 1st Sess. 62, 88 (1969–3 Cum. Bull. 200, 255); S. Rep. No. 91–552, 91st Cong., 1st Sess. 119, 121 (1969–3 Cum. Bull. 423, 501). The current regulations adopt this approach by finding that a substantial risk of forfeiture may also arise if the rights to the property are subject to a condition related to the purpose of the transfer. Some confusion has arisen as to whether other conditions may also give rise to a substantial risk of forfeiture. *See Robinson v. Commissioner*, 805 F.2d 38 (1st Cir. 1986). The proposed regulations clarify that a substantial risk of forfeiture may be established *only* through a service condition or a condition related to the purpose of the transfer.

Similarly, confusion has arisen as to whether, in determining whether a substantial risk of forfeiture exists, the likelihood that a condition related to the purpose of the transfer will occur must be considered. *Id.* A conclusion that such likelihood need not be considered would lead to anomalies not intended by the statute. For example, assume that stock transferred by an employer to an employee was made nontransferable and also subject to a condition that the stock be forfeited if the gross receipts of the employer fell by 90% over the next three years. Assume further that the employer is a longstanding seller of a product and that there is no indication that either there will be a fall in demand for the product or an inability of the employer to sell the product, so that it is extremely unlikely that the forfeiture condition will occur. Although, arguably, the condition is a condition related to the purpose of the transfer because it would, to some degree, incentivize the employee to prevent such a fall in gross receipts, the Treasury Department and the IRS do not believe that such a condition was intended to defer the taxation of the stock transfer. Accordingly, the proposed regulations would clarify that, in determining whether a substantial risk of forfeiture exists based on a condition related to the purpose of the transfer, both the likelihood that the forfeiture event will occur and the likelihood that the forfeiture will be enforced must be considered.

Finally, the proposed regulations would clarify that, except as specifically provided in section 83(c)(3) and §§1.83–3(j) and (k), transfer restrictions do not create a substantial risk of forfeiture, including transfer restrictions which carry the potential for forfeiture or disgorgement of some or all of the property, or other penalties, if the restriction is violated. This position is supported by the legislative history of section 83. The Senate Report, under the heading "General reasons for change," provides as follows:

> The present tax treatment of restricted stock plans is significantly more generous than the treatment specifically provided in the law for other types of similarly funded deferred compensation arrangements. An example of this disparity can be seen by comparing the situation where stock is placed in a nonexempt employees' trust rather than given directly to the employee subject to restrictions. If an employer transfers stock to a trust for an employee and the trust provides that the employee will receive the stock at the end of 5 years if he is alive at that time, the employee is treated as receiving and is taxed on the value of the stock at the time of the transfer. However, if the employer, instead of contributing the stock to the trust, gives the stock directly to the employee subject to the restriction that it cannot be sold for 5 years, then the employee's tax is deferred until the end of the 5-year period. In the latter situation, the employee actually possesses the stock, can vote it, and receives the dividends, yet his tax is deferred. In the case of the trust, he may have none of these benefits, yet he is taxed at the time the stock is transferred to the trust.

S. Rep. No. 91–552, 1969–3 C.B. 423, 500. See also H. Rep. No. 91–413, 1969–3 C.B. 200, 254.

The legislative history shows that Congress intended for section 83 to be interpreted in such a way that precluded the use

of transfer restrictions as a means of deferring the taxable event. If interpreted otherwise, section 83 would not alter the tax treatment of the particular transaction that Congress described as the reason for the statutory change.

Moreover, Congress later added section 83(c)(3) concerning sales that may give rise to suit under section 16(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). See Public Law No. 97–34, sec. 252, 1981–2 C.B. 256, 303. Section 83(c)(3) provides that so long as the sale of property at a profit could subject a person to suit under section 16(b) of the Exchange Act, such person's rights in such property are (A) subject to a substantial risk of forfeiture, and (B) not transferable. Section 1.83–3(j) of the regulations further provides that, for purposes of section 83 and the regulations, if the sale of property at a profit within six months after the purchase of the property could subject a person to suit under section 16(b) of the Exchange Act, the person's rights in the property are treated as subject to a substantial risk of forfeiture and as not transferable until the earlier of (i) the expiration of such six-month period, or (ii) the first day on which the sale of such property at a profit will not subject the person to suit under section 16(b) of the Exchange Act.

Consistent with section 83(c)(3) and §1.83–3(j), Revenue Ruling 2005–48, 2005–2 C.B. 259, provides that the only provision of the securities law that would delay taxation under section 83 is section 16(b) of the Exchange Act. The ruling further provides that other transfer restrictions (such as restrictions imposed by lock-up agreements or restrictions relating to insider trading under Rule 10b–5 of the Exchange Act) do not cause rights in property taxable under section 83 to be substantially nonvested. Revenue Ruling 2005–48 notes that the Treasury Department and the IRS intend to amend the section 83 regulations to explicitly set forth the holdings in the ruling.

Explanation of Provisions

The proposed regulations would amend the second sentence of §1.83–3(c)(1) of the existing regulations to add the word "only" to the phrase "[a] substantial risk of forfeiture exists [only] where . . ." The purpose of this addition is to clarify that a substantial risk of forfeiture may be established only through a service condition or a condition related to the purpose of the transfer.

The proposed regulations would amend the second sentence of §1.83–3(c)(1) of the existing regulations to delete the clause "if such condition is not satisfied." The purpose of the deletion is to clarify that, in determining whether a substantial risk of forfeiture exists based on a condition related to the purpose of the transfer, both the likelihood that the forfeiture event will occur and the likelihood that the forfeiture will be enforced must be considered.

The proposed regulations would amend §1.83–3(c)(1) of the existing regulations to add a sentence stating that a transfer restriction, including a transfer restriction which carries the potential for forfeiture or disgorgement of some or all of the property or other penalties if the restriction is violated, does not create a substantial risk of forfeiture. The purpose of this addition is to incorporate the holding in Rev. Rul. 2005–48.

Furthermore, consistent with Rev. Rul. 2005–48, the proposed regulations would amend §1.83–3(j)(2) to include an example illustrating the application of section 16(b) of the Exchange Act to an option. The regulations are not intended to provide guidance on the application of section 16(b) of the Exchange Act. Rather, for purposes of the examples it is assumed that the period of liability is determined in accordance with the applicable law, including any applicable court decisions. *See*, *for example*, *Stella v. Graham-Paige Motors*, 132 F. Supp. 100, 103 (S.D.N.Y. 1955), *rev'd other grounds*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956). The proposed regulations also would add two additional examples to §1.83–3(c)(4) illustrating that a substantial risk of forfeiture is not created solely as a result of potential liability under Rule 10b–5 of the Exchange Act or a lock-up agreement. Rev. Rul. 2005–48 will be obsoleted when the proposed regulations are published as final regulations. See §601.601(d)(2).

Proposed Effective Date

These regulations under section 83 are proposed to apply as of January 1, 2013, and will apply to property transferred on or after that date. Taxpayers may rely on the proposed regulations for property transferred after publication of these proposed regulations in the **Federal Register**.

Special Analyses

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

Comments and Requests for Public Hearing

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

Drafting Information

The principal authors of these proposed regulations are Thomas Scholz and Dara Alderman, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.83–3 is amended by:

1. Revising paragraph (c)(1).
2. Adding *Example 6* and *Example 7* to paragraph (c)(4).
3. Adding *Example 4* to paragraph (j)(2).
4. Removing paragraph (j)(3).
5. Redesignating paragraph (k)(1) as paragraph (k).
6. Removing paragraph (k)(2).
7. Adding paragraph (l).

The additions and revisions read as follows:

§1.83–3 Meaning and use of certain terms.

* * * * *

(c) *Substantial risk of forfeiture*. (1) *In general*. For purposes of section 83 and the regulations, whether a risk of forfeiture is substantial or not depends upon the facts and circumstances. A substantial risk of forfeiture exists only where rights in property that are transferred are conditioned, directly or indirectly, upon the future performance (or refraining from performance) of substantial services by any person, or upon the occurrence of a condition related to a purpose of the transfer if the possibility of forfeiture is substantial. Property is not transferred subject to a substantial risk of forfeiture to the extent that the employer is required to pay the fair market value of a portion of such property to the employee upon the return of such property. The risk that the value of property will decline during a certain period of time does not constitute a substantial risk of forfeiture. A nonlapse restriction, standing by itself, will not result in a substantial risk of forfeiture. Except as set forth in paragraphs (j) and (k) of this section, restrictions on the transfer of property, whether contractual or by operation of applicable law, will not result in a substantial risk of forfeiture. For this purpose, transfer restrictions that will not result in a substantial risk of forfeiture include, but are not limited to, restrictions that if violated, whether by transfer or attempted transfer of the property, would result in the forfeiture of some or all of the property, or liability by the employee for any damages, penalties, fees or other amount.

* * * * *

(4) * * *

Example 6. On January 3, 2013, Y corporation grants to Q, an officer of Y, a nonstatutory option to purchase Y common stock. Although the option is immediately exercisable, it has no readily ascertainable fair market value when it is granted. Under the option, Q has the right to purchase 100 shares of Y common stock for $10 per share, which is the fair market value of a Y share on the date of grant of the option. On May 1, 2013, Y sells its common stock in an initial public offering. Pursuant to an underwriting agreement entered into in connection with the initial public offering, Q agrees not to sell, otherwise dispose of, or hedge any Y common stock from May 1 through November 1 of 2013 ("the lock-up period"). Q exercises the option and Y shares are transferred to Q on August 15, 2013, during the lock-up period. The underwriting agreement does not impose a substantial risk of forfeiture on the Y shares acquired by Q because the provisions of the agreement do not condition Q's rights in the shares upon anyone's future performance (or refraining from performance) of substantial services or on the occurrence of a condition related to the purpose of the transfer of shares to Q. Accordingly, neither section 83(c)(3) nor the imposition of the lock-up period by the underwriting agreement preclude taxation under section 83 when the shares resulting from exercise of the option are transferred to Q.

Example 7. Assume the same facts as in *Example 6,* except that on May 1, 2013, Y also adopts an insider trading compliance program, under which, as applied to 2013, insiders (such as Q) may trade Y shares only between November 5 and November 30 of that year ("the trading window"). Under the program, if Q trades Y shares outside the trading window without Y's permission, Y has the right to terminate Q's employment. However, the exercise of the nonstatutory options outside the trading window for the Y shares is not prohibited under the insider trading compliance program. As of August 15, 2013 (the date Q fully exercises the option), Q is in possession of material nonpublic information concerning Y that would subject him to liability under Rule 10b–5 under the Securities Exchange Act of 1934 if Q sold the Y shares while in possession of such information. Neither the insider trading compliance program nor the potential liability under Rule 10b–5 impose a substantial risk of forfeiture on the Y shares acquired by Q, because the provisions of the program and Rule 10b–5 do not condition Q's rights in the shares upon anyone's future performance (or refraining from performance) of substantial services or on the occurrence of a condition related to the purpose of the transfer of shares to Q. Accordingly, none of section 83(c)(3), the imposition of the trading window by the insider trading compliance program and the potential liability under Rule 10b–5 preclude taxation under section 83 when the shares resulting from exercise of the option are transferred to Q.

* * * * *

(j) * * *

(2) * * *

Example 4. On January 3, 2013, Y corporation grants to Q, an officer of Y, a nonstatutory option to purchase Y common stock. Y stock is traded on an established securities market. Although the option is immediately exercisable, it has no readily ascertainable fair market value when it is granted. Under the option, Q has the right to purchase 100 shares of Y common stock for $10 per share, which is the fair market value of a Y share on the date of grant of the option. The grant of the option is not a transaction exempt from section 16(b) of the Securities Exchange Act of 1934. On August 15, 2013, Y stock is trading at more than $10 per share. On that date, Q fully exercises the option, paying the exercise price in cash, and receives 100 Y shares. Q's rights in the shares received as a result of the exercise are not conditioned upon the future performance of substantial services. Because no exemption from section 16(b) was available for the January 3, 2013 grant of the option, the section 16(b) liability period expires on July 1, 2013. Accordingly, the section 16(b) liability period expires *before* the date that Q exercises the option and the Y common stock is transferred to Q. Thus, the shares acquired by Q pursuant to the exercise of the option are not subject to a substantial risk of forfeiture under section 83(c)(3) as a result of section 16(b). As a result, section 83(c)(3) does not preclude taxation under section 83 when the shares acquired pursuant to the August 15, 2013 exercise of the option are transferred to Q. If, instead, Q exercises the nonstatutory option on May 30, 2013 when Y stock is trading at more than $10 per share, the shares acquired are subject to a substantial risk of forfeiture under section 83(c)(3) as a result of section 16(b) through July 1, 2013.

* * * * *

(l) *Effective/applicability date*. Paragraphs (j) and (k) of this section apply to property transferred after December 31, 1981. Paragraph (c)(1), *Example 6* and *7* of paragraph (c)(4), and *Example 4* of paragraph (j)(2) of this section apply to property transferred on or after January 1, 2013.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on May 29, 2012, 8:45 a.m., and published in the issue of the Federal Register for May 30, 2012, 77 F.R. 31783)

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

Numerical Finding List[1]

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