Internal Revenue
bulletin

Bulletin No. 1999–4
January 25, 1999

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. 99–4, page 19.

LIFO; price indexes; department stores. The November 1998 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, November 30, 1998.

T.D. 8800, page 20.

Final and temporary regulations under section 1502 of the Code relate to the consolidated return regulations.

T.D. 8801, page 5.

Final regulations under section 148 of the Code relate to the arbitrage restrictions applicable to tax-exempt bonds issued by State and local governments.

T.D. 8802, page 10.

Final regulations under section 337 of the Code generally affect a taxable corporation that transfers all or substantially all of its assets to a tax-exempt entity or converts from a taxable corporation to a tax-exempt entity in a transaction other than a liquidation, and generally requires the taxable corporation to recognize gain or loss as if it had sold the assets transferred at fair market value.

EMPLOYEE PLANS

T.D. 8796, page 16.

Final regulations under sections 411 and 417 of the Code relate to qualified retirement plans.

Notice 99–7, page 23.

Weighted average interest rate update. The weighted average interest rate for January 1999 and the resulting permissible range of interest rates used to calculate current liability for purposes of the full funding limitation of section 412(c)(7) of the Code are set forth.

EXEMPT ORGANIZATIONS

Announcement 99–9, page 24.

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

ADMINISTRATIVE

Notice 99–9, page 23.

The Service has made available on the IRS Internet site a draft of the Low-Income Taxpayer Clinic Grant application package for public comment. The draft describes the new grant program, authorized under section 7526 of the Code, for qualified organizations that provide legal assistance to low-income taxpayers having disputes with the Service or operate programs to inform individuals, for whom English is a second language, about their rights and responsibilities under the tax laws.

Announcement 99–6, page 24.

The Service will allow payers to establish a system to electronically receive Forms W-4P, Withholding Certificate for Pension or Annuity Payments, W-4S, Request for Federal Income Tax Withholding From Sick Pay, and W-4V, Voluntary Withholding Request.

Announcement 99–8, page 24.

The 1998 Instructions for Form 1040NR are corrected.

Finding Lists begin on page 28.
Announcement Relating to Court Decisions begins on page 4.

Department of the Treasury
Internal Revenue Service

Mission of the Service

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

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

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 of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

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

The Bulletin is divided into four parts as follows:

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

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and 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.
With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

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

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

Announcement Relating to Court Decisions

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

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

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

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

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year, and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Eisenberg v. Commissioner,[1]
155 F.3d 50 (2d Cir. 1998)

Murillo v. Commissioner,[2]
T.C. Memo 1998–13

The Commissioner WITHDRAWS the following decision:

Larotonda v. Commissioner,[3]
89 T.C. 287 (1987)

[1] Acquiescence relating to whether a discount for potential capital gains tax liabilities may be applied in valuing closely-held stock.

[2] Acquiescence in result only relating to whether the forfeiture of an Individual Retirement Account ("IRA") to the United States pursuant to a civil proceeding causes the IRA owner to be liable for the 10 percent early distribution tax under I.R.C. section 72(t).

[3] Withdrawal relating to whether petitioner's constructive receipt of a Keogh account distribution by virtue of the government's levy on the account causes the Keogh owner to also be liable for the 10 percent early distribution tax under I.R.C. section 72(m)(5).

Section 148.—Arbitrage

26 CFR 1.148–5: Yield and valuation of investments.

T.D. 8801

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

Arbitrage Restrictions on Tax-Exempt Bonds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations on the arbitrage restrictions applicable to tax-exempt bonds issued by State and local governments. Changes to applicable law were made by the Tax Reform Act of 1986. These regulations affect issuers of tax-exempt bonds and provide guidance for complying with the arbitrage regulations.

DATES: *Effective Date:* These regulations are effective on March 1, 1999.

Applicability Date: These regulations are applicable to bonds sold on or after March 1, 1999. Issuers may apply these regulations to bonds sold on or after December 30, 1998. and before March 1, 1999.

FOR FURTHER INFORMATION CONTACT: David White, 202-622-3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1490. Responses to these collections of information are required to obtain the benefits of a safe harbor.

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

The estimated annual burden per record keeper varies from .75 hour to 2 hours, depending on individual circumstances, with an estimated average of 1 hour.

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

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

Background

These final regulations contain amendments to the income tax regulations (26 CFR Part 1) under section 148 of the Internal Revenue Code of 1986 (Code). Section 148 provides rules addressing the use of proceeds of tax-exempt State and local bonds to acquire higher-yielding investments. On June 18, 1993, final regulations (T.D. 8476, 1993–2 C.B. 13) relating to the arbitrage restrictions and related rules under sections 103, 148, 149, and 150 were published in the **Federal Register** (58 F.R. 33510). Corrections to these regulations were published in the **Federal Register** on August 23, 1993 (58 F.R. 44451), and May 11, 1994 (59 F.R. 24350).

On June 27, 1996, a notice of proposed rulemaking (FI–28–96, 1996–2 C.B. 458) relating to the arbitrage restrictions was published in the **Federal Register** (61 F.R. 33405). The proposed regulations provide a rebuttable presumption for establishing fair market value for United States Treasury obligations that are purchased other than directly from the United States Treasury. In addition, the proposed regulations provide a rebuttable presumption that a solicitation that meets certain requirements is a bona fide solicitation for the guaranteed investment contract safe harbor of §1.148–5(d)(6)(iii). A public hearing was held on Thursday, October 24, 1996, and written comments were received. After consideration of all the comments, the regulations proposed by FI–28–96 are, with modifications, adopted by revision to §1.148–5(d)(6)(iii). The changes are discussed below.

Explanation of Provisions

A. *In General*

Due to concerns regarding the fair market purchase price of United States Treasury obligations purchased other than directly from the United States Treasury, the proposed regulations provide a rebuttable presumption for establishing fair market value. The proposed regulations generally apply the principles underlying the existing safe harbor in the arbitrage regulations for establishing fair market value for guaranteed investment contracts.

The proposed regulations also provide a rebuttable presumption that a solicitation meeting the requirements of the proposed regulations will be a bona fide solicitation for the guaranteed investment contract safe harbor of existing §1.148–5(d)(6)(iii).

Modifications to the proposed regulations have been made to clarify various technical aspects in response to comments received.

B. *Safe Harbor*

Commentators noted that a rebuttable presumption in the proposed regulations for purchases of United States Treasury obligations provides a lower level of protection to issuers than the safe harbor applicable to guaranteed investment contracts. Commentators generally requested that the final regulations provide a safe harbor for the purchase of United States Treasury obligations.

The final regulations create a safe harbor for all investments covered by the regulations, provided that the issuer receives at least three bids as required by the regulations. The premise of the final regulations is that a bidding procedure satisfying the requirements of the final regulations will produce a price that equals fair market value. If the requirements of the final regulations are not in fact met, no assumption can be made about the relationship of the price paid to fair market value. However, all reasonable and prudent actions taken by the issuer under the circumstances may be considered in determining whether the issuer paid fair market value.

C. *Scope of Final Regulations*

Generally, the proposed regulations apply to United States Treasury obligations purchased other than directly from the United States Treasury. Commentators requested clarification regarding the scope of the proposed regulations and requested that the regulations only apply to investments purchased for yield restricted refunding and yield restricted sinking fund escrows. In addition, commentators asked that the proposed regulations be expanded to apply to other types of investments that may be purchased for an escrow (e.g., REFCORP strips).

The final regulations apply only to guaranteed investment contracts and yield restricted defeasance escrows. With respect to yield restricted defeasance escrows, the final regulations expand the scope of investments covered by the proposed regulations to apply to all investments purchased for the escrow (e.g., United States Agency obligations, REFCORP strips and corporate obligations).

D. *Guaranteed Investment Contracts*

Commentators requested clarification regarding which investments are covered by the safe harbor for guaranteed investment contracts and which would be covered by the proposed regulations.

The term guaranteed investment contract generally does not include investments purchased for a yield restricted defeasance escrow. However, the term guaranteed investment contract does include escrow float contracts and similar agreements purchased for a yield restricted defeasance escrow. In addition, the term guaranteed investment contract includes debt service fund forward agreements and debt service reserve fund agreements (e.g., agreements to deliver United States Treasury obligations over a period of time).

E. *No Last Look*

The proposed regulations state that all providers must have equal opportunity to bid and that no provider is permitted to review other bids before bidding (e.g., a last look). A small number of commentators noted that the existence of a last look may result in higher yields from competing providers. The final regulations retain the no last look requirement because permitting a last look may adversely affect the bona fides of the bidding process.

F. *Reasonably Competitive Providers*

The proposed regulations provide that all bidders are required to be reasonably competitive providers of investments of the type being purchased. Numerous comments were received regarding the meaning of the phrase “reasonably competitive provider,” and commentators expressed concern that a bid from a noncompetitive provider may prevent the requirements of the regulations from being satisfied.

The final regulations modify this provision. The final regulations provide that the issuer must solicit at least three bids from reasonably competitive providers and that the issuer must receive at least one bid from a reasonably competitive provider. For purposes of the final regulations, a reasonably competitive provider is a provider that has an established industry reputation as a competitive provider of the type of investments being purchased. For example, in connection with the solicitation of bids for a guaranteed investment contract, an entity that has an established industry reputation as a competitive provider of guaranteed investment contracts is a reasonably competitive provider.

G. *No Material Financial Interest*

The proposed regulations, like the existing safe harbor for guaranteed investment contracts, provide that the issuer must receive at least three bona fide bids from providers that have no material financial interest in the issue. For this purpose, the proposed regulations provide that underwriters and financial advisors for an issue are considered to have a material financial interest. Numerous comments were received regarding the scope of entities that are considered to have a material financial interest under the proposed regulations.

The final regulations clarify that, for purchases of any investment covered by the safe harbor, the lead underwriter in a negotiated underwriting transaction is deemed to have a material financial interest in the issue until 15 days after the issue date of the issue. Any entity acting as a financial advisor with respect to the purchase of the investment at the time that the bid specification form is submitted to potential providers is also deemed to have a material financial interest in the issue. In addition, the final regulations require the provider to represent that its bid is not based on any other formal or informal agreement that the provider has with the issuer or any other person. A provider that is a related party to a provider that has a material financial interest in the issue is also deemed to have a material financial interest in the issue.

H. *Commercially Reasonable Terms*

The proposed regulations provide that the terms of the purchase agreement must be reasonable. The existing safe harbor for guaranteed investment contracts provides that the terms of the guaranteed investment contract, including the collateral security requirements, must be reasonable. A number of commentators requested clarification regarding what reasonable means in connection with a solicitation of United States Treasury obligations.

The final regulations provide that the terms of the bid specification for any investment covered by the safe harbor must be commercially reasonable. A term is commercially reasonable if there is a legitimate business purpose for including the term in the bid specifications other than to lower the yield or increase the cost of the bid. For example, in connection with the solicitation of investments for a yield restricted defeasance escrow, a commercially unreasonable term would be a hold firm period that is longer than the issuer reasonably requires.

I. *Comparison to State and Local Government Series Securities*

The proposed regulations provide that the yield on any United States Treasury obligation purchased by the issuer may not be less than the yield then available on State and Local Government Series Securities from the United States Department of the Treasury, Bureau of Public Debt (SLGs) with the same maturity. Commentators requested that the SLGs comparison be removed or that issuers be allowed to make the comparison on a portfolio-by-portfolio basis. Commentators also requested guidance about the time period in which the SLGs comparison is to be made.

In general, the final regulations provide that the safe harbor does not apply to investments purchased for a yield restricted defeasance escrow if the lowest cost bid is greater than the cost of the most efficient SLG portfolio. The final regulations provide that the lowest cost bid is the lowest bid for the portfolio or, if the issuer compares bids on an investment-by-investment basis, the aggregate cost of a portfolio comprised of the lowest cost bid for each investment. Any payment received by the issuer from a provider at the time a guaranteed investment contract is purchased (e.g., an escrow float contract) for a yield restricted defeasance escrow under a bidding procedure meeting the requirements of the final regulations is taken into account in determining the lowest cost bid.

The final regulations provide the following rules for comparing the lowest cost bid to SLGs. First, the most efficient SLG portfolio consists of one or more SLG securities that will allow the issuer to defease the refunded obligations at the lowest overall cost. Second, the comparison of the most efficient SLG portfolio and the lowest cost bid must be made at the time that bids are required to be submitted pursuant to the terms of the bid specifications. Intra-day pricing movements and closing spot prices of investments before and after the time in which the comparison to SLGs is required to be made are not relevant. Third, if SLGs are not available for purchase on the day that bids are required to be submitted pursuant to terms of the bid specifications because Treasury has suspended sales of those securities, the comparison of the most efficient SLG portfolio to the lowest cost bid is not required.

No comparison to SLGs is required for purchases of guaranteed investment contracts.

J. *Forward Pricing Data*

The proposed regulations provide that the yield on United States Treasury obligations purchased by the issuer may not be significantly less than the yield then available from the provider on reasonably comparable United States Treasury obligations offered to other persons for purchase on terms comparable to those offered to the issuer from a source of funds other than tax-exempt bonds. If closely comparable forward prices are not available, a reasonable basis for this comparison may be by reference to implied forward prices for Treasury obligations based on standard financial formulas. A certificate provided by the agent conducting the bidding process will establish that the comparison is met. The existing safe harbor for guaranteed investment contracts provides that the yield on the guaranteed investment contract may not be less than the yield then available from the provider on reasonably comparable guaranteed investment contracts, if any, offered to other persons from a source of funds other than gross proceeds of tax-exempt bonds.

Commentators noted that, in general, the comparison required by the proposed regulations is either too complex or not possible to construct. In lieu of a comparability requirement, commentators recommended that the regulations adopt certain additional safeguards to protect the integrity of the bidding process.

The final regulations remove the comparability requirement for all investments covered by the safe harbor. However, the final regulations include additional requirements to ensure a competitive bidding process. For example, the final regulations require that the bid form forwarded to potential providers include a statement notifying providers that by submitting a bid the potential provider is representing that it did not consult with any other providers about their bid, and that its bid is not being submitted solely as a courtesy to the issuer or any other person for purposes of satisfying the requirement that the issuer receive three bids. It is anticipated that these additional requirements will ensure that the bids reflect fair market value, as determined without regard to the source of funds.

K. *Record Keeping Requirements*

The proposed regulations provide that issuers are required to retain certain records and information with the bond documents, including a copy of the bids received (date and time stamped). Numerous comments were received regarding the difficulty of obtaining written bids for Treasury obligations.

The final regulations modify the record keeping requirements and apply those requirements to guaranteed investment contracts. One modification to the record keeping requirements is the elimination of the requirement that the bids be received in writing. The final regulations provide that the requirement for recording the bid is satisfied if the issuer or its agent makes a contemporaneous record of the bid, including the time and date each bid was received, and the identification of the person and entity submitting the bid, and keeps this record with the bond documents.

The final regulations also provide that, if the terms of the purchase agreement deviate from the terms of the bid solicitation form or if a submitted bid is modified, the issuer must keep a record explaining the purpose of the deviation or modification and, if the purchase agreement price differed from the bid, how that price was determined. If the issuer replaces investments in the winning bid portfolio with other investments, the prices of the new investments are not protected by the safe harbor unless those investments are bid under a bidding procedure meeting the requirements of the final regulations.

L. *Broker Fees for Yield Restricted Defeasance Escrows*

The proposed regulations provide that a fee paid to a bidding agent is a qualified administrative cost only if the fee is comparable to a fee that would be charged for a reasonably comparable investment of obligations acquired with a source of funds other than gross proceeds of tax-exempt bonds and the fee is reasonable. Under the proposed regulations, the fee is presumed to be reasonable if it does not exceed .02 percent of the amount invested in United States Treasury obligations. Commentators noted that the comparability requirement was unclear and that outside the context of municipal bonds, bidding for closely comparable investments is virtually non-existent. Commentators also noted that the .02 percent fee may result in too much compensation in the case of large escrows and too little compensation in the case of small escrows.

The final regulations retain the comparability and reasonableness requirements. However, the final regulations provide that a broker's fee will meet the reasonableness and comparability requirements if the fee does not exceed the lesser of $10,000 or .1 percent of the initial principal amount of investments purchased for the yield restricted defeasance escrow.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the amount of time required to meet the record keeping requirement of these final regulations, an estimated annual average of 1 hour per taxpayer, is small. Also, the regulations affect a small number of taxpayers, approximately 1400 annually. 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 Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are David White and Rebecca Harrigal of the IRS Office of Chief Counsel and Edwin G. Oswald of the Department of the Treasury. However, other personnel from the IRS and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are 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 1.148–5 is amended as follows:

1. Paragraph (d)(6)(iii) is revised.
2. Paragraph (e)(2)(iv) is added.

The revision and addition read as follows:

§1.148–5 Yield and valuation of investments.

* * * * *

(d) * * *

(6) * * *

(iii) *Safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.* The purchase price of a guaranteed investment contract and the purchase price of an investment purchased for a yield restricted defeasance escrow will be treated as the fair market value of the investment on the purchase date if all of the following requirements are satisfied:

(A) The issuer makes a bona fide solicitation for the purchase of the investment. A bona fide solicitation is a solicitation that satisfies all of the following requirements:

(*1*) The bid specifications are in writing and are timely forwarded to potential providers.

(*2*) The bid specifications include all material terms of the bid. A term is material if it may directly or indirectly affect the yield or the cost of the investment.

(*3*) The bid specifications include a statement notifying potential providers that submission of a bid is a representation that the potential provider did not consult with any other potential provider about its bid, that the bid was determined without regard to any other formal or informal agreement that the potential provider has with the issuer or any other person (whether or not in connection with the bond issue), and that the bid is not being submitted solely as a courtesy to the issuer or any other person for purposes of satisfying the requirements of paragraph (d)(6)(iii)(B)(*1*) or (*2*) of this section.

(*4*) The terms of the bid specifications are commercially reasonable. A term is commercially reasonable if there is a legitimate business purpose for the term other than to increase the purchase price or reduce the yield of the investment. For example, for solicitations of investments for a yield restricted defeasance escrow, the hold firm period must be no longer than the issuer reasonably requires.

(*5*) For purchases of guaranteed investment contracts only, the terms of the solicitation take into account the issuer's reasonably expected deposit and drawdown schedule for the amounts to be invested.

(*6*) All potential providers have an equal opportunity to bid. For example, no potential provider is given the opportunity to review other bids (i.e., a last look) before providing a bid.

(*7*) At least three reasonably competitive providers are solicited for bids. A reasonably competitive provider is a provider that has an established industry reputation as a competitive provider of the type of investments being purchased.

(B) The bids received by the issuer meet all of the following requirements:

(*1*) The issuer receives at least three bids from providers that the issuer solicited under a bona fide solicitation meeting the requirements of paragraph (d)(6)(iii)(A) of this section and that do not have a material financial interest in the issue. A lead underwriter in a negotiated underwriting transaction is deemed to have a material financial interest in the issue until 15 days after the issue date of the issue. In addition, any entity acting as a financial advisor with respect to the purchase of the investment at the time the bid specifications are forwarded to potential providers has a material financial interest in the issue. A provider that is a related party to a provider that has a material financial interest in the issue is deemed to have a material financial interest in the issue.

(*2*) At least one of the three bids described in paragraph (d)(6)(iii)(B)(*1*) of this section is from a reasonably competitive provider, within the meaning of paragraph (d)(6)(iii)(A)(*7*) of this section.

(*3*) If the issuer uses an agent to conduct the bidding process, the agent did not bid to provide the investment.

(C) The winning bid meets the following requirements:

(*1*) *Guaranteed investment contracts.* If the investment is a guaranteed investment contract, the winning bid is the highest yielding bona fide bid (determined net of any broker's fees).

(*2*) *Other investments.* If the investment is not a guaranteed investment contract, the following requirements are met:

(*i*) The winning bid is the lowest cost bona fide bid (including any broker's fees). The lowest cost bid is either the lowest cost bid for the portfolio or, if the issuer compares the bids on an investment-by-investment basis, the aggregate cost of a portfolio comprised of the lowest cost bid for each investment. Any payment received by the issuer from a provider at the time a guaranteed investment contract is purchased (e.g., an escrow float contract) for a yield restricted defeasance escrow under a bidding procedure meeting the requirements of this paragraph (d)(6)(iii) is taken into account in determining the lowest cost bid.

(*ii*) The lowest cost bona fide bid (including any broker's fees) is not greater than the cost of the most efficient portfolio comprised exclusively of State and Local Government Series Securities from the United States Department of the Treasury, Bureau of Public Debt. The cost of the most efficient portfolio of State and Local Government Series Securities is to be determined at the time that bids are required to be submitted pursuant to the terms of the bid specifications.

(*iii*) If State and Local Government Series Securities from the United States Department of the Treasury, Bureau of Public Debt are not available for purchase on the day that bids are required to be submitted pursuant to terms of the bid specifications because sales of those securities have been suspended, the cost comparison of paragraph (d)(6)(iii) (C)(*2*)(*ii*) of this section is not required.

(D) The provider of the investments or the obligor on the guaranteed investment contract certifies the administrative costs that it pays (or expects to pay, if any) to third parties in connection with supplying the investment.

(E) The issuer retains the following records with the bond documents until three years after the last outstanding bond is redeemed:

(*1*) For purchases of guaranteed investment contracts, a copy of the contract, and for purchases of investments other than guaranteed investment contracts, the purchase agreement or confirmation.

(*2*) The receipt or other record of the amount actually paid by the issuer for the investments, including a record of any administrative costs paid by the issuer, and the certification under paragraph (d)(6)(iii)(D) of this section.

(*3*) For each bid that is submitted, the name of the person and entity submitting the bid, the time and date of the bid, and the bid results.

(*4*) The bid solicitation form and, if the terms of the purchase agreement or the guaranteed investment contract deviated from the bid solicitation form or a submitted bid is modified, a brief statement explaining the deviation and stating the purpose for the deviation. For example, if the issuer purchases a portfolio of investments for a yield restricted defeasance escrow and, in order to satisfy the yield restriction requirements of section 148, an investment in the winning bid is replaced with an investment with a lower yield, the issuer must retain a record of the substitution and how the price of the substitute investment was determined. If the issuer replaces an investment in the winning bid portfolio with another investment, the purchase price of the new investment is not covered by the safe harbor unless the investment is bid under a bidding procedure meeting the requirements of this paragraph (d)(6)(iii).

(*5*) For purchases of investments other than guaranteed investment contracts, the cost of the most efficient portfolio of State and Local Government Series Securities, determined at the time that the bids were required to be submitted pursuant to the terms of the bid specifications.

(e) * * *

(2) * * *

(iv) *Special rule for investments purchased for a yield restricted defeasance escrow.* For investments purchased for a yield restricted defeasance escrow, a fee paid to a bidding agent is a qualified administrative cost only if the following requirements are satisfied:

(A) The fee is comparable to a fee that would be charged for a reasonably comparable investment if acquired with a source of funds other than gross proceeds of tax-exempt bonds, and it is reasonable. The fee is deemed to be comparable to a fee that would be charged for a comparable investment acquired with a source of funds other than gross proceeds of tax-exempt bonds, and to be reasonable if the fee does not exceed the lesser of $10,000 or .1% of the initial principal amount of investments deposited in the yield restricted defeasance escrow.

(B) For transactions in which a guaranteed investment contract and other investments are purchased for a yield restricted defeasance escrow in a single investment (e.g., an issuer bids United States Treasury obligations and an escrow float contract collectively), a broker's fee described in paragraph (e)(2)(iv)(A) of this section will apply to the initial principal amount of the investment deposited in the yield restricted defeasance escrow, and a broker's fee described in paragraph (e)(2)(iii) of this section will apply only to the guaranteed investment contract portion of the investment.* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (c) is amended by revising the entry for 1.148–5 in the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.148–5	1545–1098
	1545–1490
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 17, 1998.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 29, 1998, 8:45 a.m., and published in the issue of the Federal Register for December 30, 1998, 63 F.R. 71748)

Section 337.—Nonrecognition for Property Distributed to Parent in Complete Liquidation of Subsidiary

26 CFR 1.337(d)(4): Taxable to tax-exempt.

T.D. 8802

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

Certain Asset Transfers to a Tax-Exempt Entity

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Final regulations.

SUMMARY: This document contains final regulations that implement provisions of the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988. The final regulations generally affect a taxable corporation that transfers all or substantially all of its assets to a tax-exempt entity or converts from a taxable corporation to a tax-exempt entity in a transaction other than a liquidation, and generally require the taxable corporation to recognize gain or loss as if it had sold the assets transferred at fair market value.

DATES: *Effective Date:* These regulations are effective January 28, 1999.

Applicability Date: For dates of applicability of these regulations, see §1.337(d)–4(e).

FOR FURTHER INFORMATION CONTACT: Stephen R. Cleary, (202) 622-7530 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in these final regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545–1633.

The collection of information in this regulation is described in §1.337(d)–4(b)(1)(i). The information is a written representation made by a tax-exempt entity estimating the percentage it will use assets formerly held by a taxable corporation in an activity the income from which is subject to tax under section 511(a), as opposed to other activities. The information may be used by the taxable corporation in computing the amount of gain or loss that is recognized under the regulations. The information may also be used by the IRS in determining whether the proper amount of tax is due on the transaction. The collection of information is not mandatory but will enable the taxable corporation to support its reporting of the tax consequences of the transaction. The likely respondents are tax-exempt entities subject to the unrelated business income tax under section 511(a) (including most organizations that are exempt from tax under section 501, state colleges and universities, and certain charitable trusts).

Comments concerning 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,** Attention: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Any such comments should be submitted not later than March 1, 1999.

Comments are specifically requested concerning:

(a) Whether the collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service,** including whether the information will have practical utility;

(b) The accuracy of the estimated burden associated with the collection of information (see below);

(c) How the quality, utility, and clarity of the information requested may be enhanced;

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

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

Estimated total annual reporting burden: 125 hours.

The annual burden per respondent varies from 1 hour to 10 hours, depending on individual circumstances, with an estimated average of 5 hours.

Estimated number of respondents: 25.

Estimated frequency of responses: Once.

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

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

Background

On January 15, 1997, proposed regulations §1.337(d)–4 were published in the **Federal Register** (62 F.R. 2064, [REG–209121–89, 1997–1 C.B. 719]). The regulations were proposed to amend 26 CFR part 1 and were intended to carry out the purposes of the repeal of the *General Utilities* doctrine ("*General Utilities* repeal") as enacted in the Tax Reform Act of 1986 (the "1986 Act").

The 1986 Act amended sections 336 and 337, generally requiring corporations to recognize gain or loss when appreciated or depreciated property is distributed in complete liquidation or is sold in connection with a complete liquidation. Section 337(d) directs the Secretary to prescribe regulations as may be necessary to carry out the purposes of *General Utilities* repeal, including rules to "ensure that these purposes shall not be circumvented . . . through the use of a . . . tax-exempt entity." The legislative history concerning a 1988 amendment to section 337(d) explains:

> The bill also clarifies in connection with the built-in gain provisions of the Act that the Treasury Department shall prescribe such regulations as may be necessary or appropriate to carry out those provisions. . . . For example, this includes rules to require the recognition of gain if appreciated property of a C corporation is transferred to a . . . tax-exempt entity [footnote 32] in a carryover basis transaction that would otherwise eliminate corporate level tax on the built-in appreciation.

[footnote 32] The Act generally requires recognition of gain if a C corporation transfers appreciated assets to a tax exempt entity in a section 332 liquidation. See Code section 337(b)(2).

S. Rep. No. 445, 100th Cong., 2d Sess. 66 (1988).

Explanation of Provision

A. *The Proposed Rule*

(1) A taxable corporation that transfers all or substantially all of its assets to one or more tax-exempt entities is required to recognize gain or loss as if the assets transferred were sold at their fair market values (§1.337(d)–4(a)(1), Asset Sale Rule);

(2) A taxable corporation that changes its status to a tax-exempt entity generally is treated as having transferred all of its assets to a tax-exempt entity immediately before the change in status becomes effective in a transaction governed by the Asset Sale Rule (§1.337(d)–4(a)(2), Change in Status Rule);

(3) The Change in Status Rule does not apply (subject to application of the anti-abuse rule) if the corporation formerly was tax-exempt and the change in status is within three years of the later of (a) the corporation first filing a return as a taxable corporation, or (b) a final determination that the corporation had become a taxable corporation (§1.337(d)–4(a)(3), 3-Year Rule);

(4) The Asset Sale Rule does not apply if the transferred assets are used by the tax-exempt entity in an activity the income from which is subject to the unrelated business tax under section 511(a); notwithstanding any other provision of law, gain on such assets will later be included in unrelated business taxable income when the tax-exempt entity disposes of the assets or ceases to use the assets in an activity the income from which is subject to tax under section 511(a) (§1.337(d)–4(b)(1), UBTI Rule);

(5) The regulations apply to transfers of assets occurring after January 28, 1999, unless the transfer is pursuant to a written agreement which is (subject to customary conditions) binding on or before that date (§1.337(d)–4(e), Effective Date Rule).

The IRS and Treasury Department received approximately 32 written comments on the proposed regulations. In addition, the IRS held a public hearing on the proposed regulations on May 6, 1997. After consideration of all the written and oral comments, the IRS and Treasury Department are adopting the proposed regulations as revised by this Treasury Decision. The comments and changes to the regulations made in response to the comments are summarized below.

B. *Comments and Changes in Response to Comments*

1. Asset Sale Rule

Some commentators questioned whether section 337(d) authorizes taxation of asset transfers other than liquidations. Section 337(d) authorizes regulations to prevent circumvention of *General Utilities* repeal through the "use of" any provision of law or regulations (specifically including the corporate reorganization rules in Part III of Subchapter C). The statutory rules in sections 336 and 337(b)(2), enacted as part of *General Utilities* repeal, provide for corporate-level gain or loss recognition when a taxable corporation liquidates into a controlling tax-exempt entity. The regulations published in this Treasury Decision are intended to reach transactions that are economically similar to those liquidations but take different forms, such as a taxable corporation's transfer of substantially all of its assets to a tax-exempt entity or a taxable corporation's change in status resulting in its becoming a tax-exempt entity. The IRS and Treasury Department believe that section 337(d) provides clear authority for these regulations.

Some commentators questioned whether section 337(d) authorizes regulations that would tax transfers of assets without consideration, noting that making a gift generally does not cause the recognition of gain to the donor. Other commentators claimed that the proposed regulations, to the extent they apply to transfers of assets to charitable organizations, conflict with the policy of the charitable contribution deduction under section 170. The regulations do not affect the tax treatment of a corporation's gift of a portion of its assets to charity, nor do they affect the shareholders' tax treatment when transferring all or any part of the corporation's assets to charity by transferring all or any part of the corporation's stock to charity. The regulations apply only to transfers of all or substantially all of the assets of a taxable corporation to a tax-exempt entity or a taxable corporation's conversion to a tax-exempt entity. If shareholders donate all of a corporation's stock to a charity and the charity then liquidates the corporation, section 337(b)(2) taxes the liquidating corporation's gain. The final regulations, which remain unchanged from the proposed regulations in this respect, tax a taxable corporation's gain in other transactions that have the same economic effect.

One commentator proposed that the final regulations allow deferral of gain recognition on any asset transferred to a tax-exempt entity until the entity disposes of the asset. The commentator suggests a rule similar to that of section 1374, which provides generally that a C corporation that converts to being an S corporation is subject to tax if it disposes of assets held at the time of conversion during the ten-year period after the conversion. Under this rule, the tax-exempt entity would not be taxed on the built-in gain in assets that it retains. For the reasons stated above, the IRS and Treasury Department have concluded that the regulations generally should follow the rule in section 337(b)(2) rather than the rule contained in section 1374 to best accomplish the goal set forth in the statute and legislative history.

One commentator suggested that the Asset Sale Rule should not apply to a taxable corporation transferring assets to a tax-exempt entity in a like-kind exchange described in section 1031 or an involuntary conversion described in section 1033. In transactions described in these sections, the taxable corporation acquires replacement property that has a basis determined by reference to the basis of the property replaced. Because the built-in appreciation in the transferred asset is preserved in the replacement asset and remains in the hands of a taxable corporation, *General Utilities* repeal is not circumvented in these transactions. Accordingly, the final regulations exclude transactions from the Asset Sale Rule to the extent the transactions qualify for nonrecognition of gain or loss under section 1031 or 1033.

Some commentators proposed removing section 528 homeowners associations from the list of tax-exempt entities subject to the regulations because dispositions of assets by a homeowners association are subject to tax. Under section 528, homeowners associations are subject to tax on all of their income except for *exempt function income,* which is defined as fees, dues, or assessments from homeowners. Gains from the sale of a homeowners association's property are taxable; therefore, *General Utilities* repeal is not circumvented by transfers to homeowners associations. In addition, the properties that become the subject of section 528 homeowners associations generally are developed as business ventures, and the developer has substantial incentive to realize the increase in value of its assets in connection with their transfer to the association, thus providing additional protection with respect to *General Utilities* repeal. Also, a homeowners association may alternate between taxable and tax-exempt status because its exemption is based on a year-by-year election under section 528(c)(1)(E). In a given year, a homeowners association may prefer taxable status to tax-exempt status under section 528 because a section 528 organization is taxed at a 30 percent flat rate on income other than membership fees, dues, or assessments, while a taxable homeowners association is subject to tax on all income but at the progressive rates of section 11 (15 to 35 percent). The tax on non-exempt income under section 528 may exceed the tax the association would pay as a taxable corporation. Congress anticipated that these entities may alternate between taxable and tax-exempt status and that the assets of these entities will remain subject to tax on transfer. Imposing a tax on appreciated property each time such an entity converts its status could inhibit this flexibility. For this reason, and because *General Utilities* repeal will not be compromised, the IRS and Treasury Department believe that an organization's election to be treated under section 528 for a tax year should not trigger gain recognition. Accordingly, the final regulations do not treat section 528 homeowners associations as tax-exempt entities for purposes of section 337(d). For similar reasons, the final regulations do not define political organizations described in section 527 as tax-exempt entities for purposes of section 337(d).

Some commentators suggested that social clubs that are tax-exempt as organizations described in section 501(c)(7) should be removed from the list of tax-exempt entities for purposes of section 337(d). Commentators also suggested that tax-exempt social clubs be allowed to defer gain on transactions subject to the regulations, because social clubs may be subject to tax on gains from asset sales. Section 512(a)(3)(A) generally taxes the income of a section 501(c)(7) social club except for the social club's "exempt function income," as defined in section 512(a)(3)(B). Section 512(a)(3)(A) also applies to tax-exempt organizations described in section 501(c)(9), (17), or (20). The final regulations, however, do not provide relief from the general rules of the regulations for section 501(c)(7) organizations. Unlike section 528 homeowners associations, section 501(c)(7) social clubs are permitted to avoid gain recognition on certain asset sales. For example, if the club replaces the property sold with other property used directly in the performance of its tax-exempt function, no tax is owed on any gain recognized. Because of these exceptions, the IRS and Treasury Department believe that deferring tax on transfers of assets to section 501(c)(7) organizations would not be consistent with *General Utilities* repeal. Accordingly, the final regulations follow the proposed regulations and apply to transfers of assets to section 501(c)(7) organizations.

2. Change in Status Rule

A significant number of commentators contended that the Change in Status Rule could have a major adverse effect on mutual or cooperative electric companies that are tax-exempt as organizations described in section 501(c)(12). That section provides tax exemption for benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations (including mutual or cooperative electric companies), but only if more than 85 percent of their income is collected from members for the sole purpose of meeting losses and expenses. The 85 percent test is applied annually, so that an electric cooperative could be taxable one year and tax-exempt the next year. The commentators requested that electric cooperatives be given relief from the Change in Status Rule because business exigencies may cause these cooperatives to fail the 85 percent test. They also noted that the relief provided in the proposed regulations for organizations temporarily losing their exempt status was insufficient because more than 3 years may elapse before the organization once again meets the 85 percent test.

In addition to meeting the 85 percent test, section 501(c)(12) organizations must operate according to cooperative principles to be eligible for exemption. See Rev. Rul. 72–36, 1972–1 C.B. 151; *Buckeye Countrymark, Inc. v. Commissioner*, 103 T.C. 547, 554–555 (1994), acq. on other issues, 1997–1 C.B. 1; Puget *Sound Plywood, Inc. v. Commissioner*, 44 T.C. 305, 308 (1965), *acq. on other issues*, 1966–2 C.B. 6. An organization may operate according to cooperative principles yet fail the 85 percent test. Congress anticipated that section 501(c)(12) mutual or cooperative organizations could alternate between taxable and tax-exempt status due to the operation of the 85 percent income requirement. The IRS and Treasury Department do not believe it is appropriate to treat these entities as having disposed of all their assets when they regain tax-exempt status where the sole reason for their becoming taxable was the failure to meet the 85 percent test. Therefore, the final regulations provide that the Change in Status Rule does not apply when an organization previously tax-exempt as an organization described in section 501(c)(12) loses exemption solely because it fails the 85 percent test and later regains tax-exempt status, provided that in each intervening taxable year it meets all the requirements for exemption under section 501(c)(12) except for the 85 percent test.

One commentator suggested that because social clubs alternate between taxable and tax-exempt status they should be given relief similar to that requested by section 501(c)(12) organizations. Social clubs can lose their tax exemption if they generate excessive nonmember income in a particular year. See S. Rep. No. 1318, 94th Cong., 2d Sess. 4 (1976), 1976–2 C.B. 599. After considering this comment and the Service's experience with these organizations, we have concluded that the 3-Year Rule will provide adequate relief for social clubs from inappropriate application of the Change in Status Rule.

A number of commentators urged exempting newly formed social clubs from the application of the regulations if they become tax-exempt within seven years of their formation, rather than within the three-year period provided for other tax-exempt entities. Those commentators explained that some social clubs are organized when a real estate developer acquires land to be used for a housing development and a social club for the homeowners. The assets of the future social club are held by a corporation, but it cannot qualify as a tax-exempt section 501(c)(7) organization until several years later, after the stock or membership interests in the corporation have been transferred to the homeowners. Commentators familiar with development practices advised that it often takes up to seven years to transfer the club to the members' control. Furthermore, because the developer is forming the club as a business venture, the developer will work to realize the increase in the value of the club's assets as part of the transfer. For these reasons, providing additional time for newly-formed clubs to become tax-exempt does not conflict with *General Utilities* repeal. Therefore, the final regulations incorporate the recommendation made in the comments and provide that a social club will not be subject to the Change in Status Rule if it converts to tax-exempt status within seven taxable years after the year in which it was formed.

Two commentators suggested that the Change in Status Rule could adversely affect a taxable property and casualty insurance company that becomes tax-exempt as an organization described in section 501(c)(15) when it encounters financial difficulties leading to conservation or liquidation proceedings pursuant to authority granted by a state regulatory agency. A taxable property or casualty insurance company whose net written premiums or direct written premiums are $350,000 or less for the taxable year is eligible to be exempt from tax under section 501(c)(15). The final regulations provide an exception from the Change in Status Rule if in a taxable year an insurance company becomes an organization described in section 501(c)(15), and during that year and all subsequent years in which it is exempt under that section, the insurance company is the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar state proceeding. In such cases, the reduction in premium income to $350,000 or less is likely to be involuntary and a direct result of the state proceeding. However, the final regulations continue to apply the Change in Status Rule to all other insurance companies qualifying for tax exemption under section 501(c)(15).

3. UBTI Rule

Some commentators asked how the UBTI Rule would apply when assets that are transferred to a tax-exempt entity are used partly in an activity of the organization the income from which is subject to tax under section 511(a) ("section 511(a) activity") and partly in other activities. The UBTI Rule in the proposed regulations defers gain recognition with respect to those assets that will be used in a section 511(a) activity of the tax-exempt entity after the asset is transferred to the tax-exempt entity or after the taxable corporation converts to tax-exempt status. The final regulations provide that, if an asset will be used partly or wholly in a section 511(a) activity of a tax-exempt entity, the taxable corporation will recognize an amount of gain or loss that bears the same ratio to the asset's built-in gain or loss as 100 percent reduced by the percentage of use in the section 511(a) activity bears to 100 percent. The taxable corporation generally may rely on a written representation from the tax-exempt entity as to the anticipated percentage of use of the asset in a section 511(a) activity during the first taxable year after the transfer or change in status. If the percentage of an asset's use in the section 511(a) activity later decreases from the estimate used in computing gain or loss when the asset was transferred, the tax-exempt entity will recognize part of the deferred gain or loss in an amount that is proportionate to the decrease in use in the section 511(a) activity, and the gain or loss recognized will be subject to tax under section 511(a). The tax-exempt entity must use the same reasonable method of allocation for determining the percentage it uses assets in the section 511(a) activity for purposes of the UBTI Rule as it uses for other tax purposes (e.g., depreciation deductions). The tax-exempt entity also must use this same reasonable method of allocation for each taxable year that it holds the assets.

One commentator asked that gain not be recognized when a tax-exempt entity disposes of an asset used in a section 511(a) activity in a transaction eligible for nonrecognition treatment under the Code. The proposed regulations provide that gain is recognized on such dispositions "notwithstanding any other provision of law," corresponding with the rule in section 337(b)(2)(B)(ii), and overruling the application of nonrecognition provisions such as section 512(b)(5). In response to these comments, the final regulations allow continuing deferral to the extent that the tax-exempt entity disposes of assets in a transaction that qualifies for nonrecognition of gain or loss under section 1031 or section 1033, but only to the extent that the replacement asset is used in a section 511(a) activity. No exception is made with respect to other nonrecognition provisions.

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the Internal Revenue Service's estimate that only 25 entities per year will be responding to the collection of information, and that the total annual reporting burden of this information collection for all responding entities will be only 125 hours. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f), the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Stephen R. Cleary of the Office of Assistant Chief Counsel (Corporate), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Parts 1 and are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for 26 CFR Part 1 is amended by adding an entry in numerical order to read as follows:

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

Section 1.337(d)–4 also issued under 26 U.S.C. 337. * * *

Par. 2. Section 1.337(d)–4 is added to read as follows:

§1.337(d)–4 Taxable to tax-exempt.

(a) *Gain or loss recognition*—(1) *General rule.* Except as provided in paragraph (b) of this section, if a taxable corporation transfers all or substantially all of its assets to one or more tax-exempt entities, the taxable corporation must recognize gain or loss immediately before the transfer as if the assets transferred were sold at their fair market values. But see section 267 and paragraph (d) of this section concerning limitations on the recognition of loss.

(2) *Change in corporation's tax status treated as asset transfer.* Except as provided in paragraphs (a)(3) and (b) of this section, a taxable corporation's change in status to a tax-exempt entity will be treated as if it transferred all of its assets to a tax-exempt entity immediately before the change in status becomes effective in a transaction to which paragraph (a)(1) of this section applies. For example, if a state, a political subdivision thereof, or an entity any portion of whose income is excluded from gross income under section 115, acquires the stock of a taxable corporation and thereafter any of the taxable corporation's income is excluded from gross income under section 115, the taxable corporation will be treated as if it transferred all of its assets to a tax-exempt entity immediately before the stock acquisition.

(3) *Exceptions for certain changes in status*— (i) *To whom available.* Paragraph (a)(2) of this section does not apply to the following corporations—

(A) A corporation previously tax-exempt under section 501(a) which regains its tax-exempt status under section 501(a) within three years from the later of a final adverse adjudication on the corporation's tax exempt status, or the filing by the corporation, or by the Secretary or his delegate under section 6020(b), of a federal income tax return of the type filed by a taxable corporation;

(B) A corporation previously tax-exempt under section 501(a) or that applied for but did not receive recognition of exemption under section 501(a) before January 15, 1997, if such corporation is tax-exempt under section 501(a) within three years from January 28, 1999;

(C) A newly formed corporation that is tax-exempt under section 501(a) (other than an organization described in section 501(c)(7)) within three taxable years from the end of the taxable year in which it was formed;

(D) A newly formed corporation that is tax-exempt under section 501(a) as an organization described in section 501(c)(7) within seven taxable years from the end of the taxable year in which it was formed;

(E) A corporation previously tax-exempt under section 501(a) as an organization described in section 501(c)(12), which, in a given taxable year or years prior to again becoming tax-exempt, is a taxable corporation solely because less than 85 percent of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses; if, in a taxable year, such a corporation would be a taxable corporation even if 85 percent or more of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses (a non-85 percent violation), paragraph (a)(3)(i)(A) of this section shall apply as if the corporation became a taxable corporation in its first taxable year that a non-85 percent violation occurred; or

(F) A corporation previously taxable that becomes tax-exempt under section 501(a) as an organization described in section 501(c)(15) if during each taxable year in which it is described in section 501(c)(15) the organization is the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar state proceeding; if such a corporation continues to be described in section 501(c)(15) in a taxable year when it is no longer the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar state proceeding, paragraph (a)(2) of this section shall apply as if the corporation first became tax-exempt for such taxable year.

(ii) *Application for recognition.* An organization is deemed to have or regain tax-exempt status within one of the periods described in paragraph (a)(3)(i)(A), (B), (C), or (D) of this section if it files an application for recognition of exemption with the Commissioner within the applicable period and the application either results in a determination by the Commissioner or a final adjudication that the organization is tax-exempt under section 501(a) during any part of the applicable period. The preceding sentence does not require the filing of an application for recognition of exemption by any organization not otherwise required, such as by §1.501(a)–1, §1.505(c)–1T, and §1.508–1(a), to apply for recognition of exemption.

(iii) *Anti-abuse rule.* This paragraph (a)(3) does not apply to a corporation that, with a principal purpose of avoiding the application of paragraph (a)(1) or (a)(2) of this section, acquires all or substantially all of the assets of another taxable corporation and then changes its status to that of a tax-exempt entity.

(4) *Related transactions.* This section applies to any series of related transactions having an effect similar to any of the transactions to which this section applies.

(b) *Exceptions.* Paragraph (a) of this section does not apply to—

(1) Any assets transferred to a tax-exempt entity to the extent that the assets are used in an activity the income from which is subject to tax under section 511(a) (referred to hereinafter as a "section 511(a) activity"). However, if assets used to any extent in a section 511(a) activity are disposed of by the tax-exempt entity, then, notwithstanding any other provision of law (except section 1031 or section 1033), any gain (not in excess of the amount not recognized by reason of the preceding sentence) shall be included in the tax-exempt entity's unrelated business taxable income. To the extent that the tax-exempt entity ceases to use the assets in a section 511(a) activity, the entity will

be treated for purposes of this paragraph (b)(1) as having disposed of the assets on the date of the cessation for their fair market value. For purposes of paragraph (a)(1) of this section and paragraph (b)(1)—

(i) If during the first taxable year following the transfer of an asset or the corporation's change to tax-exempt status the asset will be used by the tax-exempt entity partly or wholly in a section 511(a) activity, the taxable corporation will recognize an amount of gain or loss that bears the same ratio to the asset's built-in gain or loss as 100 percent reduced by the percentage of use for such taxable year in the section 511(a) activity bears to 100 percent. For purposes of determining the gain or loss, if any, to be recognized, the taxable corporation may rely on a written representation from the tax-exempt entity estimating the percentage of the asset's anticipated use in a section 511(a) activity for such taxable year, using a reasonable method of allocation, unless the taxable corporation has reason to believe that the tax-exempt entity's representation is not made in good faith;

(ii) If for any taxable year the percentage of an asset's use in a section 511(a) activity decreases from the estimate used in computing gain or loss recognized under paragraph (b)(1)(i) of this section, adjusted for any decreases taken into account under this paragraph (b)(1)(ii) in prior taxable years, the tax-exempt entity shall recognize an amount of gain or loss that bears the same ratio to the asset's built-in gain or loss as the percentage point decrease in use in the section 511(a) activity for the taxable year bears to 100 percent;

(iii) If property on which all or a portion of the gain or loss is not recognized by reason of the first sentence of paragraph (b)(1) of this section is disposed of in a transaction that qualifies for nonrecognition treatment under section 1031 or section 1033, the tax-exempt entity must treat the replacement property as remaining subject to paragraph (b)(1) of this section to the extent that the exchanged or involuntarily converted property was so subject;

(iv) The tax-exempt entity must use the same reasonable method of allocation for determining the percentage that it uses the assets in a section 511(a) activity as it uses for other tax purposes, such as determining the amount of depreciation deductions. The tax-exempt entity also must use this same reasonable method of allocation for each taxable year that it holds the assets; and

(v) An asset's built-in gain or loss is the amount that would be recognized under paragraph (a)(1) of this section except for this paragraph (b)(1).

(2) Any transfer of assets to the extent gain or loss otherwise is recognized by the taxable corporation on the transfer. See, for example, sections 336, 337(b)(2), 367, and 1001;

(3) Any transfer of assets to the extent the transaction qualifies for nonrecognition treatment under section 1031 or section 1033; or

(4) Any forfeiture of a taxable corporation's assets in a criminal or civil action to the United States, the government of a possession of the United States, a state, the District of Columbia, the government of a foreign country, or a political subdivision of any of the foregoing; or any expropriation of a taxable corporation's assets by the government of a foreign country.

(c) *Definitions.* For purposes of this section:

(1) *Taxable corporation.* A *taxable corporation* is any corporation that is not a tax-exempt entity as defined in paragraph (c)(2) of this section.

(2) *Tax-exempt entity.* A *tax-exempt entity* is—

(i) Any entity that is exempt from tax under section 501(a) or section 529;

(ii) A charitable remainder annuity trust or charitable remainder unitrust as defined in section 664(d);

(iii) The United States, the government of a possession of the United States, a state, the District of Columbia, the government of a foreign country, or a political subdivision of any of the foregoing;

(iv) An Indian Tribal Government as defined in section 7701(a)(40), a subdivision of an Indian Tribal Government determined in accordance with section 7871(d), or an agency or instrumentality of an Indian Tribal Government or subdivision thereof;

(v) An Indian Tribal Corporation organized under section 17 of the Indian Reorganization Act of 1934, 25 U.S.C. 477, or section 3 of the Oklahoma Welfare Act, 25 U.S.C. 503;

(vi) An international organization as defined in section 7701(a)(18);

(vii) An entity any portion of whose income is excluded under section 115; or

(viii) An entity that would not be taxable under the Internal Revenue Code for reasons substantially similar to those applicable to any entity listed in this paragraph (c)(2) unless otherwise explicitly made exempt from the application of this section by statute or by action of the Commissioner.

(3) *Substantially all.* The term *substantially all* has the same meaning as under section 368(a)(1)(C).

(d) *Loss limitation rule.* For purposes of determining the amount of gain or loss recognized by a taxable corporation on the transfer of its assets to a tax-exempt entity under paragraph (a) of this section, if assets are acquired by the taxable corporation in a transaction to which section 351 applied or as a contribution to capital, or assets are distributed from the taxable corporation to a shareholder or another member of the taxable corporation's affiliated group, and in either case such acquisition or distribution is made as part of a plan a principal purpose of which is to recognize loss by the taxable corporation on the transfer of such assets to the tax-exempt entity, the losses recognized by the taxable corporation on such assets transferred to the tax-exempt entity will be disallowed. For purposes of the preceding sentence, the principles of section 336(d)(2) apply.

(e) *Effective date.* This section is applicable to transfers of assets as described in paragraph (a) of this section occurring after January 28, 1999, unless the transfer is pursuant to a written agreement which is (subject to customary conditions) binding on or before January 28, 1999.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (c) is amended by adding an entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.337(d)–4	1545–1633
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 17, 1998.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 28, 1998, 8:45 a.m., and published in the issue of the Federal Register for December 29, 1998, 63 F.R. 71591)

Section 411.—Minimum Vesting Standards

26 CFR 1.411(a)–11: Restriction and valuation of distributions.

T.D. 8796

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

Notice, Consent and Election Requirements of Sections 411(a)(11) and 417 for Qualified Retirement Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains regulations that provide guidance concerning the notice and consent requirements under section 411(a)(11) and the notice and election requirements under section 417 for qualified retirement plans. These regulations finalize proposed regulations published in the **Federal Register** on September 22, 1995. In order to avoid delay in the commencement of distributions, the regulations generally allow distributions to commence, with spousal consent if required, in less than 30 days after a participant receives a notice of distribution rights if the participant affirmatively so elects to have the distributions commence. The regulations affect employers that maintain qualified plans, and participants and beneficiaries in those plans.

DATES: These regulations are effective December 18, 1998.

FOR FURTHER INFORMATION CONTACT: Robert Walsh, (202) 622-6090 (not a toll- free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under the control number 1545–1471. Responses to this collection of information are mandatory.

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

The estimated burden per respondent is .011 hours.

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

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

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 411(a)(11) and section 417(e). These regulations finalize proposed regulations that were published as a notice of proposed rulemaking (EE–24–93, 1995–2 C.B. 468) (REG–209626–93, 1995–2 C.B. 468) in the **Federal Register** (60 F.R. 49236) on September 22, 1995. The notice of proposed rulemaking states that the text of the proposed regulations is the same as the text of temporary regulations which were published in the **Federal Register** (60 F.R. 49218) on the same day. A public hearing was held on the temporary regulations on April 24, 1996.

As indicated in Announcement 98–87 (1998–40 I.R.B. 11), the temporary regulations automatically expired in September, 1998, pursuant to section 7805(e). Announcement 98–87 provides, however, that plan sponsors may rely upon the identical proposed regulations until they are amended or finalized.

Prior to the issuance of the proposed regulations, §1.411(a)–11(c) provided that a participant's consent to a distribution under section 411(a)(11) was not valid unless the participant received a notice of his or her rights under the plan no more than 90 and no less than 30 days prior to the annuity starting date. Section 1.417(e)–1 set forth the same 90/30-day time period for providing the notice explaining the qualified joint and survivor annuity and waiver rights required under section 417(a)(3) (QJSA explanation).

Temporary regulations providing guidance on the amendment to section 402(f) made by the Unemployment Compensation Amendments of 1992 (UCA), published in October 1992, generally prescribed this 90/30-day time period for purposes of the notice requirement under that section. In the preamble to the UCA temporary regulations, the IRS and Treasury requested comments on the appropriateness of this time period for section 411(a)(11), as well as for section 402(f).

In response to comments on the 90/30-day time period, the proposed regulations modified the 30-day time period for purposes of sections 411(a)(11) and 417. Under the proposed regulations, if, after having received the notice of distribution rights described in §1.411(a)–11, a participant affirmatively elects a distribution, a plan will not fail to satisfy the consent requirement of section 411(a)(11) merely because the distribution is made less than 30 days after the notice was provided to the participant.

The proposed regulations under section 417 made the same change to §1.417(e)–1 and also provided a more limited modification to the 30-day time period in §1.417(e)–1. The reception to this change to the 30-day period for purposes of section 417 was generally favorable.

Commentators expressed concern about the restatement in the proposed regulations of the statutory requirement that the QJSA explanation be provided before the annuity starting date because this requirement precluded retroactive annuity payments for any period before the explanation was provided. Subsequently, section 1451 of the Small Business Job Protection Act of 1996, Public Law 104-188, 110 Stat. 1755 (SBJPA) added section 417(a)(7) to the Internal Revenue Code effective for plan years beginning on or after January 1, 1997. Section 417(a)(7) permits the plan to provide the QJSA explanation after the annuity starting date.

After consideration of the comments, these final regulations generally adopt the provisions of the proposed regulations. However, the final regulations under section 417 have been modified to provide that, for plan years beginning after December 31, 1996, the requirement that the QJSA explanation be provided before the annuity starting date does not apply to the extent provided under section 417(a)(7).

Explanation of Provisions

1. *Overview of Statutory Provisions*

Section 411(a)(11) provides that, if the value of a participant's accrued benefit exceeds $5,000, a qualified plan generally may not distribute the benefit to the participant without the participant's consent.

Section 401(a)(11) requires that certain distributions be made in the form of a qualified joint and survivor annuity (QJSA) unless, in accordance with section 417, the participant waives the QJSA and elects a different form of benefit. Profit-sharing plans and stock bonus plans that meet the requirements of sections 401(a)(11)(B)(iii)(I) through (III) are not subject to the survivor annuity requirements of sections 401(a)(11) and 417.

Section 417 sets forth the requirements applicable to a waiver of the QJSA. Section 417(a) requires the participant to obtain the consent of the participant's spouse, if any, to any waiver of the QJSA and election of a form of benefit other than a QJSA. Any election made by the participant must be revocable during the 90-day period ending on the annuity starting date. Section 417(a)(3) requires that, within a reasonable period of time before the participant's annuity starting date, a plan provide the participant with a notice explaining the participant's right to the QJSA and the participant's right to waive the QJSA (QJSA explanation).

Section 417(a)(7)(B), added by SBJPA, codified the provision in the proposed regulations which provides that a plan may permit a participant to elect (with applicable spousal consent) a distribution with an annuity starting date after the QJSA explanation was provided but before 30 days have elapsed, as long as the distribution commences more than seven days after the explanation was provided. As discussed above, section 417(a)(7)(A) further provides that a plan is permitted to provide the QJSA explanation after the annuity starting date if the distribution commences at least 30 days after such explanation was provided, subject to the same waiver of the 30-day minimum waiting period. This is intended to allow retroactive payments of benefits which are attributable to the period before the explanation.

2. *Waiver of 30-day Period for QJSA Explanation*

The proposed regulations permit a plan administrator (where not inconsistent with the terms of the plan) to commence distributions before the end of the 30-day time period after the QJSA explanation is provided, if certain requirements are met. Specifically, after an affirmative distribution election, with any applicable spousal consent, the plan may permit the distribution to commence at any time more than seven days after the QJSA explanation was provided to the participant. Any distribution election must remain revocable until the later of the annuity starting date or the expiration of the seven-day period that begins the day after the QJSA explanation is provided. For example, if a married participant receives the explanation of the QJSA on November 28 and elects (with spousal consent) on December 2 to waive the QJSA and receive an immediate single life annuity, the annuity starting date is permitted to be December 1, provided that the first payment is made no earlier than December 6 and the participant does not revoke the election before that date.

Most commentators expressed approval of this change to the 30-day waiting period. However, one commentator indicated that this change would create an incentive for participants to pressure their spouses to consent to any waiver of the QJSA as quickly as possible. Because it has been codified by section 417(a)(7)(B), the final regulations retain this waiver provision.

3. *Provision of QJSA Explanation After Annuity Starting Date*

The proposed regulations provide that the annuity starting date must be a date after the explanation of the QJSA is provided to the participant, but may precede the date the participant affirmatively elects a distribution or the date the distribution commences. Commentators indicated that this rule disadvantaged participants because it does not allow a retroactive annuity starting date to a date before the QJSA explanation was provided. However, prior to its amendment by SBJPA, the plain language of section 417 required the QJSA explanation to be provided before the annuity starting date.

As discussed above, section 1451 of the SBJPA added section 417(a)(7)(A) to the Code. That section provides that a plan may provide the QJSA explanation after the annuity starting date and that the applicable election period shall not end before the 30th day after the date on which the explanation is provided. Thus, section 417(a)(7)(A) allows retroactive payments of benefits which are attributable to the period before the QJSA explanation is provided. Accordingly, the final regulations provide that, for plan years beginning after December 31, 1996, the requirement that the QJSA explanation be provided before the annuity starting date does not apply to the extent provided under section 417(a)(7).

Section 417(a)(7)(A) provides that the Secretary may by regulations limit its application except that such regulations may not limit the period of time by which the annuity starting date precedes the provision of the written explanation other than by providing that the annuity starting date may not be earlier than termination of employment.

4. *Use of Electronic Media for Notices and Consent*

Comments on the proposed regulations requested that the IRS and Treasury clarify the extent to which plans may use new technologies, including electronic media, for providing notices under sections 402(f), 411(a)(11) and 417, and for receiving participant and beneficiary consents and elections under sections 411(a)(11) and 417. Subsequently, section 1510 of the Taxpayer Relief Act of 1997 (TRA '97) provided generally for the Secretary of the Treasury to issue guidance concerning the use of new technologies in the administration of retirement plans. Announcement 98–62 (1998–29 I.R.B. 13) requested comments on the guidance described in section 1510.

After consideration of the comments on the proposed regulations and Announcement 98–62, the IRS and Treasury have decided to propose regulations regarding the use of electronic media to provide notices under sections 402(f), 411(a)(11), and section 3405(e)(10) and for receiving participant consent under section 411(a)-(11). Those proposed regulations are set forth in a notice of proposed rulemaking published elsewhere in this issue of the **Federal Register.**

5. *90-day Time Period*

Comments on the proposed regulations requested an expansion of the 90-day time period, and the IRS and the Treasury have decided to propose changes to the 90/30-day period for providing notices under sections 402(f) and 411(a)(11). These changes are included in the proposed regulations on the use of new technologies, which are set forth in a notice of proposed rulemaking published elsewhere in this issue of the **Federal Register.**

6. *Effective Dates*

The regulations apply to distributions on or after September 22, 1995. However, plan sponsors and plan administrators may rely on the regulations under section 411(a)(11) as though they were included in the final regulations under section 411(a)(11) published in 1988–2 C.B. 48.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 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 notice of proposed rulemaking was issued prior to March 29, 1996, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Robert Walsh, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are 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 1.411(a)–11 is amended as follows:

1. Paragraph (c)(2)(ii) is revised.

2. Paragraphs (c)(2)(iii), (c)(2)(iv), (c)(2)(v) and (c)(8) are added.

The revision and additions read as follows:

§1.411(a)–11 Restriction and valuation of distributions.

* * * * *

(c) * * *

(2) * * *

(ii) Written consent of the participant to the distribution must not be made before the participant receives the notice of his or her rights specified in this paragraph (c)(2) and must not be made more than 90 days before the date the distribution commences.

(iii) A plan must provide participants with notice of their rights specified in this paragraph (c)(2) no less than 30 days and no more than 90 days before the date the distribution commences. However, if the participant, after having received this notice, affirmatively elects a distribution, a plan will not fail to satisfy the consent requirement of section 411(a)(11) merely because the distribution commences less than 30 days after the notice was provided to the participant, provided that the following requirement is met. The plan administrator must provide information to the participant clearly indicating that (in accordance with the first sentence of this paragraph (c)(2)(iii)) the participant has a right to at least 30 days to consider whether to consent to the distribution.

(iv) For purposes of satisfying the requirements of this paragraph (c)(2), the plan administrator may substitute the annuity starting date, within the meaning of §1.401(a)–20, Q&A-10, for the date the distribution commences.

(v) See §1.401(a)–20, Q&A–24 for a special rule applicable to consents to plan loans.

* * * * *

(8) *Delegation to Commissioner.* The Commissioner, in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin, may modify, or provide additional guidance with respect to, the notice and consent requirements of this section. See §601.601(d)-(2)(ii)(b) of this chapter.

* * * * *

§1.411(a)–11T [Removed]

Par. 3. Section 1.411(a)–11T is removed.

Par. 4. Section 1.417(e)–1 is amended as follows:

1. Paragraph (b)(3) is revised.

2. Paragraph (b)(4) is added.

The revision and addition read as follows:

§1.417(e)–1 Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.

* * * * *

(b) * * *

(3) *Time of consent.* (i) Written consent of the participant and the participant's spouse to the distribution must be made not more than 90 days before the annuity starting date.

(ii) A plan must provide participants with the written explanation of the QJSA required by section 417(a)(3) no less than 30 days and no more than 90 days before the annuity starting date (except as otherwise provided by section 417(a)(7) for plan years beginning after December 31, 1996). However, if the participant, after having received the written explanation of the QJSA, affirmatively elects a form of distribution and the spouse consents to that form of distribution (if necessary), a plan will not fail to satisfy the requirements of section 417(a) merely because the annuity starting date is less than 30 days after the written explanation was provided to the participant, provided that the following requirements are met:

(A) The plan administrator provides information to the participant clearly indicating that (in accordance with the first sentence of this paragraph (b)(3)(ii)) the participant has a right to at least 30 days to consider whether to waive the QJSA and consent to a form of distribution other than a QJSA.

(B) The participant is permitted to revoke an affirmative distribution election at least until the annuity starting date, or, if later, at any time prior to the expiration of the 7-day period that begins the day after the explanation of the QJSA is provided to the participant.

(C) The annuity starting date is after the date that the explanation of the QJSA is provided to the participant (except as otherwise provided by section 417(a)(7) for plan years beginning after December 31, 1996). However, the plan may permit the annuity starting date to be before the date that any affirmative distribution election is made by the participant and before the date that the distribution is permitted to commence under paragraph (b)(3)(ii)(D) of this section.

(D) Distribution in accordance with the affirmative election does not commence before the expiration of the 7-day period that begins the day after the explanation of the QJSA is provided to the participant.

(iii) The following example illustrates the provisions of this paragraph (b)(3):

Example. Employee E, a married participant in a defined benefit plan who has terminated employment, is provided with the explanation of the QJSA on November 28. Employee E elects (with spousal consent) on December 2 to waive the QJSA and receive an immediate distribution in the form of a single life annuity. The plan may permit Employee E to receive payments with an annuity starting date of December 1, provided that the first payment is made no earlier than December 6 and the participant does not revoke the election before that date. The plan can make the remaining monthly payments on the first day of each month thereafter in accordance with its regular payment schedule.

(iv) The additional rules of this paragraph (b)(3) concerning the notice and consent requirements of section 417 apply to distributions on or after September 22, 1995. For distributions before September 22, 1995, the additional rules concerning the notice and consent requirements of section 417 in §1.417(e)–1(b)(3) in effect prior to September 22, 1995 (see §1.417(e)–1 (b)(3) in 26 CFR Part 1 revised as of April 1, 1995) apply.

(4) *Delegation to Commissioner.* The Commissioner, in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin, may modify, or provide additional guidance with respect to, the notice and consent requirements of this section. See §601.601(d)(2)(ii)(*b*) of this chapter.

* * * * *

§1.417(e)–1T [Amended]

Par. 5. In §1.417(e)–1T, paragraphs (b)(3) and (4) are removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In §602.101, the table in paragraph (c) is amended by removing the entry for 1.411(a)–11T and adding the following entries in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.411(a)–11	1545-1471
* * * * *	
1.417(e)–1	1545–1471
* * * * *	

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

Approved December 2, 1998.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 17, 1998, 8:45 a.m., and published in the issue of the Federal Register for December 18, 1998, 63 F.R. 70009)

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

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

LIFO; price indexes; department stores. The November 1998 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, November 30, 1998.

Rev. Rul. 99–4

The following Department Store Inventory Price Indexes for November 1998 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, November 30, 1998.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups – soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

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

Groups	Nov. 1997	Nov. 1998	Percent Change from Nov.1997 to Nov. 1998[1]
1. Piece Goods	524.6	544.5	3.8
2. Domestics and Draperies	628.2	635.9	1.2
3. Women's and Children's Shoes	661.7	685.8	3.6
4. Men's Shoes	906.9	916.9	1.1
5. Infants' Wear	618.2	638.3	3.3
6. Women's Underwear	552.9	570.4	3.2
7. Women's Hosiery	298.8	308.4	3.2
8. Women's and Girls' Accessories	543.7	546.5	0.5
9. Women's Outerwear and Girls' Wear	428.4	417.0	–2.7
10. Men's Clothing	621.2	619.5	–0.3
11. Men's Furnishings	604.0	608.4	0.7
12. Boys' Clothing and Furnishings	513.1	519.0	1.1
13. Jewelry	978.9	977.1	–0.2
14. Notions	807.7	766.3	–5.1
15. Toilet Articles and Drugs	917.8	945.3	3.0
16. Furniture and Bedding	665.8	686.8	3.2
17. Floor Coverings	580.1	602.2	3.8
18. Housewares	811.7	811.3	0.0
19. Major Appliances	241.0	238.9	–0.9
20. Radio and Television	74.2	70.1	–5.5
21. Recreation and Education[2]	108.3	102.2	–5.6
22. Home Improvements[2]	133.2	129.6	–2.7
23. Auto Accessories[2]	107.9	107.9	0.0
Groups 1 – 15: Soft Goods	606.5	610.0	0.6
Groups 16 – 20: Durable Goods	462.6	460.4	–0.5
Groups 21 – 23: Misc. Goods[2]	111.4	106.9	–4.0
Store Total[3]	555.9	554.9	–0.2

[1]Absence of a minus sign before percentage change in this column signifies price increase.
[2]Indexes on a January 1986=100 base.
[3]The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Stan Michaels of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Michaels on (202) 622-4970 (not a toll-free call).

Section 1502.—Regulations

26 CFR 1.1502–9T: Application of overall foreign loss recapture rules to corporations filing consolidated returns (temporary).

T.D. 8800

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Consolidated Returns—Limitation on Recapture of Overall Foreign Loss Accounts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary amendments to the consolidated return regulations. The temporary amendments modify the date temporary regulations apply as published in the **Federal Register** on January 12, 1998, and modified by amendments published in the Federal Register on March 16, 1998, relating to a consolidated group's recapture of an overall foreign loss account arising in a separate return limitation year. The regulations affect consolidated groups that claim foreign tax credits. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register.**

DATES: *Effective dates:* These amendments are effective December 29, 1998.

Applicability dates: For dates of applicability of these regulations, see §1.1502–9T(b)(1)(v).

FOR FURTHER INFORMATION CONTACT: Trina Dang of the Office of Associate Chief Counsel (International), (202) 622-3850 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

As announced in Notice 98–40 (1998–35 I.R.B. 7), these temporary regulations permit taxpayers to elect to delay the effective date of §1.1502–9T, published in the **Federal Register** on January 12, 1998 (T.D. 8751, 63 F.R. 1740 [1998–10 I.R.B. 23]), and modified by amendments published in the **Federal Register** on March 16, 1998 (T.D. 8766, 63 F.R. 12641 [1998–16 I.R.B. 17]).

On January 12, 1998, Treasury and the IRS published in the **Federal Register** (T.D. 8751, 63 F.R. 1740) final, temporary and proposed regulations (the January 1998 regulations) relating to limitations on the use of certain tax credits and related attributes by corporations filing consolidated income tax returns. In general, the January 1998 regulations relate to the separate return limitation year (SRLY) provisions for general business credits, alternative minimum tax credits, foreign tax credits and overall foreign loss accounts. The January 1998 regulations were generally applicable to consolidated return years beginning on or after January 1, 1997.

On March 16, 1998, Treasury and the IRS published in the **Federal Register** (T.D. 8766, 63 F.R. 12641 [1998–16 I.R.B. 17]) final, temporary, and proposed regulations (the March 1998 regulations) modifying the effective date of the January 1998 regulations. The March 1998 regulations provide that the provisions of the January 1998 regulations will apply for consolidated return years for which the due date (without extensions) of the income tax return is after March 13, 1998. In lieu of applying this effective date, however, the March 1998 regulations permit a consolidated group to choose to apply the effective date provisions under the January 1998 regulations. The March 1998 regulations provide that taxpayers making this choice must apply all those effective date provisions for all relevant years. Thus, under the March 1998 regulations, taxpayers are not permitted to apply one provision of the January 1998 regulations (e.g., the general business credit effective date) without applying all the other provisions (e.g., the foreign tax credit effective date).

On May 7, 1998, a public hearing was held regarding the proposed January and March regulations. At the hearing and in written submissions, commentators expressed concern regarding the effective dates contained in the January 1998 and March 1998 regulations with respect to the overall foreign loss account provisions of §1.1502–9T. The commentators' principal concern was that these effective dates resulted in adverse tax consequences not anticipated by taxpayers with respect to business transactions that occurred prior to the issuance of the January 1998 regulations. Treasury and the IRS now believe that certain of these consequences are inappropriate.

Accordingly, on August 14, 1998, Treasury and the Service issued Notice 98–40 (1998–35 I.R.B. 7), announcing their intent to issue regulations providing relief from the application of §1.1502–9T (the overall foreign loss account provisions) for consolidated return years beginning before January 1, 1998.

Explanation of Provisions

As announced in Notice 98–40, taxpayers are permitted to elect not to apply §1.1502–9T(b)(1)(v) to consolidated return years beginning before January 1, 1998. Section 1.1502–3T(c)(4) is amended to clarify that a taxpayer that chooses under the March 1998 regulations to apply the effective date provisions under the January 1998 regulations may also make the election referred to in Notice 98–40.

To make the election, a taxpayer must write "Election Pursuant to Notice 98–40" across the top of page 1 of an original or amended tax return for each consolidated return year subject to the election. For the first consolidated return year to which the overall foreign loss provisions of §1.1502–9T apply (i.e., the first year beginning on or after January 1, 1998), such taxpayer must write "Notice 98–40 Election in Effect in Prior Years" across the top of page 1 of the consolidated tax return for that year. For purposes of applying §1.1502–9T with respect to such year, any member with a balance in an overall foreign loss account from a separate return limitation year on the first day of such year shall be treated as joining the group on such first day.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations principally affect corporations filing consolidated federal income tax returns that have overall foreign losses from separate return limitation years. Available data indicates that many consolidated return filers are large companies (not small businesses). In addition, the data indicates that an insubstantial number of consolidated return filers that are smaller companies have overall foreign losses. Presumably, even fewer of these filers have overall foreign loss accounts that are subject to the separate return limitation year rules. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. It has also been determined that under section 553(d) of the Administrative Procedure Act (5 U.S.C. chapter 5) these regulations should be effective immediately because they involve the applicability of regulations that modify the limitations on the use of certain tax attributes for taxable years for which a return is due after March 13, 1998. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking accompanying these regulations is being sent to the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Trina Dang of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1502–3T is amended by removing the last sentence of paragraph (c)(4) and adding two sentences in its place to read as follows:

§1.1502–3T Consolidated investment credit (temporary).

* * * * *

(c) * * *

(4) * * * A consolidated group making this choice generally must apply all such paragraphs for all relevant years. However, a consolidated group making the election provided in §1.1502–9T(b)(1)(vi) (electing not to apply §1.1502–9T(b)(1)(v) to years beginning before January 1, 1998) may nevertheless choose to apply all such paragraphs other than §1.1502–9T(b)(1)(v) for all relevant years.

* * * * *

Par. 3. In §1.1502–9, paragraph (a) is amended by revising the last two sentences to read as follows:

§1.1502–9 Application of overall foreign loss recapture rules to corporations filing consolidated returns.

(a) * * * See §1.1502–9T(b)(1)(v) for the rule that ends the separate return limitation year limitation for consolidated return years for which the due date of the income tax return (without extensions) is after March 13, 1998, and §1.1502–9T(b)(1)(vi) for an election to continue the separate return limitation year limitation for consolidated return years beginning before January 1, 1998. See also §1.1502–3T(c)(4) for an optional effective date rule (generally making the rules of paragraphs (b)(1)(iii) and (iv) of this section inapplicable for a consolidated return year beginning after December 31, 1996, if the due date of the income tax return (without extensions) for such year is on or before March 13, 1998).

* * * * *

Par. 4. Section 1.1502–9T is amended by revising paragraph (b)(1)(v) and adding paragraph (b)(1)(vi) to read as follows:

§1.1502–9T Application of overall foreign loss recapture rules to corporations filing consolidated returns (temporary).

* * * * *

(b)(1)(v) *Special effective date for SRLY limitation.* Except as provided in paragraph (b)(1)(vi) of this section, §1.1502–9(b)(1)(iii) and (iv) apply only to consolidated return years for which the due date of the income tax return (without extensions) is on or before March 13, 1998. For consolidated return years for which the due date of the income tax return (without extensions) is after March 13, 1998, the rules of §1.1502–9(b)(1)(ii) shall apply to overall foreign losses from separate return years that are separate return limitation years. For purposes of applying §1.1502–9(b)(1)(ii) in such years, the group treats a member with a balance in an overall foreign loss account from a separate return limitation year on the first day of the first consolidated return year for which the due date of the income tax return (without extensions) is after March 13, 1998, as a corporation joining the group on such first day. An overall foreign loss that is part of a net operating loss or net capital loss carryover from a separate return limitation year of a member that is absorbed in a consolidated return year for which the due date of the income tax return (without extensions) is after March 13, 1998, shall be added to the appropriate consolidated overall foreign loss account in the year that it is absorbed. For consolidated return years for which the due date of the income tax return (without extensions) is after March 13, 1998, similar principles apply to overall foreign losses when there has been a consolidated return change of ownership (regardless of when the change of ownership occurred). See also §1.1502–3T(c)(4) for an optional effective date rule (generally making this paragraph (b)(1)(v) applicable to a consolidated return year beginning after December 31, 1996, if the due date of the income tax return (without extensions) for such year is on or before March 13, 1998).

(vi) *Election to defer application of special effective date.* A consolidated group may elect not to apply paragraph (b)(1)(v) of this section to consolidated return years beginning before January 1, 1998. To make this election, a consolidated group must write “Election Pursuant to Notice 98–40” across the top of page 1 of an original or amended tax return for each consolidated return year subject to the election. For the first consolidated return year to which the overall foreign loss provisions of paragraph (b)(1)(v) of this section apply (i.e., the first year beginning on or after January 1, 1998), such consolidated group must write “Notice 98–40 Election in Effect in Prior Years” across the top of page 1 of the consolidated tax return for that year. For purposes of applying §1.1502–9(b)(1)(ii) with respect to such year, any member with a balance in an overall foreign loss account from a separate return limitation year on the first day of such year shall be treated as joining the group on such first day.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 28, 1998, 8:45 a.m., and published in the issue of the Federal Register for December 29, 1998, 63 F.R. 71589)

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 99–7

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for December 1998 is 5.06 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
January	1999	6.24	5.62 to 6.55	5.62 to 6.87

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans Division. For further information regarding this notice, call (202) 622-6076 between 2:30 and 3:30 p.m. Eastern time (not a toll-free number). Mr. Newman's number is (202) 622-8458 (also not a toll-free number).

Low-Income Taxpayer Clinics Grant Program: Availability of Draft Grant Application Package

Notice 99–9

SUMMARY: This document contains a Notice that the IRS has made available, for public comment, a draft of the Low Income Taxpayer Clinic Grant application package. The IRS solicits public comment in order that interested parties may present their views to the IRS prior to implementation of the new grant program during 1999. Consideration will be given to these comments before a final grant application package is adopted in Spring 1999. Copies of the draft grant application package can be downloaded from the IRS Internet site at: *http://www.irs.ustreas.gov.*

DATES: Submit written comments on or before February 27, 1999.

ADDRESSES: Send submissions to: Internal Revenue Service (Attn: LITC Grant C7-171), 5000 Ellin Road, Lanham, MD 20706. Alternatively, submit commits and data via electronic mail (e-mail) to: **lowincomeclinic@ccmail.irs.gov.*

FOR FURTHER INFORMATION CONTACT: Concerning the grant program and the submissions of comments, Eli McDavid, 202-283-0181 (not a toll free number).

SUPPLEMENTARY INFORMATION: Section 3601 of the IRS Restructuring and Reform Act of 1998, Pub. Law No. 105-206, added new section 7526 to the Internal Revenue Code. Section 3601 authorizes the IRS, subject to the availability of appropriated funds, to make grants to provide matching funds for the development, expansion, or continuation of qualified low income taxpayer clinics. Section 3601 authorizes the IRS to provide grants to qualified organizations that provide legal assistance to low-income taxpayers having disputes with the IRS. The IRS also may provide grants to qualified organizations that operate programs to inform individuals, for whom English is a second language, about their rights and responsibilities under the Internal Revenue Code. Copies of the draft grant application package can be downloaded from the IRS Internet site at: *http://www.irs.ustreas.gov.* The IRS is soliciting written comments on this draft grant application package on or before February 27, 1999. Consideration will be given to these comments before a final grant application package is adopted in Spring 1999.

Issues for Comment

The IRS invites public comments on the following issues (and any others) raised by the new grant program or draft application package:

(1) What should be considered a "nominal fee" for purposes of section 7526(b)(1)(A)(I)?

(2) How should satisfaction of the "90%/250%" income requirements contained in section 7526(b)(1)(B)(I) be determined?

(3) What should be considered in evaluating the "criteria for awards" set forth in section 7526(b)(4)?

Deborah Butler,
Assistant Chief Counsel,
Office of Assistant Chief
Counsel (Field Service).

(Filed by the Office of the Federal Register on January 11, 1999, 1:41 p.m., and published in the issue of the Federal Register for January 14, 1999, 64 F.R. 2535)

Part IV. Items of General Interest

Announcement 99-6

The IRS Will Permit Electronic Submission of Forms W-4P, W-4S, and W-4V

The Internal Revenue Service will allow payers to establish a system to electronically receive Forms W-4P, Withholding Certificate for Pension or Annuity Payments, W-4S, Request for Federal Income Tax Withholding From Sick Pay, and W-4V, Voluntary Withholding Request. In general, the electronic system must meet the requirements described in paragraphs (1) through (6) below. In the next revision of Publication 15-A, Employer's Supplemental Tax Guide, the IRS will reflect the provisions of this announcement.

For purposes of this announcement, "payer" refers to a person authorized to withhold income taxes under section 3402 of the Internal Revenue Code and file an information return with respect to such withholdings. "Payee" refers to the person who receives income from a payer.

Forms W-4P, W-4S, and W-4V

The Internal Revenue Service will allow payers of pensions or annuities, sick pay, unemployment compensation, social security benefits, including social security equivalent tier 1 railroad retirement benefits, Commodity Credit Corporation loans, and certain crop disaster payments, to establish a system for payees to electronically submit Forms W-4P, W-4S, and W-4V. In general, the electronic system must meet the requirements described in paragraphs (1) – (6) below.

Requirements

(1) *In general.* The electronic system must ensure that the information received by the payer is the information sent by the payee. The system must document all occasions of user access that result in a submission. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and submitting the Form W-4P, W-4S, or W-4V is the person identified on the form.

(2) *Same information as on paper Forms W-4P, W-4S, or W-4V.* The electronic submission must provide the payer with exactly the same information as the paper Forms W-4P, W-4S, or W-4V.

(3) *Signature requirement.* The electronic submission must be signed with an electronic signature by the payee whose name is on the Form W-4P, W-4S, or W-4V. The electronic signature must identify the payee submitting the electronic form and must authenticate the submission. For this purpose, the term "authenticate" has the same meaning as it does when applied to a written signature on a paper Form W-4P, W-4S, or W-4V. An electronic signature can be in any form that satisfies the foregoing requirements. The electronic signature must be the final entry in the submission.

(4) *Copies of electronic Forms W-4P, W-4S, or W-4V.* Upon request by the Internal Revenue Service, the payer must supply a hard copy of the electronic Form W-4P, W-4S, or W-4V and a statement that, to the best of the payer's knowledge, the electronic Form W-4P, W-4S, or W-4V was submitted by the named payee. The hard copy of the electronic Form W-4P, W-4S, or W-4V must provide exactly the same information as, but need not be a facsimile of, the respective paper form.

(5) *Recordkeeping.* Payers who choose to establish a system to receive electronic Forms W-4P, W-4S, or W-4V must comply with the applicable recordkeeping requirements. See Rev. Proc. 98–25, 1998–11 I.R.B. 7.

(6) *Effective date.* This announcement applies to Forms W-4P, W-4S, and W- 4V submitted electronically by payees on or after January 25, 1999.

For further information regarding this announcement, contact Jean Casey of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations) at (202)622-6060 (not a toll-free call).

Correction of 1998 Instructions for Form 1040NR

Announcement 99–8

The printed version of the 1998 Instructions for Form 1040NR, U.S. Nonresident Alien Income Tax Return, contains an error. Line 2 of the Itemized Deductions Worksheet (page 15 of the instructions) should read:

> "Enter the total of the amount on Schedule A, line 8, plus any casualty or theft losses included on line 16."

The 1998 Form 1040NR instructions posted on the IRS Internet web site are correct.

Foundations Status of Certain Organizations

Announcement 99–9

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

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

Childlink International Inc., Chevy Chase, MD
Children and Family First Inc., Jackson, MS
Children at Heart Inc., East Brunswick, NJ
Children-in-Need Center, Milwaukie, OR
Children Inc., Memphis, TN
Children Living With AIDS, Lancaster, OH
Children of the Future, Chicago, IL
Children of Yahu, Albany, MN
Childrens Advocacy & Treatment Center in Huntington Inc., Huntington, WV
Childrens Aid Fund Inc., Lakewood, NJ
Childrens Alternative Learning Program, Rodeo, CA
Childrens Art Studio of Wellesley Inc., Wellesley, MA

Childrens Community Garden Inc., Raleigh, NC
Childrens Dental Care Inc., Spring, TX
Childrens Exploratory Inc., San Diego, CA
Childrens Foundation Inc., Lafayette, LA
Childrens Heart Project International, Birmingham, AL
Childrens Home Inc., Antioch, CA
Childrens Rescue Mission Inc., Pearland, TX
Childrens Safety Foundation Inc., Goldenrod, FL
Childrens Survival Center, Atlanta, GA
Chilhowie Community Fund Incorporated, Chilhowie, VA
Chilmark Town Affairs Council Inc., Chilmark, MA
Chitragupta Parivar of North America, Cleveland, OH
Choice Scholarships, W. Warwick, RI
Chrisma Village Inn, Bronx, NY
Christ Concerned Community Inc., Markham, IL
Christ for Latvia Network Inc., Waukesha, WI
Christ Housing and Ministries Programs Inc., Bradenton, FL
Christ in Us Ministries, Coweta, OK
Christ Ministries Incorporated, Vero Beach, FL
Christ to Inmates Ministries Inc., Shelbyville, IN
Christech Inc., Lake Mary, FL
Christian Counseling Connection Inc., Clarkston, WA
Christian Golfers Association, Dublin, OH
Christian Mission Sponsorship Inc., Green Bay, WI
Christian Organization for Resource Accountability and Licensing, New Brighton, MN
Christian Radio Ministries of Hampton Roads, Virginia Beach, VA
Christians Against Drugs, Brookshire, TX
Christian Youth Daycare & Learning Center Inc., Atlanta, GA
Christmas in April-Central New Mexico Inc., Santa Fe, NM
Christmas in April Fredericksburg Inc., Spotsylvania, VA
Christmas in April Greater Miami Inc., Miami, FL
Christmas in April Springfield Massachusetts Inc., Longmeadow, MA
Christmas in the City Inc., Boston, MA
Christs Voice Across the Ages Society Inc., Chicago, IL
Chung Moo Doe Association of Greater Dallas Inc., Dallas, TX
Church Based Counseling, Long Beach, CA
Church for Humanity and Love in a Caring Environment, Oak Brook, IL
Church of Innerology, Burbank, CA
Church of the Lord, Cedar Vale, KS
Cimarron Fair Board Inc., Lahoma, OK
Cincinnati Houses Rehabitation Inc., Cincinnati, OH
Cincinnati Leadership and Sunday School Association Inc., Bellevue, KY
Circle of Friends Inc., Sedona, AZ
Circle of Life Retreat Center Inc., Williamsburg, VA
Cities in Schools of Colorado Inc., Commerce City, CO
Citizen Advocacy of Rensselaer County Inc., Troy, NY
Citizens Council for Michigan Public Universities, Lansing, MI
Citizens for a Better Amite, Amite, LA
Citizens for Alternatives to Animal Labs Inc., Brooklyn, NY
Citizens for Economic Growth, Amherst, OH
Citizens for Government Accountability Inc., Dahlgren, VA
Citizens for Religious Freedom, San Francisco, CA
Citizens of San Antonio Against Law Suit Misinformation Inc., San Antonio, TX
City Hall Arts and Technology Center Inc., Kingston, NY
City of Chicago D-Day Reenactment World War II Commemorative, Oak Park, IL
Cityview Community Council Incorporated, Lorain, OH
Civil Rights Consortium, Kansas City, MO
Civitas Initiative, Chicago, IL
Clara Tyson Rehabilitation Christian Center, Detroit, MI
Clarence Darrow Commemorative Committee, Chicago, IL
Clarinda Heartland of Iowa Inc., Clarinda, IA
Clarks Life Center Inc., College Park, GA
Clarksburg Community Betterment Organization Inc., Clarksburg, MO
Class Act Booster Club, Londonderry, NH
Class of 2000 Education Fund, Sultan, WA
Classic Business Consultants, Maywood, IL
Classic City Golfers Association Inc., Athens, GA
Clay Organized for Wellness Incorporated, Clay, WV
Clear Bay Ecology Center Inc., Bethesda, MD
Cleveland Animal Lifeline Inc., Lyndhurst, OH
Cleveland Bicentennial Commission Inc., Cleveland, OH
Clic International Cancer & Leukemia in Childhood, St. Louis, MO
Clinic South, Chattanooga, TN
Clinical Electromedical Research Academy CHTD, Las Vegas, NV
Closer Look Communications, Boulder, CO
CMCHDC Foundation Inc., Columbia, MO
Coalition for Back to School Supplies, Kansas City, MO
Coalition for Black Unity, Baton Rouge, LA
Coalition for Integration of the Disabled, Miami, FL
Coalition for Respect Inc., Jacksonville, FL
Coalition for Student Awareness, Milwaukee, WI
Coalition for the Advancement or Regional Transportation Inc., Louisville, KY
Coalition of Independent American Charities, Riverside, CA
Coalition of Ministers Against Crime, Houston, TX
Coalition on Aid in the Black Community, Houston, TX
Coalition on Alcoholism and Other Chemical Dependencies, St. Louis, MO
Coastal Bend Crime Stoppers Inc., Beeville, TX
Coastal Conservation Foundation, Tucson, AZ
Coastal Georgia Wildlife Rehabilitation Center Inc., Saint Simons Island, GA
Cobb County District Attorneys Anti-Drug Poster Contest Inc., Marietta, GA
Coburg Village Inc., Brooklyn, NY
Cocke County Ambulance Service Boosters Inc., Newport, TN
Codependency New Life Seminars Inc., Dublin, CA
Coedy Program, Clayton, CA
Coffinberry Playground Inc., Fairview Park, OH

College Community Little League Soccer, Cedar Rapids, IA
Colleges That Enable, Wyomissing, PA
Collierville Soccer Association, Collierville, TN
Colonel Read Foundation for Courage in the Arts, Richmond, VA
Colonial Heights Athletic Commission Inc., Kingsport, TN
Colorado Alliance to Restore Equality, Denver, CO
Colorado Chmis Inc., Denver, CO
Colorado Head Start Parent Association, Sterling, CO
Colorado Mediation Foundation, Denver, CO
Colorado Office of Space Advocacy, Colorado Springs, CO
Colorado Riparian Association, Boulder, CO
Colorado Theatre Market Alliance, Westminster, CO
Colorado Trails and Open Space, Silver Plume, CO
Columbus Quincentenniel Committee of Middletown Inc., Middletown, CT
Comfy Critters Incorporated, Astoria, NY
Comite de Voluntarios, Rio Bravo, TX
Commercial Music Educators, Tuscaloosa, AL
Commission Against Senseless Killings Inc., Memphis, TN
Committee for American Leadership Inc., Wilmington, DE
Committee for the Preservation of Auburns African American History, Auburn, AL
Committee of Friends Inc., Baton Rouge, LA
Committee on the Employment of People with Disabilities, Tucson, AZ
Commonwealth Healthcare Institute, Richmond, VA
Communicating at Coney, Fort Thomas, KY
Communication Station Inc., Memphis, TN
Communities in Schools Port Arthur Inc., Beaumont, TX
Communities United Together, Laplace, LA
Community AIDS Prevention Task Force Inc., Cheshire, MA
Community Alliance of Manatee for AIDS Inc., St. Petersburg, FL
Community Assistance Foundation, Irvine, CA
Community Association for Responsible Planning Inc., Tetonia, ID
Community Based Initiatives, Seattle, WA
Community Center of Personal Enrichment Inc., Griffin, GA
Community Center of the Southern Berkshires Inc., W. Stockbridge, MA
Community Coalition for Media Change, Oakland, CA
Community Corrections Inc., Salisbury, MD
Community Development and Improvement Institute Inc., Freeport, NY
Community Development Coalition CDC Inc., Wichita, KS
Community Development Coalition Inc., Scottsbluff, NE
Community Empowerment Organization CEO, York, PA
Community First Inc., Washington, DC
Community Health Clinic of Joplin, Joplin, MO
Community Housing Assistance Corporation, Newport Beach, CA

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

Definition of Terms

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

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

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

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

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

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law 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 the 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 Contribution 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. Proc..—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedral 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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Notices:

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Revenue Rulings:

Treasury Decisions:

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1998–1 through 1998–52 will be found in Internal Revenue Bulletin 1999–1, dated January 4, 1999.

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[1] A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1998–1 through 1998–52 will be found in Internal Revenue Bulletin 1999–1, dated January 4, 1999.

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