Internal Revenue
bulletin

Bulletin No. 2003-48
December 1, 2003

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2003–120, page 1154.

Life insurance companies; computation of required interest. This ruling provides that a life insurance company calculates "required interest" under section 812(b)(2)(A) of the Code using the mean of the amount of the reserve at the beginning of the taxable year and the amount of the reserve at the end of such year.

Rev. Rul. 2003–121, page 1153.

LIFO; price indexes; department stores. The September 2003 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 2003.

REG–146692–03, page 1164.

Section 103(a) of the Code provides that, generally, interest on bonds issued by state and local governments is excluded from gross income. "Qualified mortgage revenue bonds" may also be qualified bonds. A bond may only be a qualified mortgage revenue bond if the effective rate of mortgage interest on the mortgages provided with the bond proceeds does not exceed the yield on the bonds by more that 1.125 percentage points. The proposed regulations provide rules for calculating the effective rate of mortgage interest. Specifically, the proposed regulations provide that amounts paid for pool mortgage insurance are to be excluded from the calculation (which results in a lower effective rate of mortgage interest). A public hearing is scheduled for January 28, 2004.

Rev. Proc. 2003–84, page 1159.

Optional election to make monthly 706(a) computations. This procedure allows certain partnerships that invest in tax-exempt obligations to make an election that enables the partners to take into account monthly the inclusions required under sections 702 and 707(c) of the Code and provides rules for partnership income tax reporting under section 6031 for such partnerships. Rev. Proc. 2002–68 modified and superseded.

EXEMPT ORGANIZATIONS

Announcement 2003–74, page 1171.

This announcement is a public notice of the suspension of the federal tax exemption under section 501(p) of the Code of certain organizations that have been designated as supporting or engaging in terrorist activity or supporting terrorism. Contributions made to these organizations during the period that the organization's tax-exempt status is suspended are not deductible for federal tax purposes.

Announcement 2003–76, page 1171.

Zaire Unlimited of Calumet Park, IL, no longer qualifies as an organization to which contributions are deductible under section 170 of the Code.

(Continued on the next page)

Announcements of Disbarments and Suspensions begin on page 1168.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

EMPLOYMENT TAX

Notice 2003–66, page 1159.
2004 social security contribution and benefit base; domestic employee coverage threshold. The Commissioner of the Social Security Administration has announced (1) the OASDI contribution and benefit base for remuneration paid in 2004 and self-employment income earned in taxable years beginning in 2004, and (2) the domestic employee coverage threshold amount for 2004.

ADMINISTRATIVE

T.D. 9093, page 1156.
Final regulations under section 7701 of the Code contain special rules regarding the entity classification of certain foreign business entities, including a special rule that terminates the grandfathered status of certain foreign business entities upon a 50-percent change of control, and a special rule that clarifies and further modifies the relevancy rules relating to certain foreign eligible entities.

Announcement 2003–78, page 1172.
This announcement contains a withdrawal of proposed regulation section 301.7701-3(h), which provided a rule that would have operated to change the classification of a foreign disregarded entity if a so-called "extraordinary transaction" occurred one day before or within one year after the election to treat the entity as disregarded. REG-110385-99 partially withdrawn.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

* **Beginning with Internal Revenue Bulletin 2003–43**, we are publishing the index at the end of the month, rather than at the beginning.

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

Section 171.—Amortizable Bond Premium

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

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

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

LIFO; price indexes; department stores. The September 2003 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 2003.

Rev. Rul. 2003–121

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

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

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

	Groups	Sept. 2002	Sept. 2003	Percent Change from Sept. 2002 to Sept. 2003[1]
1.	Piece Goods	484.6	482.6	-0.4
2.	Domestics and Draperies	574.2	559.7	-2.5
3.	Women's and Children's Shoes	658.0	651.9	-0.9
4.	Men's Shoes	886.9	847.3	-4.5
5.	Infants' Wear	618.5	611.8	-1.1
6.	Women's Underwear	548.2	517.8	-5.5
7.	Women's Hosiery	343.2	355.5	3.6
8.	Women's and Girls' Accessories	549.2	584.6	6.4
9.	Women's Outerwear and Girls' Wear	385.7	377.3	-2.2
10.	Men's Clothing	561.1	542.3	-3.4
11.	Men's Furnishings	593.8	579.8	-2.4
12.	Boys' Clothing and Furnishings	446.2	448.2	0.4
13.	Jewelry	896.7	875.9	-2.3
14.	Notions	809.1	788.2	-2.6
15.	Toilet Articles and Drugs	971.4	980.4	0.9
16.	Furniture and Bedding	625.9	620.7	-0.8
17.	Floor Coverings	601.1	588.6	-2.1
18.	Housewares	748.9	717.2	-4.2
19.	Major Appliances	222.2	210.3	-5.4
20.	Radio and Television	47.7	44.7	-6.3
21.	Recreation and Education[2]	85.4	81.9	-4.1
22.	Home Improvements[2]	124.9	123.9	-0.8
23.	Automotive Accessories[2]	112.0	111.7	-0.3
	Groups 1–15: Soft Goods	578.4	568.8	-1.7
	Groups 16–20: Durable Goods	407.9	391.4	-4.0

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

Groups	Sept. 2002	Sept. 2003	Percent Change from Sept. 2002 to Sept. 2003[1]
Groups 21–23: Misc. Goods[2]	96.0	93.5	-2.6
Store Total[3]	515.8	504.3	-2.2

[1]Absence of a minus sign before the percentage change in this column signifies a price increase.

[2]Indexes on a January 1986 = 100 base.

[3]The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Denise Carmichael of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Ms. Carmichael at (202) 622–6888 (not a toll-free call).

Section 702.—Income and Credits of Partner

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 704.—Partner's Distributive Share

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 706.—Taxable Years of Partner and Partnership

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 708.—Continuation of Partnership

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

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

Life insurance companies; computation of required interest. This ruling provides that a life insurance company calculates "required interest" under section 812(b)(2)(A) of the Code using the mean of the amount of the reserve at the beginning of the taxable year and the amount of the reserve at the end of such year.

Rev. Rul. 2003–120

ISSUE

What is the amount of reserves used to calculate "required interest" under section 812(b)(2)(A) of the Internal Revenue Code?

FACTS

IC is a life insurance company subject to tax under Part I of subchapter L of the Internal Revenue Code (§§ 801–818). For purposes of determining its life insurance company taxable income, IC computes the amount of the section 807(c)(1) life insurance reserves under section 807(d)(2), using the greater of the applicable Federal interest rate or the prevailing State assumed rate. For purposes of this revenue ruling, assume that the applicable Federal interest rate for the contracts is 6.0% and that the applicable Federal interest rate exceeds the prevailing State assumed rate for the contracts.

On January 1, 200x, the opening balance of IC's life insurance reserves (determined under section 807(d)(2)) equaled $1,000,000x. On December 31, 200x, the closing balance of IC's life insurance reserves for the contracts totaled $1,224,434x.

LAW AND ANALYSIS

To prevent a life insurance company from realizing a double benefit for tax-preferred investment income (tax-exempt interest and dividends providing a dividends-received deduction) used to fund the company's liabilities to policyholders, sections 807 and 805 require the company to adjust certain income and deduction items for the policyholders' share of such tax preferred income.

To determine the increase or decrease in reserves for a taxable year, a life insurance company reduces its end-of-year reserves by the "policyholders' share" of tax-exempt interest. Section 807(a) and (b). The company's deduction under section 805(a)(2) for a net increase in reserves, therefore, is reduced by the policyholders' share of tax exempt interest. Conversely, if there is a net decrease in reserves, the company's gross income under section 803(a)(2) is increased by the policyholders' share of tax exempt interest. The adjustments effectively deny the company any exclusion for the policyholders' share of tax-exempt interest.

Section 805(a)(4) prevents a double benefit with regard to dividends eligible for the dividends-received deduction by limiting a life insurance company's deduction for dividends (other than "100 percent dividends" as defined in section 805(a)(4)(C)) received by the company. The deduction is limited to the "company's share" of the dividends received. *See* section 805(a)(4)(A)(ii). No dividends-received deduction is allowed for the policyholders' share of dividends received.

Section 812 provides the mechanism to calculate the life insurance company's and policyholders' respective shares of net investment income. For purposes of section 805(a)(4), the company's share is the percentage obtained by dividing (1) the company's share of the net investment income for the taxable year, by (2) the net investment income for the year. Section 812(a)(1). The policyholders' share is the excess of 100 percent over the company's percentage share. Section 812(a)(2).

The first step in applying section 812 is to determine, under section 812(d), the amount of the life insurance company's "gross investment income" for the taxable year. Next, "net investment income" for the taxable year is calculated under section 812(c). Except as otherwise provided in section 812(c)(2) with regard to income attributable to assets held in a segregated asset account for variable contracts, the net investment income for a taxable year equals 90% of gross investment income for the year. Under section 812(b)(1), the life insurance company's share of net investment income is the excess (if any) of the net investment income for the taxable year over the sum of the "policy interest" for the taxable year and the "gross investment income's proportionate share of policyholder dividends" for the taxable year. The policyholders' share of net investment income, therefore, is the portion of net investment income equal to the lesser of (1) the sum of policy interest and gross investment income's proportionate share of policyholder dividends for the taxable year or (2) the total net investment income.

Section 812(b)(2) provides that policy interest equals the sum of—

(A) required interest (at the greater of the prevailing State assumed rate or the applicable Federal interest rate) on section 807(c) reserves (other than unearned premiums and unpaid losses under section 807(c)(2));

(B) the deductible portion of excess interest;

(C) the deductible portion of any amount (whether or not a policyholder dividend) that is not taken into account under section 812(b)(2)(A) or (B) and that is credited either to (i) a policyholder's fund under a pension plan contract for employees (other than retired employees), or (ii) a deferred annuity contract before the annuity stating date; and

(D) interest on amounts left on deposit with the company.

If neither the prevailing State assumed interest rate nor the applicable Federal interest rate is used in determining the reserve for a contract, required interest is calculated using another appropriate interest rate.

Although required interest is a significant component of policy interest, section 812(b)(2) provides no guidance (other than the interest rates) regarding the method of calculating required interest. The legislative history that accompanied the enactment of section 812 in 1984, however, states that "the formula used for purposes of determining the policyholders' share is based generally on the proration formula used under prior law in computing gain or loss from operations (*i.e.*, by reference to 'required interest')." *See* H. Rep. No. 432, Pt. 2, 98th Cong., 2d Sess. 1430–31 (1984); S. Prt. 169, Vol. I, 98th Cong. 2d Sess. 557–59 (1984).

Under section 809(a)(2) of pre-1984 law, a life insurance company's required interest for any taxable year equaled the sum of the products obtained by multiplying (i) each rate of interest required, or assumed by the taxpayer, in calculating the reserves described in section 810(c) of pre-1984 law [now section 807(c)], by (ii) the means of the amount of the reserves computed at that rate at the beginning and the end of the taxable year. *See also* section 1.809–2(d) of the Income Tax Regulations.[1] As the formula in section 812 is based generally on the proration formula used under former section 809(a)(2), required interest under section 812(b)(2)(A) is calculated using mean reserves. Accordingly, required interest under section 812(b)(2)(A) equals the sum of products obtained by multiplying (i) the mean of the beginning-of-year and end-of-year reserves under section 807(c)(1)–(6) (other than section 807(c)(2)) by (ii) the applicable interest rate (the prevailing State assumed interest rate, the applicable Federal interest rate, or another appropriate interest rate).

The opening balance of IC's section 807(c)(1) life insurance reserves is $1,000,000x and the closing balance of the reserves is $1,224,434x. The mean of the reserves is $1,112,217x . Therefore, the required interest on the life insurance reserves is $66,733x [$1,112,217x 6% = $66,733x].

HOLDING

Required interest under § 812(b)(2)(A) is calculated using the mean of the amount of the reserve at the beginning of the taxable year and the amount of the reserve at the end of such year.

DRAFTING INFORMATION

The principal author of this revenue ruling is Stephen Hooe of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Mr. Hooe at (202) 622–7595 (not a toll-free call).

Section 851.—Definition of Regulated Investment Company

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

[1] If provisions of pre-1984 law are incorporated into a current life insurance company tax provision, the regulations under the pre-1984 law may serve as an interpretative guide to the provision in the absence of any contrary guidance in the legislative history. *See* H. Rep. 432, at 1401; S. Prt. 169, at 524.

Section 852.—Taxation of Regulated Investment Companies and Their Shareholders

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 1275.—Other Definitions and Special Rules

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 6001.—Notice or Regulations Requiring Records, Statements, and Special Returns

26 CFR 1.706–1: Taxable Years of partner and partnership.

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 6031.—Return of Partnership Income

26 CFR 1.6031(a)–1T: Return of partnership income.

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 6229.—Period of Limitations for Making Assessments

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 6231.—Definitions and Special Rules

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 6233.—Extension to Entities Filing Partnership Returns, etc.

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 6698.—Failure to File Partnership Return

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 6722.—Failure to Furnish Correct Payee Statements

May a partner in a partnership that invests in tax-exempt obligations make monthly allocations of partnership items under section 706(a)? See Rev. Proc. 2003-84, page 1159.

Section 7701.—Definitions

26 CFR 301.7701–3: Classification of certain business entities.

T.D. 9093

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Special Rules for Certain Foreign Business Entities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing rules regarding the application of the general entity classification rules to certain foreign business entities, in particular providing a rule that terminates the grandfathered status of certain foreign business entities upon a 50 percent change of ownership and a special rule that clarifies and further modifies the rules relating to whether the classification of certain foreign eligible entities is relevant for Federal tax purposes.

EFFECTIVE DATES: These regulations are effective as of October 22, 2003.

FOR FURTHER INFORMATION CONTACT: Ronald M. Gootzeit, (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 18, 1996, Treasury and IRS published in the **Federal Register** (T.D. 8697, 1997–1 C.B. 215 [61 FR 66584]) final regulations relating to the classification of business entities under section 7701 (check-the-box regulations). On November 29, 1999, Treasury and the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–110385–99, 1999–2 C.B. 670 [64 FR 66591] proposing to amend §§301.7701–2 and 301.7701–3 of the current check-the-box regulations (proposed regulations). A public hearing on the proposed regulations was held on January 31, 2000. In addition, written comments were received. Most of the written and oral comments related to proposed §301.7701–3(h), which provided a rule that would have operated to change the classification of a foreign disregarded entity if a so-called "extraordinary transaction" occurred one day before or within one year after the election to treat the entity as disregarded. On June 26, 2003, Treasury and the IRS issued Notice 2003–46, 2003–28 I.R.B. 53, announcing the intention to withdraw this extraordinary transaction rule of proposed §301.7701–3(h) and to finalize the remaining provisions of the proposed regulations.

With the publication of a notice of withdrawal (REG-110385–99, published as Announcement 2003–78) elsewhere in this issue of the Bulletin, proposed §301.7701–3(h) is withdrawn. This Treasury decision adopts without substantive change the remaining provisions of the proposed regulations. The final regulations thus adopt the following provisions from the proposed regulations: (1) the rule that terminates the grandfathered status of certain foreign business entities when there has been a 50 percent change of ownership of such entity; (2) the provision clarifying that a foreign eligible entity with respect to which an entity classification election is made and which is not

otherwise relevant for Federal tax purposes is deemed so relevant only on the effective date specified on a Form 8832, "*Entity Classification Election*"; and (3) the modifications to the classification rules for certain foreign eligible entities that have never been relevant or are no longer relevant for Federal tax purposes.

Explanation of Provisions

A. *Grandfathered Foreign Per Se Entities*

The check-the-box regulations allow certain foreign business entities that were in existence and treated as partnerships prior to the date the check-the-box regulations were proposed (PS–43–95, 1996–1 C.B. 865 [61 FR 21989]) and that would otherwise be classified as *per se* corporations under §301.7701–2(b)(8)(i) to remain classified as partnerships if the conditions enumerated in §301.7701–2(d)(1) are satisfied. These rules also provide that the occurrence of certain events results in a termination of this grandfathered status. See §301.7701–2(d)(3)(i). The final regulations adopt the rule in the proposed regulations at §301.7701–2(d)(3)(i) that provides an additional event resulting in the termination of an entity's grandfathered status. Under this rule, an entity's grandfathered status is terminated on the date when one or more persons who were not owners of the entity as of November 29, 1999, own in the aggregate a 50 percent or greater interest in the entity. Consistent with the proposed regulations, the final regulations provide that this rule will apply as of the date the final regulations are published in the federal register; therefore, if persons that were not owners of a grandfathered entity on November 29, 1999, obtain a greater than 50 percent ownership interest between November 29, 1999, and October 22, 2003, the grandfathered entity will cease to have that status on October 22, 2003.

Several commentators requested clarification as to whether this rule takes into account changes in direct ownership only or also changes in indirect ownership, and they suggested that the rule should take into account only changes in direct ownership. Treasury and the IRS believe that for purposes of grandfathered foreign *per se* entities a rule that took only direct changes of ownership into account could be easily circumvented in inappropriate cases. Therefore, this rule has not been modified in these final regulations. Some commentators requested that the rule be limited to significant changes in ownership within a specified period of time. For example, one commentator suggested that the rule be limited to situations where persons obtained a 50 percent or greater ownership interest within a 12-month period. The final regulations do not adopt this suggestion because Treasury and the IRS believe that an entity should retain grandfathered status only if there have been no significant changes in the ownership of that entity.

B. *Relevance of Classification*

The check-the-box regulations provide that if the classification of a foreign eligible entity that was previously relevant for Federal tax purposes ceases to be relevant for 60 consecutive months and then subsequently becomes relevant again, the entity's classification at the start of the subsequent period of relevance will be determined under the default classification rules (60-month rule).

These final regulations adopt the two rules in the proposed regulations that relate to the application of the 60-month rule. First, these final regulations adopt the rule providing that the classification of a foreign eligible entity that files an entity classification election is deemed to be relevant for Federal tax purposes on the effective date of the election for purposes of the 60-month rule. Second, these final regulations adopt the rule providing that the classification of a foreign eligible entity whose classification has never been relevant for Federal tax purposes will initially be determined pursuant to the default classification provisions of §301.7701–3(b)(2) at the time the classification of the entity first becomes relevant.

Commentators generally agreed with and supported the approach taken in the proposed regulations with respect to the relevance issues, and several commentators requested that these provisions be retroactive when finalized. These final regulations do not adopt the suggestion that these provisions be applied retroactively because Treasury and the IRS believe that it is not in the interest of sound tax administration.

One commentator requested that the provisions be revised to clarify that it is the Federal tax classification of the foreign eligible entity, and not the entity itself, that is deemed to be relevant. Treasury and the IRS have adopted this clarifying change in these final regulations.

One commentator requested that the regulations clarify why the classification of a foreign eligible entity, not otherwise relevant, that files Form 8832, *"Entity Classification Election"*, is deemed relevant only on the date the entity classification election is effective. The commentator neither suggested what the period of deemed relevance should be if not limited to one day nor suggested a principle for when the deemed relevance should terminate such that the 60-month rule would be triggered. In the interest of certainty and administrability of the application of the 60-month rule, Treasury and the IRS have retained the limitation of deemed relevance to the day on which the entity's classification is effective.

One commentator requested further guidance on when and under what circumstances the classification of a foreign eligible entity that was previously relevant ceases to be relevant under the 60-month rule. Treasury and the IRS believe §301.7701–3(d)(1) and (3) provide sufficient guidance on when an entity's classification becomes relevant and, accordingly, when an entity's classification ceases to be relevant.

One commentator suggested that the regulations be revised to provide that an election by a non-relevant foreign entity to continue its current classification may be filed at any time within the 60-month period starting on the day after the date of the most recent election for that entity, and that such election will start a new 60-month period. Section 301.7701–3(c) provides that an eligible entity may elect to be classified other than as provided under the default classification rules of §301.7701–3(b), or to change its election. Allowing an eligible entity whose classification is not relevant to renew its election for purposes of the 60-month rule would frustrate the policies underlying that rule. Accordingly, the suggestion was not adopted.

One commentator requested clarification and examples regarding the determination of the classification of a foreign

eligible entity whose classification was never relevant or whose classification has not been relevant for 60 months and therefore has lapsed under the 60-month rule. In either case (assuming in the latter case that no election is made following the lapse of the classification), the entity's classification initially will be determined under the default classification rules of §301.7701–3(b)(2) when the classification of the entity becomes relevant. Under the general rules of §301.7701–3(c), an eligible entity may elect at such time to be classified other than as provided under the default classification rules, and may elect at some later time to change its classification. Treasury and the IRS do not believe at this time that further guidance or examples are needed to illustrate these general rules.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these final regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required.

Drafting Information

The principal authors of these regulations are Aaron A. Farmer and Ronald M. Gootzeit, Office of Associate Chief Counsel (International). However, other personnel from the Treasury and the IRS participated in their development.

* * * * *

Adoption of Amendments to the Regulations

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

PART 301—PROCEDURE AND ADMINISTRATION

Par. 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.7701–2 is amended by:

1. Removing the language "or" at the end of paragraph (d)(3)(i)(B).

2. Removing the period at the end of paragraph (d)(3)(i)(C) and adding "; or" in its place.

3. Adding paragraph (d)(3)(i)(D).

4. Adding a sentence at the end of paragraph (e).

The additions read as follows:

§301.7701–2 Business entities; definitions.

* * * * *

(d) * * *

(3) * * *

(i) * * *

(D) The date any person or persons, who were not owners of the entity as of November 29, 1999, own in the aggregate a 50 percent or greater interest in the entity.

* * * * *

(e) *Effective date*. * * * However, paragraph (d)(3)(i)(D) of this section applies on or after October 22, 2003.

Par. 3. Section 301.7701–3 is amended as follows:

1. The text of paragraph (d)(1) following the paragraph heading is redesignated as paragraph (d)(1)(i), and a paragraph heading is added for paragraph (d)(1)(i).

2. Paragraph (d)(1)(ii) is added.

3. Paragraph (d)(2) is revised.

4. Paragraphs (d)(3) and (d)(4) are added.

The revision and additions read as follows:

§301.7701–3 Classification of certain business entities.

* * * * *

(d) *Special rules for foreign eligible entities*—(1) *Definition of relevance* —(i) *General rule*. * * *

(ii) *Deemed relevance*—(A) *General rule*. For purposes of this section, except as provided in paragraph (d)(1)(ii)(B) of this section, the classification for Federal tax purposes of a foreign eligible entity that files Form 8832, *"Entity Classification Election"*, shall be deemed to be relevant only on the date the entity classification election is effective.

(B) *Exception*. If the classification of a foreign eligible entity is relevant within the meaning of paragraph (d)(1)(i) of this section, then the rule in paragraph (d)(1)(ii)(A) of this section shall not apply.

(2) *Entities the classification of which has never been relevant*. If the classification of a foreign eligible entity has never been relevant (as defined in paragraph (d)(1) of this section), then the entity's classification will initially be determined pursuant to the provisions of paragraph (b)(2) of this section when the classification of the entity first becomes relevant (as defined in paragraph (d)(1)(i) of this section).

(3) *Special rule when classification is no longer relevant*. If the classification of a foreign eligible entity is not relevant (as defined in paragraph (d)(1) of this section) for 60 consecutive months, then the entity's classification will initially be determined pursuant to the provisions of paragraph (b)(2) of this section when the classification of the foreign eligible entity becomes relevant (as defined in paragraph (d)(1)(i) of this section). The date that the classification of a foreign entity is not relevant is the date an event occurs that causes the classification to no longer be relevant, or, if no event occurs in a taxable year that causes the classification to be relevant, then the date is the first day of that taxable year.

(4) *Effective date*. Paragraphs (d)(1)(ii), (d)(2), and (d)(3) of this section apply on or after October 22, 2003.

* * * * *

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

Approved October 8, 2003.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 21, 2003, 8:45 a.m., and published in the issue of the Federal Register for October 22, 2003, 68 F.R. 60286)

Part III. Administrative, Procedural, and Miscellaneous

Social Security Contribution and Benefit Base for 2004

Notice 2003–66

Under authority contained in the Social Security Act ("the Act"), the Commissioner, Social Security Administration, has determined and announced (68 F.R. 60437, dated October 22, 2003) that the contribution and benefit base for remuneration paid in 2004, and self-employment income earned in taxable years beginning in 2004 is $87,900.

"Old-Law" Contribution and Benefit Base

General

The "old-law" contribution and benefit base for 2004 is $65,100. This is the base that would have been effective under the Act without the enactment of the 1977 amendments. We compute the base under section 230(b) of the Act as it read prior to the 1977 amendments.

The "old-law" contribution and benefit base is used by:

(a) The Railroad Retirement program to determine certain tax liabilities and tier II benefits payable under that program to supplement the tier I payments which correspond to basic Social Security benefits,

(b) The Pension Benefit Guaranty Corporation to determine the maximum amount of pension guaranteed under the Employee Retirement Income Security Act (as stated in section 230(d) of the Social Security Act),

(c) Social Security to determine a year of coverage in computing the special minimum benefit, as described earlier, and

(d) Social Security to determine a year of coverage (acquired whenever earnings equal or exceed 25 percent of the "old-law" base for this purpose only) in computing benefits for persons who are also eligible to receive pensions based on employment not covered under section 210 of the Act.

Domestic Employee Coverage Threshold

General

The minimum amount a domestic worker must earn so that such earnings are covered under Social Security or Medicare is the domestic employee coverage threshold. For 2004, this threshold is $1,400. Section 3121(x) of the Internal Revenue Code provides the formula for increasing the threshold.

Computation

Under the formula, the domestic employee coverage threshold amount for 2004 shall be equal to the 1995 amount of $1,000 multiplied by the ratio of the national average wage index for 2002 to that for 1993. If the resulting amount is not a multiple of $100, it shall be rounded to the next lower multiple of $100.

Domestic Employee Coverage Threshold Amount

Multiplying the 1995 domestic employee coverage threshold amount ($1,000) by the ratio of the national average wage index for 2002 ($33,252.09) to that for 1993 ($23,132.67) produces the amount of $1,437.45. We then round this amount to $1,400. Accordingly, the domestic employee coverage threshold amount is $1,400 for 2004.

(Filed by the Office of the Federal Register on October 21, 2003, 8:45 a.m., and published in the issue of the Federal Register for October 22, 2003, 68 F.R. 60437)

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also: §§ 171, 702, 704, 706, 708, 851, 852, 1275, 6229, 6231, 6233, 6698, 6722; 1.706–1, 1.6001–1(a), 1.6031(a)–1T.)

Rev. Proc. 2003–84

SECTION 1. PURPOSE

This revenue procedure allows certain partnerships that invest in tax-exempt obligations to make an election that enables the partners to take into account monthly the inclusions required under §§ 702 and 707(c) of the Internal Revenue Code and provides rules for partnership income tax reporting under § 6031 for such partnerships.

SECTION 2. BACKGROUND

A partnership may be used to create the economic equivalent of a variable-rate tax-exempt bond. To create this instrument, a sponsor purchases a tax-exempt obligation and transfers the tax-exempt obligation to an entity that qualifies as a partnership for federal tax purposes (tax-exempt-bond partnership). The tax-exempt-bond partnership issues two classes of equity interests: interests that are entitled to a preferred variable return on its capital (variable-rate interests) and interests that are entitled to all of the remaining income of the partnership (inverse interest). The variable return on the variable-rate interests tracks current short-term exempt yields. Under § 702(b), tax-exempt interest income received by a partnership retains its character when the partnership allocates the income to a partner.

Under § 706(a), a partner generally includes in income for a taxable year the partner's allocable share of items of partnership income, gain, loss, deduction, and credit for the partnership's taxable year ending within or with the partner's taxable year. A partner must also include in income for a taxable year guaranteed payments under § 707(c) that are taken into account by the partnership under its method of accounting in the partnership's taxable year ending within or with the partner's taxable year. Moreover, for each taxable year in which a partnership has income, deductions, or credits, § 6031(a) and (b) requires the partnership to file a Form 1065, *U.S. Return of Partnership Income*, and to issue Schedules K–1 (Form 1065) to each partner.

Annual inclusion of income under § 706(a) can be incompatible with the needs of money market funds and of medium- and long-term bond funds that invest in obligations that produce interest that is exempt from tax. For example, if a regulated investment company's (RIC's) taxable year does not correspond to the taxable year of a tax-exempt-bond partnership in which it holds an interest, the RIC

may not be allocated sufficient tax-exempt interest income from the partnership to pay exempt-interest dividends quarterly. *See* § 852.

To resolve this problem, many tax-exempt-bond partnerships attempted to make an election under § 761(a) to be excluded from the provisions of subchapter K. A tax-exempt-bond partnership is not eligible to elect to be wholly or partially excluded from subchapter K, however, and an attempted election has no effect. Two of the requirements for eligibility to make an election under § 761(a) are that the partners must own the partnership property as co-owners and the partners must be able to compute their income without the necessity of computing partnership taxable income. *See* § 1.761–2(a)(1) and (2) of the Income Tax Regulations. If a business entity (classified as a partnership) owns a tax-exempt bond and issues membership interests that apportion the benefits and burdens of that bond to its members in a manner that differs significantly from direct investment in the bond, the holders of those membership interests do not satisfy the requirement that they own the partnership property as co-owners. *Cf.* § 301.7701–4(c) of the Procedure and Administration Regulations. Moreover, if one class of partners has a right to partnership income that is superior to the right of another class of partners, then the net partnership income or loss allocated to the partners with inferior rights to partnership income can be determined only by computing the net income or loss of the partnership and then by reducing that net income by income allocable to partners with superior rights to partnership income. Such a partnership does not meet the requirement of § 1.761–2(a)(1) that the members of the organization be able to compute their incomes without the necessity of computing partnership income.

To assist tax-exempt-bond partnerships to meet the needs of the market for tax-exempt obligations within the requirements of the Internal Revenue Code, the Internal Revenue Service (Service) has issued two revenue procedures. Rev. Proc. 2002–16, 2002–1 C.B. 572, was issued to allow money market fund partners in tax-exempt-bond partnerships to take into account on a monthly basis their distributive shares of partnership items (monthly closing) if the partnership made an effective election under that revenue procedure (monthly closing election).

Rev. Proc. 2002–68, 2002–2 C.B. 753, modified and superseded Rev. Proc. 2002–16 to extend the monthly closing election to all partners in tax-exempt-bond partnerships and established a transition rule. The transition rule provides that for any taxable year beginning before January 1, 2004, the Service will not challenge a partnership's or a partner's tax treatment that is consistent with an election to be excluded from the provisions of subchapter K under § 761(a), provided that the partnership would be an eligible partnership as defined in Rev. Proc. 2002–68 and the partners' inclusion of income, gain, loss, deduction and credits is consistent with that permitted under the revenue procedure.

In Rev. Proc. 2002–68, the Service also requested comments on simplified income tax reporting procedures for some or all of the eligible tax-exempt-bond partnerships. This revenue procedure is issued in response to comments received.

SECTION 3. SUMMARY OF MAJOR CHANGES

This revenue procedure modifies and supersedes Rev. Proc. 2002–68 by making the following changes:

.01 Section 4 of this revenue procedure expands the definition of tax-exempt-bond partnerships that are eligible to make a monthly closing election and provides that all partners must consent to the election.

.02 Section 5.01 of this revenue procedure provides that a monthly closing election is made by including a binding provision to that effect in the partnership's governing documents.

.03 Section 8 of this revenue procedure provides that a partnership that has a monthly closing election in effect for the partnership's entire taxable year and that meets the other requirements of section 8 of this revenue procedure is not required to file a Form 1065 or to issue Schedules K–1 (Form 1065) to its partners for the taxable year.

.04 Section 9.02(3) of this revenue procedure provides grandfathering rules.

SECTION 4. SCOPE

This revenue procedure applies to eligible partnerships (described in section 4.01 of this revenue procedure) that make a monthly closing election (described in section 5 of this revenue procedure).

.01 *Eligible Partnership*. An entity is an eligible partnership for a calendar month if all of the following conditions are met:

(1) As of the election test date and as of every operational test date that occurs on or before the end of such calendar month, the partnership satisfies both the income test and the expense test. The test dates are described in section 4.05 of this revenue procedure, and the income test and the expense test are described in section 4.02 and section 4.03, respectively.

(2) The entity is a partnership for federal tax purposes;

(3) All allocations of income, gain, loss, deduction, and credit of the partnership are made in accordance with § 704(b); and

(4) A written partnership agreement (or other governing document) provides that —

(a) the entity is making the monthly closing election under this revenue procedure; and,

(b) all partners consent to the election.

.02 *Income test*. At least 95 percent of the partnership's gross income (computed without regard to items described in section 4.04 of this revenue procedure) is or is reasonably expected to be from:

(1) interest on tax-exempt obligations as defined in § 1275(a)(3) and § 1.1275–1(e);

(2) exempt-interest dividends as defined in § 852(b)(5) that are paid by a RIC as defined in § 851(a); and

(3) gain from the sale, redemption, or other disposition of assets generating the income described in section 4.02(1) and (2) of this revenue procedure and income from the temporary investment (for a period no greater than 7 months) of the proceeds of the disposition, but only if the assets that are sold, redeemed, or disposed are original assets of the partnership. For this purpose, an asset is an original asset of the partnership if the asset is contributed to the partnership or is acquired with capital contributed to the partnership (and not with the proceeds of the sale, redemption, or other disposition of a partnership asset).

.03 *Expense test*. Substantially all of the partnership's expenses and deductions (computed without regard to items described in section 4.04 of this revenue procedure) are properly allocable to:

(1) producing, collecting, managing, protecting, and conserving the income described in section 4.02(1), (2), or (3) of this revenue procedure or the assets generating the income;

(2) acquiring, managing, conserving, maintaining, or disposing of property held for the production of the income described in section 4.02(1), (2), or (3) of this revenue procedure; and

(3) servicing the equity in the partnership.

.04 *Exclusion*. For the purposes of sections 4.02 and 4.03 of this revenue procedure, reasonable amounts charged to persons requesting information from the partnership under section 8.03 of this revenue procedure and the costs of collecting, managing, computing, and supplying the information are not taken into account.

.05 *Test Dates and Test Periods*. The income test described in section 4.02 of this revenue procedure and the expense test described in section 4.03 of this revenue procedure must be satisfied both as of the first day of the first month for which the partnership's monthly closing election is effective (the election test date) and, beginning with the fourth month after the partnership's monthly closing election becomes effective, on the last day of each month (the operational test date). The partnership determines whether the income test and the expense test are satisfied as of the election test date by reference to the election test period. The partnership determines whether the income test and expense test are satisfied as of each operational test date by reference to the operational test period. In applying the income and expense tests for a test period, a termination of the partnership under § 708(b)(1)(B) during that period is ignored.

(1) *The Election Test Period*. The election test period differs depending upon how long the partnership has been in existence (determined from its start-up date). A partnership's start-up date is the later of the date the entity had more than one owner and the date the entity had more than a *de minimis* amount of assets.

(a) If, on the election test date, the partnership has been in existence for at least 6 full calendar months, then the test period is the longer of the 6 full calendar months preceding the election test date and the portion of the partnership's taxable year that precedes the election test date; and

(b) If, on the election test date, the partnership has not been in existence for at least 6 full calendar months, then the election test period is the first 6 full calendar months of the partnership's existence.

(2) *The Operational Test Period*. The operational test period is the 3-calendar-month period consisting of the calendar month within which the operational test date falls and the preceding 2 calendar months.

SECTION 5. MAKING THE MONTHLY CLOSING ELECTION

.01 *Manner of Making the Election*. An eligible partnership makes a monthly closing election by providing in the entity's governing documents that—

(a) the partnership is making a monthly closing election that is effective as provided under section 5.02 of this revenue procedure, and

(b) all partners consent to the election.

.02 *Effective Date of the Election*. The monthly closing election is effective on the later of:

(a) the start-up date of the partnership (as defined in section 4.05(1) of this revenue procedure), or

(b) the first day of the month in which the provision described in section 5.01 of this revenue procedure is first included in the entity's governing documents.

.03 *Terminations under § 708(b)(1)(B)*. A termination of the partnership under § 708(b)(1)(B) does not terminate the monthly closing election and does not cause the partnership to close its books under § 1.706–1(c) other than as described in section 6 of this revenue procedure.

SECTION 6. MONTHLY CLOSING OF THE BOOKS

If, at the end of any calendar month, an eligible partnership has a monthly closing election in effect, then, with respect to each partner, the partnership must close its books as described in § 1.706–1(c)(2) as if each partner had sold its entire interest in the partnership on the last day of that month. Each partner must include in its taxable income for that month both the partner's distributive share of items described in § 702(a) with respect to the partner that were earned by the partnership since either the last closing of the books or the first day of the partnership's taxable year (whichever is later) and any guaranteed payments under § 707(c) to the partner that are taken into account by the partnership since the last closing of the books. If a partner is on a 52–53 week taxable year, then the provisions of § 1.441–2(e) apply as if the last day of the month were the last day of the partnership's taxable year.

SECTION 7. TERMINATION OF MONTHLY CLOSING ELECTION AND RE-ELECTION AFTER TERMINATION

.01 A partnership's monthly closing election terminates as of the first day of the month during which a partnership first fails to be an eligible partnership as defined in section 4.01 of this revenue procedure.

.02 If the partnership's monthly closing election terminates, the partnership may not make another monthly closing election without the consent of the Commissioner.

.03 A partnership's monthly closing election may be revoked only with the consent of the Commissioner.

SECTION 8. REPORTING REQUIREMENTS

.01 *Initial Filing Requirement*. A partnership must file an abbreviated Form 1065, *U.S. Return of Partnership Income*, for the first taxable year during which the monthly closing election was in effect. The abbreviated Form 1065 must be filed by the date that the partnership's income tax return for that taxable year would ordinarily be due and must be signed by a person with the authority to sign the partnership's Form 1065. The words "Filed in Accordance with Rev. Proc. 2003–84" must be typed or printed across the top of the form. The partnership is required to provide only the following information on the abbreviated Form 1065:

(1) A statement that the partnership has made an election under this revenue procedure to which all present and future partners consent;

(2) Identification of the partnership by name, address, and EIN;

(3) The name, title, address, and phone number of the contact person from whom partners, beneficial owners, middlemen, and the Internal Revenue Service may request information about the partnership;

(4) The issue date of the partnership interests and the CUSIP (Committee on Uniform Securities Identification Procedures) number or other identification of each class of partnership interest;

(5) A statement that the entity's governing documents expressly provide that the entity is making a monthly closing election; and

(6) The effective month of the election and the start-up date of the partnership. *See* section 4.05(1) of this revenue procedure for a definition of the start-up date.

.02 *Annual Filing Requirements*.

(1) *Elimination of Annual Filing Requirements*. A partnership is not required to file a Form 1065, *U.S. Return of Partnership Income*, or to issue Schedules K–1 (Form 1065) to its partners for any taxable year if the following requirements are satisfied:

(a) The partnership's monthly closing election is effective for the partnership's entire taxable year;

(b) The partnership makes the initial filing described in section 8.01 of this revenue procedure;

(c) A written partnership agreement (or other governing document) provides that —

(i) the entity and its partners will comply with the reporting requirements of sections 8.02 and 8.03, and 8.04 of this revenue procedure in lieu of complying with the requirements of § 6031(a) through (d), and,

(ii) all partners consent to such reporting; and

(d) The partnership complies with the requirements of sections 8.03 and 8.04 of this revenue procedure.

(2) *Effect of Elimination of Annual Filing Requirement*. An entity that is not required to file a partnership return under this revenue procedure is not required to file a partnership return under § 6031(a) and, as a result, is not a partnership as defined under § 6231(a)(1). Consequently, the entity and its members will not be subject to the provisions of subchapter C of chapter 63. An abbreviated Form 1065 used to make the initial filing described in section 8.01 of this revenue procedure is not considered to be a partnership return for purposes of § 6233.

(3) *Monthly Closing Election Effective for Portion of Taxable Year*. A partnership that makes a monthly closing election that is effective after the first day of its taxable year must comply with the partnership reporting rules of § 6031(a) for that taxable year (but is still permitted to close its books on a monthly basis). If the partnership also makes the initial filing described in section 8.01 of this revenue procedure by the due date for its return for the first full taxable year during which the monthly closing election is in effect, then the partnership qualifies for elimination of annual filing requirements under section 8.01 of this revenue procedure for subsequent taxable years.

(4) *Annual Reporting Required*. Failure to qualify for the elimination of annual filing requirements under section 8.02(1) of this revenue procedure does not terminate the partnership's monthly closing election. However, a partnership that fails to satisfy all of the requirements of section 8.02(1) of this revenue procedure is required to file a complete (not abbreviated) Form 1065 and to issue Schedules K–1 (Form 1065) to its partners as required by § 6031(a). A partnership that fails to file a Form 1065 or to issue Schedules K–1 as required is subject to the applicable penalties under §§ 6698 and 6722 for failure to file a partnership return and to furnish payee statements, as well as any other applicable penalties. Moreover, if a partnership is required to file a return under § 6031(a) but fails to do so, the period of limitations on assessment of tax attributable to items of that partnership remains open indefinitely under § 6229(a).

.03 *Requests for Information*. Within 45 days of a request by the Service or a partner (or a beneficial owner or a nominee of a beneficial owner), the partnership must make available all the information necessary to compute a partner's taxable income, tax-exempt income, gain, loss, deduction, or credit, including sufficient information for a partner to determine the portion of the tax-exempt interest that may be subject to the alternative minimum tax and information regarding each partner's share of any bond premium amortization under § 171, any market or original issue discount, and capital gain or loss.

.04 *Nominee and Beneficial Ownership Reporting*.

(1) If an eligible electing partnership complies with the requirements of sections 8.02 and 8.03 of this revenue procedure, the nominee reporting requirements of § 6031(c) and the regulations thereunder do not apply. In place of those requirements, the partnership and the partners must comply with this section 8.04. *See* § 1.6001–1(a) and (e) for rules that apply to recordkeeping requirements.

(2) Any person on whose behalf another person holds as a nominee an interest in an eligible partnership (a beneficial owner), other than a beneficial owner for which the relevant advisor or manager agrees to comply with section 8.04(3) of this revenue procedure, shall notify the partnership of its beneficial ownership status and provide the partnership with:

(a) its name, address, and taxpayer identification number and the name, address, and taxpayer identification number of its nominee; and

(b) the name of the partnership, its CUSIP number or other information sufficient to identify the partnership interest, and the amount of the partnership interest.

(3) In the case of a group of RICs that is managed or advised by a common, or affiliated, manager or advisor (the manager), the manager may elect to be responsible for collecting, retaining, and providing the Service upon demand the beneficial ownership information. To make such an election, the manager must provide each eligible partnership in which any of the RICs has an equity interest a statement indicating that it is responsible for collecting, retaining, and providing the Service upon demand the beneficial ownership information that otherwise would be required to be provided directly to the eligible partnerships by the beneficial owners. In addition, the manager must provide the partnership with:

(a) its name, address, and taxpayer identification number and contact information for the person from whom the Service can request beneficial ownership information; and

(b) the name of the partnership, its CUSIP number or other information sufficient to identify the partnership interests,

and the amount of the partnership interests.

SECTION 9 EFFECTIVE DATE AND TRANSITION RULES

.01 *In General*. This revenue procedure is effective on November 5, 2003.

.02 *Grandfathering Rules*.

(1) If, prior to January 1, 2004, under the provisions of Rev. Proc. 2002–16 or Rev. Proc. 2002–68, a partnership made an effective Monthly Closing election and a partner consented to the election, then the partnership and the partner may continue to comply with either Rev. Proc. 2002–16 or Rev. Proc. 2002–68, as applicable, except that monthly statements are not required.

(2) Except as provided in section 9.02(4) of this revenue procedure, if, prior to January 1, 2004, under the provisions of Rev. Proc. 2002–16 or Rev. Proc. 2002–68, a partnership made an effective Monthly Closing election and a partner consented to the election and if the partnership and partner consistently report the transaction in a manner that is consistent with an election to be excluded from the provisions of subchapter K under § 761(a), then the Service will not challenge that treatment. If section 9.02(4) of this revenue procedure causes this paragraph (2) to cease to apply, the partner and partnership remain eligible for any relief described in paragraph (1) above that they are otherwise entitled to enjoy.

(3) Except as provided in section 9.02(4) of this revenue procedure, if a partnership's start-up date is before January 1, 2004, the Service will not challenge the partnership's or its partners' tax treatment that is consistent with an election to be excluded from the provisions of subchapter K under § 761(a) for any taxable year during all of which the entity is an eligible partnership as defined in section 4.01 of this revenue procedure (without regard to section 4.01(4) of this revenue procedure). *See* section 4.05(1) of this revenue procedure for the definition of a partnership's start-up date.

(4) If, on or after January 1, 2005, a partnership acquires new assets, then, as of the first day of the month in which the new assets are acquired, the partnership is no longer eligible for the grandfathering rule provided in section 9.02(2) or (3) of this revenue procedure. For purposes of the preceding sentence, none of the following is treated as the acquisition of a new asset by the partnership:

(a) The receipt of payment (including temporary investment of that payment) on, or in respect of, a sale, redemption, or other disposition of an asset of the partnership;

(b) The receipt of a contribution in cash (including temporary investment of that cash) to fund expenses of the partnership described in section 4.03 of this revenue procedure or to fund distributions to partners in respect of accrued but unpaid tax-exempt interest (including accrued but unpaid tax-exempt original issue discount); or

(c) The acquisition of an asset pursuant to a plan to keep the principal balance of the assets in the partnership stable by reinvesting principal payments.

(5) For purposes of section 9.02(4) of this revenue procedure)—

(a) An investment is temporary if it is held for 7 months or less; and

(b) If an asset was acquired with reasonable certainty it would be a temporary investment but, due to unforeseeable circumstances, it is held for more than 7 months, then, for purposes of section 9.02(4) of this revenue procedure, it is treated as acquired on the first day that it has been held for more than 7 months.

SECTION 10 EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–68 is modified and superseded.

SECTION 11 PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure 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 control number 1545–1768. 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 OMB control number.

The collection of information is in section 8 of this revenue procedure. The collection of information is required to obtain a benefit, and is required to inform the Service which partnerships are making the monthly closing election. The likely respondents are businesses.

The estimated total annual reporting and recordkeeping burden is 500 hours.

The estimated annual burden per respondent/recordkeeper is 1/2 hour. The estimated number of respondents and recordkeepers is 1,000.

The estimated annual frequency of responses (used for reporting requirements only) is once.

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 tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is David A. Shulman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Shulman at (202) 622–3070 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Mortgage Revenue Bonds

REG–146692–03

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that provide guidance regarding the limitation on the effective rate of mortgage interest for purposes of mortgage revenue bonds issued by State and local governments. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 7, 2004. Outlines of topics to be discussed at the public hearing scheduled for January 28, 2004, at 10 a.m., must be received by January 7, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–146692–03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–146692–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Michael P. Brewer, (202) 622–3980; concerning submissions of comments, the hearing, and requests to be placed on the building access list to attend the meeting, Treena V. Garrett, (202) 622–3401 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 103(a) of the Internal Revenue Code of 1986 (Code) provides that, generally, interest on any State or local bond is not included in gross income. However, this exclusion does not apply to any private activity bond that is not a qualified bond.

A. *Mortgage Revenue Bonds*

Section 141(e)(1) provides that a qualified mortgage bond or a qualified veterans' mortgage bond (together, mortgage revenue bonds) issued under section 143 may be a qualified bond.

Sections 143(a)(2)(A)(ii) and 143(b) provide, in part, that for an issue to be an issue of qualified mortgage bonds or qualified veterans' mortgage bonds, respectively, the issue must satisfy the requirements of section 143(g). Section 143(g)(1) provides that an issue will meet the requirements of section 143(g) if the issue satisfies the requirements of section 143(g)(2) and, in the case of an issue 95 percent or more of the net proceeds of which are to be used to provide residences for veterans, if the issue satisfies the requirements of section 143(g)(3).

Section 143(g)(2)(A) provides that an issue will meet the requirements of section 143(g)(2) only if the excess of (1) the effective interest rate on the mortgages provided under the issue, over (2) the yield on the issue, is not greater than 1.125 percentage points.

Section 143(g)(2)(B)(i) provides that in determining the effective rate of interest on any mortgage for purposes of section 143(g)(2), all fees, charges, and other amounts borne by the mortgagor that are attributable to the mortgage or the bond issue are taken into account.

Section 143(g)(2)(B)(ii) provides that, for purposes of determining the effective rate of mortgage interest, the following items (among others) shall be treated as borne by the mortgagor: (1) All points or similar charges paid by the seller of the property; and (2) the excess of the amounts received from any person other than the mortgagor by any person in connection with the acquisition of the mortgagor's interest in the property over the usual and reasonable acquisition costs of a person acquiring like property when owner-financing is not provided through the use of mortgage revenue bonds.

Section 143(g)(2)(B)(iii) provides that, for purposes of determining the effective rate of mortgage interest, the following items shall not be taken into account: (1) Any expected rebate of arbitrage profits; and (2) any application fee, survey fee, credit report fee, insurance charge, or similar amount to the extent such amount does not exceed amounts charged in such area in cases when owner-financing is not provided through the use of mortgage revenue bonds. The exclusion for application fees, survey fees, credit report fees, insurance charges, or similar amounts does not apply to origination fees, points, or similar amounts.

In the case of an issue 95 percent or more of the net proceeds of which are to be used to provide residences for veterans, section 143(g)(3) provides that certain earnings on nonpurpose investments must either be paid or credited to mortgagors, or paid to the United States, in certain circumstances.

In the Tax Reform Act of 1986, Pub. L. No. 99–514 (the 1986 Act), Congress reorganized sections 103 and 103A of the Internal Revenue Code of 1954 (1954 Code) regarding tax-exempt bonds into sections 103 and 141 through 150 of the Code. Congress intended that to the extent not amended by the 1986 Act, all principles of pre-1986 Act law would continue to apply to the reorganized provisions. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II–686 (1986), 1986–3 (Vol. 4) C.B. 686.

Interpreting section 103A(i)(2)(B)(iii) of the 1954 Code, which is substantially identical to section 143(g)(2)(B)(iii) of the Code, §6a.103A–2(i)(2)(ii)(C) of the Temporary Income Tax Regulations provides the following: "For example, amounts paid for FHA, VA, or similar private mortgage insurance on an individual's mortgage need not be taken into account so long as such amounts do not exceed the amounts charged in the area with respect to a similar mortgage that is not financed with qualified mortgage bonds. Premiums charged for pool mortgage insurance will be considered amounts in excess of the usual and reasonable amounts charged for

insurance in cases where owner financing is not provided through the use of qualified mortgage bonds." Pool mortgage insurance is not defined in the regulations.

B. *Qualified Guarantees*

Under §1.148–4(f), for purposes of computing yield on an issue, fees paid for a qualified guarantee for the issue are treated as additional interest on the issue. In general, a guarantee is a qualified guarantee if: (1) As of the date the guarantee is obtained, the issuer reasonably expects that the present value of the fees for the guarantee will be less than the present value of the expected interest savings on the issue as a result of the guarantee; (2) the arrangement creates a guarantee in substance; and (3) the fees for the guarantee do not exceed a reasonable, arm's-length charge for the transfer of credit risk. The regulations provide that the guarantee of a loan of proceeds of an issue, as opposed to a guarantee of the issue, may constitute a qualified guarantee, but this rule does not apply to guarantees of mortgages financed with mortgage revenue bonds.

Explanation of Provisions

A. *Pool Mortgage Insurance*

Recently, questions have arisen regarding whether an issuer should be required to treat the portion of the interest payments on a pool of mortgages used to pay fees for a guarantee of a pass-through security backed by the pool of mortgages as an amount borne by the mortgagors that must be taken into account in determining the effective rate of interest on the mortgages for purposes of section 143(g). Taking the guarantee fees into account results in a higher effective rate of interest on the mortgages than if the fees were not taken into account.

The IRS and Treasury Department have determined that the guarantee fees should not be treated as amounts borne by the mortgagors that must be taken into account in determining the effective rate of interest on the mortgages for purposes of section 143(g). An issuer may achieve substantially the same result as not taking the guarantee fees into account in computing the effective rate of interest on the mortgages by substituting a qualified guarantee on the bonds for the guarantee of the pool of mortgages. If an issuer does not take the mortgage guarantee fees into account in computing the effective rate of interest on the mortgages, the difference between the bond yield and the effective rate on the mortgages is reduced because the effective rate on the mortgages is reduced. A qualified guarantee of the bonds accomplishes the same result by increasing bond yield, rather than reducing the effective rate of interest on the mortgages. Issuers should not be required to change the form of their transactions in these circumstances.

Accordingly, to the extent the amounts charged for a guarantee of a pool of mortgages do not exceed amounts charged in the area in cases when owner-financing is not provided through the use of mortgage revenue bonds, the proposed regulations provide that such amounts are not treated as borne by the mortgagors and are not taken into account in determining the effective rate of interest on the mortgages for purposes of section 143(g).

B. *Proposed Regulations*

The proposed regulations create a new §1.143(g)–1. The proposed regulations provide that an issue satisfies the requirements of section 143(g) only if the issue meets the requirements of §1.143(g)–1(b) and, in the case of an issue 95 percent or more of the net proceeds of which are to be used to provide residences for veterans, the issue also meets the requirements of §1.143(g)–1(c). The requirements of section 143(g) and the proposed regulations are applicable in addition to the requirements of section 148 and §§1.148–0 through 1.148–11.

The proposed regulations provide that an issue shall be treated as meeting the requirements of §1.143(g)–1(b) only if the excess of (1) the effective rate of interest on the mortgages financed by the issue, over (2) the yield on the issue, is not greater over the term of the issue than 1.125 percentage points.

In determining the effective rate of interest on any mortgage, the proposed regulations provide that all fees, charges, and other amounts borne by the mortgagor that are attributable to the mortgage or to the bond issue are taken into account. Such amounts include points, commitment fees, origination fees, servicing fees, and prepayment penalties paid by the mortgagor.

The proposed regulations provide that items that are treated as borne by the mortgagor and are taken into account in calculating the effective rate of interest also include: (1) All points, commitment fees, origination fees, or similar charges borne by the seller of the property; and (2) the excess of any amounts received from any person other than the mortgagor by any person in connection with the acquisition of the mortgagor's interest in the property over the usual and reasonable acquisition costs of a person acquiring like property where owner-financing is not provided through the use of mortgage revenue bonds.

The proposed regulations further provide that the following items are not treated as borne by the mortgagor and are not taken into account in calculating the effective rate of interest: (1) Any expected rebate of arbitrage profit; and (2) any application fee, survey fee, credit report fee, insurance charge or similar settlement or financing cost to the extent such amount does not exceed amounts charged in the area in cases where owner-financing is not provided through the use of mortgage revenue bonds.

With respect to insurance charges, the proposed regulations provide that amounts paid for Federal Housing Administration, Veterans' Administration, or similar private mortgage insurance on an individual's mortgage, or amounts paid for pool mortgage insurance on a pool of mortgages, are not taken into account so long as such amounts do not exceed the amounts charged in the area with respect to a similar mortgage, or pool of mortgages, that is not financed with mortgage revenue bonds. Moreover, for this purpose, amounts paid for pool mortgage insurance include amounts paid to an entity (for example, the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or other mortgage insurer) to directly guarantee the pool of mortgages financed with the bonds, or to guarantee a pass-through security backed by the pool of mortgages financed with the bonds.

The proposed regulations do not provide guidance regarding all aspects of the application of section 143(g)(2). The proposed regulations provide that to the extent not inconsistent with the 1986 Act or subsequent law, the provisions of

§6a.103A–2(i)(2) (other than paragraphs (i)(2)(i) and (i)(2)(ii)(A) through (C)) apply to provide additional rules relating to compliance with the requirement that the effective rate of mortgage interest not exceed the bond yield by more than 1.125 percentage points.

The proposed regulations also do not provide guidance regarding the application of section 143(g)(3). The proposed regulations provide that to the extent not inconsistent with the 1986 Act or subsequent law, the provisions of §6a.103A–2(i)(4) apply to provide guidance regarding the application of section 143(g)(3).

Proposed Effective Dates

The proposed regulations will apply to bonds sold on or after the date of publication of final regulations in the **Federal Register**, that are subject to section 143. Issuers may also apply the proposed regulations in whole, but not in part, to bonds sold on or after November 5, 2003, and before the date of publication of final regulations in the **Federal Register**, that are subject to section 143. In addition, issuers may apply the proposed regulations in whole, but not in part, to any bonds that are sold before November 5, 2003, and subject to section 143. Finally, subject to the applicable effective dates for the corresponding statutory provisions, issuers may apply the proposed regulations in whole, but not in part, to any bonds that are subject to section 103A(i) of the 1954 Code.

Special Analyses

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

Comments and Public Hearing

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

A public hearing has been scheduled for January 28, 2004, at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the lobby more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

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

Persons who wish to present oral comments at the hearing must submit written comments by January 7, 2004, and submit an outline of the topics to be discussed and the amount of time to be devoted to each topic by January 7, 2004.

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

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

Drafting Information

The principal authors of these regulations are Timothy L. Jones and Michael P. Brewer, Office of Associate Chief Counsel (Tax-Exempt and Government Entities), IRS, and Bruce M. Serchuk, Office of Tax Policy, Treasury Department. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.143(g)–1 is added to read as follows:

§1.143(g)–1 Requirements related to arbitrage.

(a) *In general*. Under section 143, for an issue to be an issue of qualified mortgage bonds or qualified veterans' mortgage bonds (together, mortgage revenue bonds), the requirements of section 143(g) must be satisfied. An issue satisfies the requirements of section 143(g) only if such issue meets the requirements of paragraph (b) of this section and, in the case of an issue 95 percent or more of the net proceeds of which are to be used to provide residences for veterans, such issue also meets the requirements of paragraph (c) of this section. The requirements of section 143(g) and this section are applicable in addition to the requirements of section 148 and §§1.148–0 through 1.148–11.

(b) *Effective rate of mortgage interest not to exceed bond yield by more than 1.125 percentage points*—(1) *Maximum yield*. An issue shall be treated as meeting the requirements of this paragraph (b) only if the excess of the effective rate of interest on the mortgages financed by the issue, over the yield on the issue, is not greater over the term of the issue than 1.125 percentage points.

(2) *Effective rate of interest*. (i) In determining the effective rate of interest on any mortgage for purposes of this paragraph (b), there shall be taken into account all fees, charges, and other amounts borne by the mortgagor that are attributable to the mortgage or to the bond issue. Such amounts include points, commitment fees, origination fees, servicing fees, and prepayment penalties paid by the mortgagor.

(ii) Items that shall be treated as borne by the mortgagor and shall be taken into account in calculating the effective rate of interest also include:

(A) All points, commitment fees, origination fees, or similar charges borne by the seller of the property; and

(B) The excess of any amounts received from any person other than the mortgagor by any person in connection with the acquisition of the mortgagor's interest in the property over the usual and reasonable acquisition costs of a person acquiring like property when owner-financing is not provided through the use of mortgage revenue bonds.

(iii) The following items shall not be treated as borne by the mortgagor and shall not be taken into account in calculating the effective rate of interest:

(A) Any expected rebate of arbitrage profit under paragraph (c) of this section; and

(B) Any application fee, survey fee, credit report fee, insurance charge or similar settlement or financing cost to the extent such amount does not exceed amounts charged in the area in cases when owner-financing is not provided through the use of mortgage revenue bonds. For example, amounts paid for Federal Housing Administration, Veterans' Administration, or similar private mortgage insurance on an individual's mortgage, or amounts paid for pool mortgage insurance on a pool of mortgages, are not taken into account so long as such amounts do not exceed the amounts charged in the area with respect to a similar mortgage, or pool of mortgages, that is not financed with mortgage revenue bonds. For this purpose, amounts paid for pool mortgage insurance include amounts paid to an entity (for example, the Government National Mortgage Association, the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation, or other mortgage insurer) to directly guarantee the pool of mortgages financed with the bonds, or to guarantee a pass-through security backed by the pool of mortgages financed with the bonds.

(C) The following example illustrates the provisions of this paragraph (b)(2)(iii):

Example. Housing Authority X issues bonds intended to be qualified mortgage bonds under section 143(a). At the time the bonds are issued, X enters into an agreement with a group of mortgage lending institutions (lenders) under which the lenders agree to originate and service mortgages that meet certain specified requirements. After originating a specified amount of mortgages, each lender issues a "pass-though security" (each, a PTS) backed by the mortgages and sells the PTS to X. Under the terms of the PTS, the lender pays X an amount equal to the regular monthly payments on the mortgages (less certain fees), whether or not received by the lender (plus any prepayments and liquidation proceeds in the event of a foreclosure or other disposition of any mortgages). FNMA guarantees the timely payment of principal and interest on each PTS. From the payments received from each mortgagor, the lender pays a fee to FNMA for its guarantee of the PTS. The amounts paid to FNMA do not exceed the amounts charged in the area with respect to a similar pool of mortgages that is not financed with mortgage revenue bonds. Under this paragraph (b)(2)(iii), the fees for the guarantee provided by FNMA are an insurance charge because the guarantee is pool mortgage insurance. Because the amounts charged for the guarantee do not exceed the amounts charged in the area with respect to a similar pool of mortgages that is not financed with mortgage revenue bonds, the amounts charged for the guarantee are not taken into account in computing the effective rate of interest on the mortgages financed with X's bonds.

(3) *Additional rules*. To the extent not inconsistent with the Tax Reform Act of 1986, Public Law 99–514 (the 1986 Act), or subsequent law, §6a.103A–2(i)(2) (other than paragraphs (i)(2)(i) and (i)(2)(ii)(A) through (C)) of this chapter applies to provide additional rules relating to compliance with the requirement that the effective rate of mortgage interest not exceed the bond yield by more than 1.125 percentage points.

(c) *Arbitrage and investment gains to be used to reduce costs of owner-financing*. As provided in section 143(g)(3), certain earnings on nonpurpose investments must either be paid or credited to mortgagors, or paid to the United States, in certain circumstances. To the extent not inconsistent with the 1986 Act or subsequent law, §6a.103A–2(i)(4) of this chapter applies to provide guidance relating to compliance with this requirement.

(d) *Effective Dates*—(1) *In general*. Except as otherwise provided in this section, §1.143(g)–1 applies to bonds sold on or after the date of publication of final regulations in the **Federal Register**, that are subject to section 143. Issuers may apply §1.143(g)–1, in whole, but not in part, to bonds sold on or after November 5, 2003, and before the date of publication of final regulations in the **Federal Register**, that are subject to section 143.

(2) *Permissive retroactive application in whole*. Except as provided in paragraph (d)(4) of this section, an issuer may apply §1.143(g)–1, in whole, but not in part, to any bonds that are sold before November 5, 2003, and subject to section 143.

(3) *Bonds subject to the Internal Revenue Code of 1954*. Except as provided in paragraph (d)(4) of this section, and subject to the applicable effective dates for the corresponding statutory provisions, an issuer may apply §1.143(g)–1, in whole, but not in part, to any bonds that are subject to section 103A(i) of the Internal Revenue Code of 1954.

(4) *Special rule for pre-July 1, 1993, bonds*. To the extent that an issuer applies this section to any bonds pursuant to paragraph (d)(2) or (d)(3) of this section, §6a.103A–2(i)(3) of this chapter also applies to the bonds if the bonds were issued before July 1, 1993.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 4, 2003, 8:45 a.m., and published in the issue of the Federal Register for November 5, 2003, 68 F.R. 62549)

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

Announcement 2003-71

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

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

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

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

Name	Address	Designation	Effective Date
Loy, Michael F.	Pittsburgh, KS	CPA	July 23, 2003

Consent Suspensions From Practice Before the Internal Revenue Service

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

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

Name	Address	Designation	Date of Suspension
Gillis, Robert F.	Jacksonville, FL	Enrolled Agent	July 1, 2003 to January 31, 2004
Ziedins, Aivars	Castle Rock, CO	Enrolled Agent	Indefinite from July 1, 2003

Name	Address	Designation	Date of Suspension
A. N. Hebesha	Visalia, CA	Enrolled Agent	Indefinite from July 11, 2003
Stafford, Robert M.	Allston, MA	CPA	Indefinite from July 14, 2003
Carnahan, Larry K.	Ashland, KY	Attorney	Indefinite from July 18, 2003
McAlarney, Nancy A.	Kissimmee, FL	Enrolled Agent	Indefinite from July 24, 2003
Rahman, Ernest	Melville, NY	Enrolled Agent	Indefinite from July 31, 2003
Oleksy, Dennis L.	Cary, IL	Enrolled Agent	Indefinite from August 12, 2003
Witti, Mary E.	Boulder City, NV	Enrolled Agent	Indefinite from September 1, 2003
Lau, Willie	Howell, NJ	Enrolled Agent	Indefinite from September 1, 2003
Couch, Leslie L.	Kihei, HI	Enrolled Agent	Indefinite from September 5, 2003
Khoudary, Nicholas	East Brunswick, NJ	Enrolled Agent	Indefinite from September 15, 2003
Solomon, Dorothy	Los Angeles, CA	Enrolled Agent	Indefinite from October 6, 2003
McMahon, Angela	Toms River, NJ	Enrolled Agent	Indefinite from October 20, 2003
Lee, Chun Hyong	Lakewood, WA	CPA	Indefinite from October 22, 2003

Expedited Suspensions From Practice Before the Internal Revenue Service

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

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

Name	Address	Designation	Date of Suspension
Daniels, Mario	Flint, MI	CPA	Indefinite from September 4, 2003
Hertz, Kevin	McAllen, TX	CPA	Indefinite from October 1, 2003
Roselli, Antonio	Topsfield, MA	CPA	Indefinite from October 17, 2003
Moran, Maxine C.	San Clemente, CA	CPA	Indefinite from October 17, 2003
Muscio, Richard J.	Solana Beach, CA	CPA	Indefinite from October 17, 2003
Yates, James L.	LaPlata, MD	CPA	Indefinite from October 21, 2003

Censure Issued by Consent

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

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

Name	Address	Designation	Date of Censure
Haynes, Gwenivar L.	Ellenwood, GA	Enrolled Agent	August 1, 2003
Ritchie, Donald	Milton, MA	Enrolled Agent	September 3, 2003
Bagley, Haywood	Vista, CA	Enrolled Agent	September 4, 2003
Book, Robert L.	Plymouth, MN	Enrolled Agent	September 15, 2003

Suspension of Tax-Exempt Status of Organizations Identified With Terrorism

Announcement 2003–74

I. Purpose

This announcement is a public notice of the suspension under section 501(p) of the Internal Revenue Code of the federal tax exemption of certain organizations that have been designated as supporting or engaging in terrorist activity or supporting terrorism. Contributions made to an organization during the period that the organization's tax-exempt status is suspended are not deductible for federal tax purposes.

II. Background

The federal government has designated a number of organizations as supporting or engaging in terrorist activity or supporting terrorism under the Immigration and Nationality Act, the International Emergency Economic Powers Act, and the United Nations Participation Act of 1945. Federal law prohibits most contributions to organizations that have been so designated.

Section 501(p) of the Code was enacted as part of the Military Family Tax Relief Act of 2003 (P.L. 108–121), effective November 11, 2003. Section 501(p)(1) suspends the exemption from tax under section 501(a) of any organization described in section 501(p)(2). An organization is described in section 501(p)(2) if the organization is designated or otherwise individually identified (1) under certain provisions of the Immigration and Nationality Act as a terrorist organization or foreign terrorist organization; (2) in or pursuant to an Executive Order which is related to terrorism and issued under the authority of the International Emergency Economic Powers Act or section 5 of the United Nations Participation Act of 1945 for the purpose of imposing on such organization an economic or other sanction; or (3) in or pursuant to an Executive Order issued under the authority of any federal law, if the organization is designated or otherwise individually identified in or pursuant to the Executive Order as supporting or engaging in terrorist activity (as defined in the Immigration and Nationality Act) or supporting terrorism (as defined in the Foreign Relations Authorization Act) and the Executive Order refers to section 501(p)(2).

Under section 501(p)(3) of the Code, suspension of an organization's tax exemption begins on the date of the first publication of a designation or identification with respect to the organization, as described above, or the date on which section 501(p) was enacted, whichever is later. This suspension continues until all designations and identifications of the organization are rescinded under the law or Executive Order under which such designation or identification was made.

Under section 501(p)(4) of the Code, no deduction is allowed under any provision of the Internal Revenue Code for any contribution to an organization during any period in which the organization's tax exemption is suspended under section 501(p). Thus, for example, no charitable contribution deduction is allowed under section 170 (relating to the income tax), section 545(b)(2) (relating to undistributed personal holding company income), section 556(b)(2) (relating to undistributed foreign personal holding company income), section 642(c) (relating to charitable set asides), section 2055 (relating to the estate tax), section 2106(a)(2) (relating to the estate tax for nonresident aliens) and section 2522 (relating to the gift tax) for contributions made to the organization during the suspension period.

Prior to the effective date of suspension of exemption under section 501(p), the three organizations listed below were designated under Executive Order 13224, entitled "Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten To Commit, or Support Terrorism." Contributions made to these organizations in violation of the Executive Order prior to this suspension are not tax deductible under the Internal Revenue Code.

III. Notice of Suspensions and Nondeductibility of Contributions

Organizations whose tax exemption has been suspended under section 501(p) and the effective date of such suspension are listed below. Contributions made to these organizations during the period of suspension are not deductible for federal tax purposes.

Benevolence International Foundation, Inc.
Palos Hills, Illinois
Effective Date: November 11, 2003

Global Relief Foundation, Inc.
Bridgeview, Illinois
Effective Date: November 11, 2003

Holy Land Foundation for Relief and Development
Richardson, Texas
Effective Date: November 11, 2003

IV. Federal Tax Filings

An organization whose exempt status has been suspended under section 501(p) does not file Form 990 and is required to file the appropriate Federal income tax returns for the taxable periods beginning on the date of the suspension. The organization must continue to file all other appropriate federal tax returns, including employment tax returns, and may also have to file federal unemployment tax returns.

V. Contact Information

For additional information regarding the designation or identification of an organization described in section 501(p)(2), contact the Compliance Division at the Office of Foreign Assets Control of the U.S. Treasury Department at 202–622–2490. Additional information is also available for download from the Office's Internet Home Page at *www.treas.gov/ofac*.

For additional information regarding the suspension of the federal tax exemption of an organization under section 501(p), contact Robert Fontenrose at (202) 283–9484 at the Internal Revenue Service.

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2003–76

The name of an organization that no longer qualifies as an organization described in section 170(c)(2) of the Internal Revenue Code of 1986 is listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date

of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on October 28, 2002, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Zaire Unlimited
Calumet Park, IL

Partial Withdrawal of Proposed Regulations Relating to Changes in Entity Classification

Announcement 2003–78

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of notice of proposed rulemaking.

SUMMARY: This document withdraws a portion of a notice of proposed rulemaking (REG–110385–99, 1999–2 C.B. 670) published on November 29, 1999, addressing certain transactions that occur within a specified period before or after a foreign entity changed its classification to disregarded-entity status.

EFFECTIVE DATES: The withdrawal of proposed §301.7701–3(h) is effective October 22, 2003.

FOR FURTHER INFORMATION CONTACT: Ronald M. Gootzeit, (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 18, 1996, Treasury and IRS published in the **Federal Register** final regulations (T.D. 8697, 1997–1 C.B. 215 [61 FR 66584]) relating to the classification of business entities under section 7701 (check-the-box regulations). On November 29, 1999, Treasury and the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–110385–99, 1999–2 C.B. 670 [64 FR 66591]) proposing to amend §§301.7701–2 and 301.7701–3 of the current check-the-box regulations (proposed regulations). A public hearing on the proposed regulations was held on January 31, 2000. In addition, written comments were received. Most of the written and oral comments related to proposed §301.7701–3(h), which provided a rule that would have operated to change the classification of a foreign disregarded entity if a so-called "extraordinary transaction" occurred one day before or within one year after the election to treat the entity as disregarded. In general, commentators criticized the approach adopted in this rule as overly broad and expressed concern that it would mitigate the increased certainty promoted by the check-the-box regulations in 1996.

After considering the comments received, Treasury and the IRS issued Notice 2003–46, 2003–28 IRB 53, on June 26, 2003, announcing the intention to withdraw the extraordinary transaction rule in proposed §301.7701–3(h) and to finalize the remaining provisions of the proposed regulations addressing grandfathered entities and the relevancy of classification status.

With the publication of this document, proposed §301.7701–3(h) is withdrawn. Final regulations (T.D. 9093) adopting without substantive change the portions of the proposed regulations relating to grandfathered entities and the relevancy of classification status are being published on page 1156 of this issue of the Bulletin. These final regulations do not adopt the extraordinary transaction rule in proposed §301.7701–3(h).

Drafting Information

The principal author of this withdrawal notice is Ronald M. Gootzeit, Office of Associate Chief Counsel (International). However, other personnel from Treasury and the IRS participated in its development.

* * * * *

Partial Withdrawal of a Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, §301.7701–3(h) of the notice of proposed rulemaking published in the **Federal Register** on November 29, 1999, (64 FR 66591) is withdrawn.

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

(Filed by the Office of the Federal Register on October 21, 2003, 8:45 a.m., and published in the issue of the Federal Register for October 22, 2003, 68 F.R. 60305)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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

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