Internal Revenue
bulletin

Bulletin No. 2004-32
August 9, 2004

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. 2004–81, page 161.

LIFO; price indexes; department stores. The May 2004 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, May 31, 2004.

Rev. Rul. 2004–83, page 157.

Corporate reorganizations. This ruling provides that if, pursuant to an integrated plan, a parent corporation sells the stock of a subsidiary to another subsidiary and the acquired subsidiary liquidates into the acquiring subsidiary, the transaction is a reorganization under section 368(a)(1)(D) of the Code.

Rev. Rul. 2004–84, page 163.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for August 2004.

Rev. Rul. 2004–87, page 154.

Bankruptcy; golden parachute payments. This ruling provides rules for the application of section 280G of the Code, concerning golden parachute payments, in the context of a bankruptcy. Specifically, this ruling addresses whether the acquisition of stock by the former creditors results in a change in ownership or control, whether a corporation whose stock is de-listed is eligible for the exemption for certain corporations whose stock is not readily tradeable on an established securities market if the shareholder approval and disclosure requirements described in the final regulations are satisfied, and whether stock that is de-listed from a securities market is considered readily tradeable if it is traded on an over-the-counter market (such as the pink sheets).

T.D. 9138, page 160.

This Treasury decision removes temporary regulation section 1.463–1T, which provides a rule for an election to deduct vested accrued vacation pay for a taxpayer's first taxable year ending after July 18, 1984. The repeal of section 463 of the Code in 1987 has rendered the temporary regulation obsolete.

T.D. 9140, page 159.

Final regulations under section 461 of the Code clarify that the transfer of a taxpayer's note or promise to provide property or services in the future is not a transfer for the satisfaction of a contested liability under section 461(f). A transfer of a taxpayer's stock or the stock or note of a related party also is not a transfer for the satisfaction of a contested liability under section 461(f). The regulations further provide that, in general, economic performance does not occur when a taxpayer transfers money or other property to a trust, escrow account, or court to provide for the satisfaction of a contested payment liability.

REG–150562–03, page 175.

Proposed regulations relate to the application of section 1045 of the Code to partnerships and their partners. The regulations provide rules regarding the deferral of gain on a partner's sale of qualified small business stock and deferral of gain on a partner's sale of qualified small business stock distributed by a partnership. A public hearing is scheduled for November 2, 2004.

Notice 2004–52, page 168.

This notice requests comments regarding the treatment of certain financial transactions commonly known as credit default swaps (CDSs).

(Continued on the next page)

Actions Relating to Court Decisions is on the page following the Introduction.
Announcements of Disbarments and Suspensions begin on page 184.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Rev. Proc. 2004–48, page 172.
This document provides that certain eligible entities may request relief for a late S corporation election and a late election to be classified as an association taxable as a corporation within 18 months of the original due date of the S corporation election (but in no event later than 6 months after the due date of the tax return, excluding extensions, for the first year the entity intended to be an S corporation).

ESTATE TAX

Rev. Proc. 2004–47, page 169.
This document provides a simplified alternate procedure (in lieu of requesting a letter ruling) for certain executors of estates and trustees of trusts to request relief to make a late reverse qualified terminable interest property (QTIP) election under section 2652 of the Code.

EXCISE TAX

Rev. Rul. 2004–80, page 164.
Retail excise tax; highway tractor; truck. This ruling applies the primarily designed tests in section 145.4051–1(e)(1) and (2) of the regulations under the Highway Revenue Act of 1982 (Pub. L. 97–424) for purposes of determining whether a vehicle is a truck or a highway tractor.

ADMINISTRATIVE

Rev. Rul. 2004–88, page 165.
TEFRA partnership; disregarded entity; pass-thru partner; tax matter partner. This ruling addresses whether a disregarded entity partner will disqualify a partnership from being a "small partnership" excluded from the TEFRA partnership provisions. The ruling also addresses whether a disregarded entity may be designated as the tax matters partner of a partnership.

Rev. Proc. 2004–48, page 172.
This document provides that certain eligible entities may request relief for a late S corporation election and a late election to be classified as an association taxable as a corporation within 18 months of the original due date of the S corporation election (but in no event later than 6 months after the due date of the tax return, excluding extensions, for the first year the entity intended to be an S corporation).

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Actions Relating to Decisions of the Tax Court

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

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

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

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

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

The Commissioner does NOT ACQUIESCE in the following decision:

United States v. Roland Harry Macher (In re Macher),[1]
91 AFTR2d 2003–2654,
2003–2 USTC ¶50,537
(Bankr. W.D. Va.), *aff'd* 303 B.R.
798 (W.D. Va. 2003)

[1] Nonacquiescence relating to whether a bankruptcy court has the authority to order the United States to process and consider a debtor's plan of reorganization in accordance with procedures applicable to offers in compromise submitted by taxpayers who are not currently in bankruptcy.

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.

Bankruptcy; golden parachute payments. This ruling provides rules for the application of section 280G of the Code, concerning golden parachute payments, in the context of a bankruptcy. Specifically, this ruling addresses whether the acquisition of stock by the former creditors results in a change in ownership or control, whether a corporation whose stock is de-listed is eligible for the exemption for certain corporations whose stock is not readily tradeable on an established securities market if the shareholder approval and disclosure requirements described in the final regulations are satisfied, and whether stock that is de-listed from a securities market is considered readily tradeable if it is traded on an over-the-counter market (such as the pink sheets).

Rev. Rul. 2004–87

ISSUE

In the situations described below, has there been a change in ownership or control for purposes of §§ 280G and 4999 of the Internal Revenue Code? If so, are any contingent payments potentially exempt under § 280G(b)(5)(A)(ii) (concerning payments from certain corporations that are approved by its shareholders)?

FACTS

Situation 1. On March 1, 2005, Corporation A, files a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. See 11 U.S.C. § 1101, *et seq*. Corporation A common stock is widely held and actively traded on the New York Stock Exchange. There are no other shares of Corporation A outstanding. Committees of creditors holding unsecured claims and equity security holders are appointed pursuant to 11 U.S.C. § 1102.

After negotiations between the unsecured creditors' committee, the equity committee, and Corporation A, a plan of reorganization is presented to the bankruptcy court and approved. Under the plan of reorganization, all of the existing shares of Corporation A common stock are cancelled and new shares of common stock are authorized. Under the plan of reorganization, the unsecured creditors of Corporation A will receive 75% of the new common stock, distributed in proportion to their claims. Certain shareholders will receive 25% of the new common stock, distributed in proportion to their pre-reorganization stock holdings. No single unsecured creditor will receive 20% or more of the outstanding shares of Corporation A after the reorganization.

Under the plan of reorganization, the existing Board of Directors is replaced by a new Board of Directors that is endorsed by the pre-reorganization Board of Directors.

Situation 2. Assume the same facts as in *Situation 1* except that after the reorganization the largest creditor of Corporation A will receive 25% of the outstanding shares of Corporation A.

Situation 3. Common stock of Corporation B is widely-held and actively traded on the New York Stock Exchange. No other shares of Corporation B are outstanding. Since January 2000, Corporation B has experienced financial difficulties.

On June 15, 2005, Corporation B determines that it is insolvent and files a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Committees of creditors holding unsecured claims and equity security holders are appointed pursuant to 11 U.S.C. § 1102.

On January 15, 2006, Corporation B's stock is de-listed from the New York Stock Exchange and is thereafter no longer tradeable on any established securities market (as defined in § 1.897–1(m)). No trading occurred with respect to stock in Corporation B on any other market, including any over-the-counter market (*e.g.*, the pink sheets, the over-the-counter-bulletin board (OTCBB), the automated confirmation transaction service (ACT), or any similar market).

In March 2006, Corporation C proposes to purchase more than one-third of the total gross fair market value of the assets of Corporation B. Corporation B files a motion in the bankruptcy court for approval of the sale. Pursuant to an employment contract, the sale would trigger certain payments to Executive E, a disqualified individual with respect to Corporation B. E files a request in the bankruptcy court to allow Corporation B to make the payments as administrative expenses of the bankruptcy estate under 11 U.S.C. § 503(a). The request specifies that the payments will be made because of the sale of assets to Corporation C, the total amount of each payment, and a brief description of each payment. The request also explains why the payments are actual, necessary costs and expenses of preserving the bankruptcy estate.

After notice and hearing, the bankruptcy court approves the sale of assets and the request for payment of administrative expense by orders dated September 15, 2006.

On October 1, 2006, Corporation C acquires the assets from Corporation B, and the payments are made to E.

Situation 4. Assume the same facts as in *Situation 3* except that the stock of Corporation B is tradeable on an over-the-counter market after de-listing from the New York Stock Exchange.

LAW

Section 280G of the Code was enacted to discourage substantial payments to top executives and other personnel of a target corporation in connection with an acquisition. In some situations, the existence of golden parachute arrangements could encourage executives and other key personnel to favor a proposed takeover that may not be in the best interests of the shareholders. To the extent amounts must be paid

to executives and other key personnel of the target corporation because of golden parachutes or similar arrangements, there is less for the shareholders of that corporation. See, S. Prt. No. 98–169, at 195 (1984); JOINT COMMITTEE ON TAXATION, 98th CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, at 199–200 (1984).

Section 280G denies a deduction for any excess parachute payment. Section 4999 imposes a nondeductible 20-percent excise tax on the recipient of any excess parachute payment, within the meaning of § 280G(b).

An excess parachute payment is defined in § 280G(b)(1) as an amount equal to the excess of any parachute payment over the portion of the disqualified individual's base amount that is allocated to such payment.

Section 280G(b)(2)(A) defines a parachute payment as any payment in the nature of compensation to (or for the benefit of) a disqualified individual if (i) such payment is contingent on a change in the ownership of a corporation, the effective control of a corporation, or the ownership of a substantial portion of the assets of a corporation (a change in ownership or control), and (ii) the aggregate present value of the payments in the nature of compensation which are contingent on such change equals or exceeds an amount equal to 3 times the base amount.

Section 280G(b)(5)(A)(ii) of the Code provides, in part, that a parachute payment does not include any payment to a disqualified individual with respect to a corporation (other than a small business corporation as defined in § 1361(b) but without regard to paragraph (1)(C) thereof) if (I) immediately before the change described in § 280G(b)(2)(A) no stock in such corporation was readily tradeable on an established securities market or otherwise, and (II) the shareholder approval requirements of § 280G(b)(5)(B) are met with respect to such payment.

Section 280G(b)(5)(B)(ii) of the Code provides that the shareholder approval requirements of § 280G(b)(5) are met with respect to any payment if (i) such payment was approved by a vote of the persons who owned, immediately before the change described in § 280G(b)(2)(A)(i), more than 75 percent of the voting power of all outstanding stock of the corporation, and (ii) there was adequate disclosure to shareholders of all material facts concerning all payments which (but for this paragraph) would be parachute payments with respect to a disqualified individual.

Under §1.280G–1 of the Income Tax Regulations, Q/A–6(a), a parachute payment does not include any payment to a disqualified individual with respect to a corporation if (1) immediately before the change in ownership or control, no stock in such corporation was readily tradeable on an established securities market or otherwise, and (2) the shareholder approval requirements of Q/A–7 are met with respect to such payment. Under §1.280G–1, Q/A–6(e) of the regulations, stock is treated as readily tradeable if it is regularly quoted by brokers or dealers making a market in such stock. Section 1.280G–1 of the regulations, Q/A–6(f) provides that an established securities market means an established securities market as defined in §1.897–1(m) of the regulations.

Section 1.280G–1, Q/A–7(a), of the regulations provides that the shareholder approval requirements are met with respect to the payment if (1) the payment is approved by more than 75% of the voting power of all outstanding stock entitled to vote (as described in Q/A–7) immediately before the change in ownership or control, and (2) before the vote there is adequate disclosure to all persons entitled to vote (as described in Q/A–7) of all material facts concerning all material payments which (but for Q/A–6) would be parachute payments with respect to the disqualified individual.

Section 1.280G–1 of the regulations, Q/As 27, 28, and 29 provides guidance concerning when a corporation is considered to have undergone a change in ownership of a corporation, a change in effective control of a corporation, or a change in the ownership of a substantial portion of the assets of a corporation (a change in ownership or control).

Q/A–27(a) provides that a change in the ownership of a corporation occurs on the date that any one person, or more than one person acting as a group, acquires ownership of stock of the corporation that, together with stock held by such person (or more than one person acting as a group under Q/A–27(b)) possesses more than 50 percent of the total fair market value or total voting power of the stock of such corporation. Q/A–27(b) provides that persons will not be considered to be acting as a group merely because they happen to purchase or own stock of the same corporation at the same time, or as a result of the same public offering.

Q/A–28(a) provides, in part, that a change in the effective control of a corporation is presumed to occur on the date that either (1) any one person, or more than one person acting as a group (as defined in Q/A–28(d)), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) ownership of stock of the corporation possessing 20 percent or more of the total voting power of the stock of such corporation; or (2) a majority of the members of the corporation's board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the corporation's board of directors prior to the date of the appointment or election. The presumption may be rebutted by showing that the acquisition of stock or replacement of the board does not transfer the power to control (directly or indirectly) from any one person (or more than one person acting as a group) to another person (or group). Q/A–28(d) contains the same language as Q/A–27(b) concerning when more than one person is considered to be acting as a group.

Q/A–29 provides that a change in the ownership of a substantial portion of a corporation's assets occurs on the date that any one person, or more than one person acting as a group (as defined in Q/A–29(c)) acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the corporation that have a total gross fair market value equal to or more than one-third of the total gross fair market value of all of the assets of the corporation immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the corporation, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets. Q/A–29(c) contains the same language as Q/A–27(b) concerning when person will be considered to be acting as a group.

In a bankruptcy case, an entity may file a request for payment of an administrative expense of the bankruptcy estate. See 11 U.S.C. § 503(a). Pursuant to 11 U.S.C. § 503(b)(1)(A), after notice and hearing, the bankruptcy court shall allow the payment of administrative expenses which were actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case. 11 U.S.C. § 503(b)(1)(A).

ANALYSIS — Situation 1

The receipt of stock by a creditor under a bankruptcy plan of reorganization is often involuntary in that the creditors of a bankrupt estate typically would prefer that the debt be paid in cash rather than in stock of the debtor. The fact that unsecured creditors are represented by a committee and that the plan of reorganization of the debtor provides for the creditors to receive stock instead of cash is ordinarily a function of the financial resources of the estate and is not necessarily indicative of any intention of the creditors to act as a group to acquire control of the debtor. In this situation, Corporation A filed a voluntary petition for relief in the bankruptcy court and the pre-bankruptcy creditors did not act together to force Corporation A into bankruptcy. The fact that the pre-bankruptcy creditors were appointed to a committee of creditors and received stock in proportion to their pre-bankruptcy debt does not indicate that the creditors acted together to acquire stock in Corporation A. Thus, the creditors are not acting as a group, within the meaning of Q/A–27(b) or Q/A–28(d), to acquire the stock of Corporation A.

ANALYSIS — Situation 2

Because one creditor acquired 20 percent or more of Corporation A's stock within a 12-month period, Corporation A is presumed, under Q/A–28(a), to have experienced a change in effective control. However, this presumption may be rebutted by a showing that the largest creditor will not act to control the management and policies of Corporation A.

ANALYSIS — Situation 3

Because Corporation C acquired more than one third of the total gross fair market value of all of the assets of Corporation B, there is a change in ownership of Corporation B under Q/A–29. However, if Corporation B qualifies as a corporation described in § 280G(b)(5)(A)(ii)(I), concerning payments from corporations that meet certain shareholder approval and disclosure requirements, and the requirements of § 280G(b)(5)(A)(ii)(II) are satisfied, the payments are exempt from the definition of parachute payment.

Under these facts, the stock of Corporation B was de-listed from an established securities market and was not otherwise readily tradeable on the date of the change in control. Further, no trading occurred on any market (including any over-the-counter market). Thus, Corporation B is a corporation described in § 280G(b)(5)(A)(ii)(I) on the date of the change in control.

In order to satisfy the requirements of § 280G(b)(5)(A)(ii)(II) outside of the bankruptcy context, generally, Q/A–7(a) of the regulations requires that the payment must be adequately disclosed to shareholders and then approved by more than 75% of the voting power of all outstanding stock entitled to vote immediately before the change in ownership or control. However, for a corporation in bankruptcy, the continuing interests of equity owners can be difficult to determine or predict. Through the bankruptcy process, the pre-bankruptcy shareholders may end up with a continuing equity interest in the company or the equity may end up partially or fully transferred to creditors. Correspondingly, the pre-bankruptcy shareholders may lack a material continuing equity interest in the affairs of the corporation and therefore also lack the corresponding motivation to appropriately evaluate the payments at issue.

In Situation 3, the payments to E were approved by the bankruptcy court pursuant to 11 U.S.C. § 503(b)(1)(A). The bankruptcy court therefore made a factual finding that the payments were actual, necessary costs and expenses of preserving the bankruptcy estate. The legislative history of § 280G indicates that the golden parachute rules were enacted to discourage excessive payments to executives and other key personnel in order to protect the shareholders. See S. Rpt. No. 98–169 at 195. The bankruptcy court approval serves to protect the estate and the ultimate owners from unnecessary or excessive payments made to executives. Consequently, for purposes of § 280G, the shareholder approval and disclosure requirements of § 280G(b)(5)(A)(i)(II) and Q/A–7 are deemed satisfied, and the payments to E are not parachute payments.

ANALYSIS — Situation 4

Similar to *Situation 3*, there has been a change in ownership of Corporation B under Q/A–29. Additionally, if Corporation B qualifies as a corporation described in § 280G(b)(5)(A)(ii)(I) (concerning payments from corporations that meet certain shareholder approval and disclosure requirements) on the date of the change in control and the requirements of § 280G(b)(5)(A)(ii)(II) are satisfied, the payments are exempt from the definition of parachute payment.

The trading of stock on an over-the-counter market (*e.g.*, the pink sheets, the OTCBB, the ACT, or any similar market) when the corporation is a debtor in a case under the Bankruptcy Code is impaired, and therefore, the stock is not considered "readily tradeable" for purposes of § 280G.

Accordingly, for the reasons discussed in *Situation 3*, the payments to E are not parachute payments.

HOLDINGS — Situation 1

In *Situation 1*, because no person (or persons acting as a group) acquired more than 50 percent of the total fair market value or total voting power of Corporation A (Q/A–27); because no person (or persons acting as a group) acquired within a 12-month period 20% or more of the outstanding stock of Corporation B and the new Board of Directors is approved by the pre-reorganization Board of Directors (Q/A–28); and because there is no acquisition of the assets of Corporation A (Q/A–29), Corporation A did not undergo a change in ownership or control under § 280G.

HOLDINGS — Situation 2

Corporation A is presumed to have experienced a change in effective control under § 280G. The presumption may be rebutted in accordance with Q/A–28(b).

HOLDINGS — Situation 3

Because Corporation C acquired more than one third of the total gross fair market value of all of the assets of Corporation B, there is a change in ownership of Corporation B under Q/A–29. However, Corporation B is eligible for the exemption provided in § 280G(b)(5)(A)(ii). Under these facts, the shareholder approval and disclosure requirements described in § 280G(b)(5)(B) and Q/A–7 are deemed to be satisfied, and thus, the payments to E are exempt from the definition of parachute payment.

HOLDINGS — Situation 4

For purposes of §280G, the trading of stock on an over-the-counter market when the corporation is a debtor in a case under the Bankruptcy Code is impaired, and therefore, the stock is not considered "readily tradeable." Thus, Corporation B is eligible for the exemption provided in § 280G(b)(5)(A)(ii). Under these facts, the shareholder approval and disclosure requirements described in § 280G(b)(5)(B) and Q/A–7 are deemed to be satisfied, and the payments to E are exempt from the definition of parachute payment.

EFFECTIVE DATE

This revenue ruling applies to any payment that is contingent on a change in ownership or control if the change of ownership or control occurs on or after July 19, 2004. Notwithstanding the foregoing, where a corporation is a debtor in a case under the Bankruptcy Code, its securities traded on an over-the-counter market also are not considered "readily tradeable" for purposes of § 280G(b)(5)(A)(ii) with respect to a change in ownership or control that occurred before July 19, 2004.

COMMENTS REQUESTED

Comments are requested concerning whether, or to what extent, the definition of "readily tradeable" under § 280G(b)(5)(A)(ii) should exclude stock of a corporation that is tradeable on an over-the-counter market (*e.g.*, the pink sheets, the OTCBB, the ACT, or any similar market).

Comments should be submitted by October 18, 2004, to CC:PA:LPD:PR (Revenue Ruling 2004–87), Room 5203, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered between the hours of 8 a.m. and 4 p.m., Monday through Friday to CC:PA:LPD:PR (Revenue Ruling 2004–87), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, D.C. Alternatively, comments may be submitted via the Internet at *Notice.Comments@irscounsel.treas.gov*. All comments will be available for public inspection.

DRAFTING INFORMATION

The principal author of this revenue ruling is Erinn Madden of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this revenue ruling, contact Ms. Madden at (202) 622–6030 (not a toll-free call).

Section 304.—Redemption Through Use of Related Corporations

26 CFR 1.304–2: Acquisition by related corporation (other than subsidiary).

If, pursuant to an integrated plan, a parent corporation sells the stock of a wholly owned subsidiary for cash to another wholly owned subsidiary and the acquired subsidiary completely liquidates into the acquiring subsidiary, the transaction is treated as a reorganization under § 368(a)(1)(D). See Rev. Rul. 2004-83, page 157.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

Corporate reorganizations. This ruling provides that if, pursuant to an integrated plan, a parent corporation sells the stock of a subsidiary to another subsidiary and the acquired subsidiary liquidates into the acquiring subsidiary, the transaction is a reorganization under section 368(a)(1)(D) of the Code.

Rev. Rul. 2004–83

ISSUE

Under the facts described below, what is the proper tax treatment if, pursuant to an integrated plan, a parent corporation sells the stock of a wholly owned subsidiary for cash to another wholly owned subsidiary and the acquired subsidiary completely liquidates into the acquiring subsidiary.

FACTS

Situation 1

Corporation P owns all the stock of Corporation S and Corporation T. P, S, and T are members of a consolidated group. As part of an integrated plan, S purchases all the stock of T from P for cash and T completely liquidates into S. Assume that if T had sold its assets directly to S and T had completely liquidated into P, the transaction would have qualified as a reorganization under § 368(a)(1)(D) of the Internal Revenue Code.

Situation 2

The facts are the same as in Situation 1 except that P, S, and T are not members of a consolidated group.

LAW

Section 368(a)(1)(D) provides that a reorganization includes a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction that qualifies under § 354, 355, or 356.

In Rev. Rul. 70–240, 1970–1 C.B. 81, B owned all the outstanding stock of Corporation X and Corporation Y. X sold its operating assets to Y for cash equal to their fair market value and used its remaining assets to pay its debts. X then liquidated and B received a liquidating distribution in exchange for his X stock. The ruling

concludes that the transfer by X of its operating assets to Y is regarded as the acquisition by Y of substantially all the assets of X and is a reorganization under § 368(a)(1)(D). *Accord Atlas Tool Co. v. Commissioner*, 70 T.C. 86 (1978), *aff'd*, 614 F.2d 860 (3rd Cir. 1980), *cert. denied*, 449 U.S. 836 (1980); *Armour v. Commissioner*, 43 T.C. 295 (1964).

In determining whether a transaction qualifies as a reorganization under § 368(a), the transaction must be evaluated under relevant provisions of law, including the step transaction doctrine. Section 1.368–1(a) of the Income Tax Regulations. The step transaction doctrine "treats a series of formally separate 'steps' as a single transaction if such steps are in substance integrated, interdependent, and focused toward a particular result." *Penrod v. Commissioner*, 88 T.C. 1415, 1428 (1987).

In Rev. Rul. 67–274, 1967–2 C.B. 141, pursuant to a plan of reorganization, Corporation Y acquired all the stock of Corporation X in exchange for voting stock of Y. Thereafter, X completely liquidated into Y. The ruling concludes that the two steps do not qualify as a reorganization under § 368(a)(1)(B) followed by a liquidation under § 332, but instead qualify as a single acquisition of X's assets in a reorganization under § 368(a)(1)(C). *See also* Rev. Rul. 72–405, 1972–2 C.B. 217 (treating the acquisition of the assets of a target corporation in a forward triangular merger followed by the liquidation of the acquiring subsidiary as a reorganization under § 368(a)(1)(C)); Rev. Rul. 2001–46, 2001–2 C.B. 321 (applying the approach reflected in Rev. Rul. 67–274 to a stock acquisition followed by a merger of the acquired corporation into the acquiring corporation).

Section 1.1361–4(a)(2) provides that if an S corporation makes a QSub election with respect to a subsidiary (an election to disregard a subsidiary as an entity separate from its S corporation parent), the subsidiary is deemed to have liquidated into the S corporation. In Example 3 of § 1.1361–4(a)(2)(ii), pursuant to a plan, Individual A contributes all the outstanding stock of Y to his wholly owned S corporation, X, and immediately causes X to make a QSub election for Y. The example concludes that the transaction is a reorganization under § 368(a)(1)(D), assuming the other conditions for reorganization treatment are satisfied.

Section 304(a)(1) provides, in general, for purposes of §§ 302 and 303, if one or more persons are in control of each of two corporations and, in return for property, one of the corporations acquires stock in the other corporation from the person (or persons) so in control, then such property shall be treated as a distribution in redemption of the stock of the corporation acquiring such stock.

Section 1.1502–80(b), which relates to consolidated returns, provides that § 304 does not apply to any acquisition of stock of a corporation in an intercompany transaction.

ANALYSIS

In Situation 1, because P, S, and T are members of a consolidated group, and S's purchase of the T stock from P is an intercompany transaction under § 1.1502–80(b), § 304 cannot apply to P's sale of T stock to S. As described above, if T had transferred its assets directly to S and T had completely liquidated into P, the stock sale and liquidation would have qualified as a reorganization under § 368(a)(1)(D). Consistent with Rev. Ruls. 67–274 and 72–405 and Example 3 of § 1.1361–4(a)(2)(ii), the step transaction doctrine applies to treat the stock sale and liquidation as a reorganization under § 368(a)(1)(D). Authorities that reject the application of the step transaction doctrine based on the policy of § 338, such as § 1.338–3(d) and Rev. Rul. 90–95, 1990–2 C.B. 67, are not relevant in this case because there is no purchase of T stock within the meaning of § 338(h)(3)(A) and § 1.338–3(b).

Situation 2 differs from Situation 1 only in that P, S, and T are not members of a consolidated group. As a result, if the step transaction doctrine does not apply to step together the stock sale and liquidation, the stock sale would be treated as a distribution in redemption of the S stock under § 304(a)(1) and the liquidation of T into S would qualify as a liquidation under § 332.

There is no policy that requires § 304 to be applied when § 368(a)(1)(D) would otherwise apply. *See* J. Comm. on Tax'n., 98th Cong. 2nd Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984* 192 (Comm. Print 1984). Moreover, the legislative history to the Deficit Reduction Act of 1984, P.L. 98–369, 1984–3 (Vol. 1) C.B. 1, indicates that § 304 was not intended to override reorganization treatment. *See* H.R. Rep. No. 98–432 Pt. 2, 1624 (1984). Accordingly, in Situation 2, as in Situation 1, the step transaction doctrine applies to treat the stock sale and liquidation as a reorganization under § 368(a)(1)(D).

HOLDING

Under the facts presented, if, pursuant to an integrated plan, a parent corporation sells the stock of a wholly owned subsidiary for cash to another wholly owned subsidiary and the acquired subsidiary completely liquidates into the acquiring subsidiary, the transaction is treated as a reorganization under § 368(a)(1)(D).

DRAFTING INFORMATION

The principal author of this revenue ruling is Lisa S. Dobson of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Ms. Dobson at (202) 622–7790 (not a toll-free call).

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461–2: Contested liabilities.

T.D. 9140

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Transfers to Provide for Satisfaction of Contested Liabilities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to transfers of money or other property to provide for the satisfaction of contested liabilities. The regulations affect taxpayers that are contesting an asserted liability and that transfer their own stock or indebtedness, the stock or indebtedness of a related party, or a promise to provide services or property in the future, to provide for the satisfaction of the liability prior to the resolution of the contest. The regulations also affect taxpayers that transfer money or other property to a trust, an escrow account, or a court to provide for the satisfaction of a liability for which payment is economic performance.

DATES: *Effective Date:* These regulations are effective July 20, 2004.

Applicability Dates: For dates of applicability, see §1.461–2(g).

FOR FURTHER INFORMATION CONTACT: Norma Rotunno, (202) 622–7900 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR Part 1 under section 461(f) of the Internal Revenue Code (Code). On November 21, 2003, temporary regulations (T.D. 9095, 2003–49 I.R.B. 1175) were published in the **Federal Register** (68 FR 65634) relating to the transfer of money or other property to provide for the satisfaction of an asserted liability that a taxpayer is contesting. A notice of proposed rulemaking (REG–136890–02, 2003–49 I.R.B. 1191) cross-referencing the temporary regulations also was published in the **Federal Register** (68 FR 65645) on November 21, 2003. No public hearing was requested or held. One comment was received responding to the notice of proposed rulemaking. After consideration of the comment, the proposed regulations are adopted by this Treasury decision.

Summary of Comment

The temporary regulations clarify that, in general, economic performance does not occur in the taxable year in which a taxpayer transfers money or other property to a trust, escrow account, or court to provide for the satisfaction of an asserted liability under section 461(f) for which payment constitutes economic performance. Rather, economic performance occurs in the taxable year in which a taxpayer transfers money or other property to the person asserting the liability that the taxpayer is contesting, or in the taxable year in which payment from the trust, escrow account, or court registry is made to the person to which the liability is owed. The temporary regulations also indicate that economic performance may be satisfied under section 468B and the regulations thereunder (relating to designated settlement funds and qualified settlement funds).

A commentator suggested that the regulations provide an example of a transfer to a contested liability fund that qualifies for a deduction in the taxable year of transfer because it also satisfies the requirements for a qualified settlement fund under §1.468B–1. The final regulations do not adopt this comment because the requirements for establishing a qualified settlement fund under §1.468B–1 are complex and are beyond the scope of these regulations.

Effective Date

In general, these final regulations apply to transfers made in taxable years beginning after December 31, 1953, and ending after August 16, 1954. However, these regulations apply to transfers of any stock of the taxpayer or any stock or indebtedness of a related person on or after November 19, 2003. Additionally, §1.461–2(e)(2)(i), relating to economic performance, applies to transfers of money or other property after July 18, 1984, the effective date of section 461(h). Section 1.461–2(e)(2)(ii) applies to (1) transfers of money or other property after July 18, 1984, to satisfy workers compensation or tort liabilities, and (2) transfers of money or other property in taxable years beginning after December 31, 1991, the effective date of §1.461–4(g), to satisfy payment liabilities designated under §1.461–4(g) (other than liabilities for workers compensation or tort).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does 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, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Norma Rotunno of the Office of the Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1— INCOME TAXES

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

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

Par. 2. In §1.461–2, paragraphs (c)(1), (e)(2), (e)(3) *Example 2*, and (g) are revised to read as follows:

§1.461–2 Contested liabilities.

* * * * *

(c) *Transfer to provide for the satisfaction of an asserted liability*—(1) *In general*. (i) A taxpayer may provide for the satisfaction of an asserted liability by transferring money or other property beyond his control to—

(A) The person who is asserting the liability;

(B) An escrowee or trustee pursuant to a written agreement (among the escrowee or trustee, the taxpayer, and the person who is asserting the liability) that the money or other property be delivered in accordance with the settlement of the contest;

(C) An escrowee or trustee pursuant to an order of the United States or of any State or political subdivision thereof or any agency or instrumentality of the foregoing, or of a court, that the money or other property be delivered in accordance with the settlement of the contest; or

(D) A court with jurisdiction over the contest.

(ii) In order for money or other property to be beyond the control of a taxpayer, the taxpayer must relinquish all authority over the money or other property.

(iii) The following are not transfers to provide for the satisfaction of an asserted liability—

(A) Purchasing a bond to guarantee payment of the asserted liability;

(B) An entry on the taxpayer's books of account;

(C) A transfer to an account that is within the control of the taxpayer;

(D) A transfer of any indebtedness of the taxpayer or of any promise by the taxpayer to provide services or property in the future; and

(E) A transfer to a person (other than the person asserting the liability) of any stock of the taxpayer or of any stock or indebtedness of a person related to the taxpayer (as defined in section 267(b)).

* * * * *

(e) * * *

(2) *Application of economic performance rules to transfers under section 461(f)*. (i) A taxpayer using an accrual method of accounting is not allowed a deduction under section 461(f) in the taxable year of the transfer unless economic performance has occurred.

(ii) Economic performance occurs for liabilities requiring payment to another person arising out of any workers compensation act or any tort, or any other liability designated in §1.461–4(g), as payments are made to the person to which the liability is owed. Except as provided in section 468B or the regulations thereunder, economic performance does not occur when a taxpayer transfers money or other property to a trust, an escrow account, or a court to provide for the satisfaction of an asserted workers compensation, tort, or other liability designated under §1.461–4(g) that the taxpayer is contesting unless the trust, escrow account, or court is the person to which the liability is owed or the taxpayer's payment to the trust, escrow account, or court discharges the taxpayer's liability to the claimant. Rather, economic performance occurs in the taxable year the taxpayer transfers money or other property to the person that is asserting the workers compensation, tort, or other liability designated under §1.461–4(g) that the taxpayer is contesting or in the taxable year that payment is made from a trust, an escrow account, or a court registry funded by the taxpayer to the person to which the liability is owed.

(3) * * *

* * * * *

Example 2. Corporation X is a defendant in a class action suit for tort liabilities. In 2002, X establishes a trust for the purpose of satisfying the asserted liability and transfers $10,000,000 to the trust. The trust does not satisfy the requirements of section 468B or the regulations thereunder. In 2004, the trustee pays $10,000,000 to the plaintiffs in settlement of the litigation. Under paragraph (e)(2) of this section, economic performance with respect to X's liability to the plaintiffs occurs in 2004. X may deduct the $10,000,000 payment to the plaintiffs in 2004.

* * * * *

(g) *Effective dates*. (1) Except as otherwise provided, this section applies to transfers of money or other property in taxable years beginning after December 31, 1953, and ending after August 16, 1954.

(2) Paragraph (c)(1)(iii)(E) of this section applies to transfers of any stock of the taxpayer or any stock or indebtedness of a person related to the taxpayer on or after November 19, 2003.

(3) Paragraph (e)(2)(i) of this section applies to transfers of money or other property after July 18, 1984.

(4) Paragraph (e)(2)(ii) and paragraph (e)(3) *Example 2* of this section apply to—

(i) Transfers after July 18, 1984, of money or other property to provide for the satisfaction of an asserted workers compensation or tort liability; and

(ii) Transfers in taxable years beginning after December 31, 1991, of money or other property to provide for the satisfaction of asserted liabilities designated in §1.461–4(g) (other than liabilities for workers compensation or tort).

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

Approved July 7, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 19, 2004, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2004, 69 F.R. 43302)

Section 463.—Accrual of Vacation Pay

26 CFR 1.463–1T: Removed.

T.D. 9138

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Transitional Rule for Vested Accrued Vacation Pay

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Removal of temporary regulation.

SUMMARY: This document removes a temporary regulation that provides a rule for an election to deduct vested accrued vacation pay for the first taxable year ending after July 18, 1984. The repeal of the underlying code section in 1987 has rendered the temporary regulation obsolete. The removal of this regulation will not affect taxpayers.

DATES: This Treasury decision is effective on July 15, 2004.

FOR FURTHER INFORMATION CONTACT: Jamie J. Kim at (202) 622–4950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Prior to repeal in 1987, section 463 of the Internal Revenue Code (Code) permitted taxpayers to elect to deduct reasonable additions to a reserve account for vacation pay, including amounts earned by employees before the close of the taxable year that, because of contingencies, would not be deductible under section 162(a) as an accrued expense. In connection with the enactment of the economic performance rules under section 461(h), section 91(i) of the Tax Reform Act of 1984, Public Law 98–369 (98 Stat. 494, 609), provided a transitional rule under which certain taxpayers could make an election under section 463 for the first taxable year ending after July 18, 1984. On February 4, 1986, the IRS and Treasury published temporary regulation §1.463–1T (T.D. 8073, 1986–1 C.B. 45) in the **Federal Register** (51 FR 4312), as amended on April 2, 1986, (51 FR 11302), to provide guidance on making the election under section 463 pursuant to the transitional rule. The repeal of section 463 by section 10201(a) of the Revenue Act of 1987, Public Law 100–203 (101 Stat. 1330–382, 1330–387), has rendered temporary regulation §1.463–1T obsolete.

Special Analyses

It has been determined that the removal of this regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Because this rule merely removes regulatory provisions made obsolete by statute, prior notice and comment and a delayed effective date are unnecessary and contrary to the public interest. 5 U.S.C 553(b)(B) and (d)(3). Because no notice of proposed rulemaking is required, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Drafting Information

The principal author of this Treasury decision is Jamie J. Kim of the Office of Associate Chief Counsel (Income Tax and Accounting), IRS.

* * * * *

Removal of Temporary Regulation

Accordingly, 26 CFR Part 1 is 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 * * *

§1.463–1T [Removed]

Par. 2. Section 1.463–1T is removed.

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

Approved July 7, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 15, 2004, 8:45 a.m., and published in the issue of the Federal Register for July 16, 2004, 69 F.R. 42559)

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

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

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

LIFO; price indexes; department stores. The May 2004 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, May 31, 2004.

Rev. Rul. 2004–81

The following Department Store Inventory Price Indexes for May 2004 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, May 31, 2004.

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	May 2003	May 2004	Percent Change from May 2003 to May 2004[1]
1.	Piece Goods	456.3	483.5	6.0
2.	Domestics and Draperies	557.6	542.2	-2.8
3.	Women's and Children's Shoes	637.0	645.0	1.3
4.	Men's Shoes	855.8	868.4	1.5
5.	Infants' Wear	599.6	575.6	-4.0
6.	Women's Underwear	519.8	512.2	-1.5
7.	Women's Hosiery	349.5	338.2	-3.2
8.	Women's and Girls' Accessories	550.2	567.5	3.1
9.	Women's Outerwear and Girls' Wear	374.5	377.2	0.7
10.	Men's Clothing	562.3	548.4	-2.5
11.	Men's Furnishings	587.2	594.3	1.2
12.	Boys' Clothing and Furnishings	463.5	445.2	-3.9
13.	Jewelry	877.9	905.2	3.1
14.	Notions	789.7	797.5	1.0
15.	Toilet Articles and Drugs	979.7	1001.4	2.2
16.	Furniture and Bedding	620.2	613.8	-1.0
17.	Floor Coverings	578.9	587.9	1.6
18.	Housewares	730.9	714.8	-2.2
19.	Major Appliances	213.7	201.6	-5.7
20.	Radio and Television	45.9	42.4	-7.6
21.	Recreation and Education[2]	83.4	80.8	-3.1
22.	Home Improvements[2]	126.1	129.1	2.4
23.	Automotive Accessories[2]	111.6	112.1	0.4
	Groups 1–15: Soft Goods	568.1	570.1	0.4
	Groups 16–20: Durable Goods	397.1	384.2	-3.2
	Groups 21–23: Misc. Goods[2]	94.7	93.4	-1.4
	Store Total[3]	506.0	503.2	-0.6

[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 Michael Burkom of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkom at (202) 622–7924 (not a toll-free call).

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for August 2004.

Rev. Rul. 2004–84

This revenue ruling provides various prescribed rates for federal income tax purposes for August 2004 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2004–84 TABLE 1

Applicable Federal Rates (AFR) for August 2004

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	2.37%	2.36%	2.35%	2.35%
110% AFR	2.62%	2.60%	2.59%	2.59%
120% AFR	2.85%	2.83%	2.82%	2.81%
130% AFR	3.09%	3.07%	3.06%	3.05%
Mid-Term				
AFR	4.00%	3.96%	3.94%	3.93%
110% AFR	4.41%	4.36%	4.34%	4.32%
120% AFR	4.81%	4.75%	4.72%	4.70%
130% AFR	5.22%	5.15%	5.12%	5.10%
150% AFR	6.03%	5.94%	5.90%	5.87%
175% AFR	7.05%	6.93%	6.87%	6.83%
Long-Term				
AFR	5.21%	5.14%	5.11%	5.09%
110% AFR	5.73%	5.65%	5.61%	5.58%
120% AFR	6.27%	6.17%	6.12%	6.09%
130% AFR	6.79%	6.68%	6.63%	6.59%

REV. RUL. 2004–84 TABLE 2

Adjusted AFR for August 2004

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	1.71%	1.70%	1.70%	1.69%
Mid-term adjusted AFR	3.30%	3.27%	3.26%	3.25%
Long-term adjusted AFR	4.64%	4.59%	4.56%	4.55%

REV. RUL. 2004–84 TABLE 3	
Rates Under Section 382 for August 2004	
Adjusted federal long-term rate for the current month	4.64%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.72%

REV. RUL. 2004–84 TABLE 4	
Appropriate Percentages Under Section 42(b)(2) for August 2004	
Appropriate percentage for the 70% present value low-income housing credit	8.07%
Appropriate percentage for the 30% present value low-income housing credit	3.46%

REV. RUL. 2004–84 TABLE 5	
Rate Under Section 7520 for August 2004	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	4.8%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 1361.—S Corporation Defined

Under what circumstances can an eligible entity request relief for a late S corporation election when the entity also fails to timely file an election to be classified as an association taxable as a corporation? See Rev. Proc. 2004-48, page 172.

Section 1362.—Election; Revocation; Termination

Under what circumstances can an eligible entity request relief for a late S corporation election when the entity also fails to timely file an election to be classified as an association taxable as a corporation? See Rev. Proc. 2004-48, page 172.

Section 2056.—Bequests, etc., to Surviving Spouse

Simplified alternate procedure (in lieu of requesting a letter ruling) for certain executors of estates and trustees of trusts in order to request relief to make a late reverse qualified terminable interest property (QTIP) election under section 2652 of the Code. See Rev. Proc. 2004-47, page 169.

Section 2632.—Special Rules for Allocation of GST Exemption

26 CFR 26.2632–1: Allocation of GST exemption.

Simplified alternate procedure (in lieu of requesting a letter ruling) for certain executors of estates and trustees of trusts in order to request relief to make a late reverse qualified terminable interest property (QTIP) election under section 2652 of the Code. See Rev. Proc. 2004-47, page 169.

Section 2652.—Other Definitions

26 CFR 26.2652–1: Transferor defined; other definitions.
26 CFR 26.2652–2: Special election for qualified terminable interest property.

Simplified alternate procedure (in lieu of requesting a letter ruling) for certain executors of estates and trustees of trusts in order to request relief to make a late reverse qualified terminable interest property (QTIP) election under section 2652 of the Code. See Rev. Proc. 2004-47, page 169.

Section 4051.—Imposition of Tax on Heavy Trucks and Trailers Sold at Retail

26 CFR 145.4051–1: Imposition of tax on heavy trucks and trailers sold at retail.

Retail excise tax; highway tractor; truck. This ruling applies the primarily designed tests in section 145.4051–1(e)(1) and (2) of the regulations under the Highway Revenue Act of 1982 (Pub. L. 97–424) for purposes of determining whether a vehicle is a truck or a highway tractor.

Rev. Rul. 2004–80

ISSUE

Is the vehicle described below a truck or a tractor for purposes of the retail excise tax imposed by § 4051 of the Internal Revenue Code?

FACTS

The vehicle tows trailers and semitrailers (trailers); the trailers exceed 35 feet in length and have a gross vehicle weight (GVW) rating of 20,000 pounds. The vehicle has a standard chassis cab (4-door with crew cab), accommodating five passengers, and is outfitted with certain luxury features. The cab has an electric trailer

brake control that connects to the brakes of a towed trailer and to a hook up for trailer lights. The vehicle has two storage boxes behind the cab that can accommodate incidental items such as small tools and vehicle repair equipment.

The chassis cab has a GVW rating of 23,000 pounds and a gross combination weight (GCW) rating of 43,000 pounds. The vehicle is equipped with hydraulic disc brakes with a four wheel automatic braking system, a 300 horsepower engine, and a six-speed automatic transmission. The front axle of the vehicle has an 8,000 pound rating and the rear axle has a 15,000 pound rating.

The vehicle has three types of hitching devices: a removable ball gooseneck hitch, a fifth wheel hitch, and a heavy duty trailer receiver hitch. The vehicle's platform, which is approximately 139 inches long, is designed with a rectangular well to accommodate the gooseneck and fifth wheel hitches (bed hitches). This platform slopes at the rear of the rectangular well and has tie-down hooks. Optional removable steel stake rails can be placed around the platform.

LAW AND ANALYSIS

Section 4051(a)(1) imposes an excise tax on the first retail sale of automobile truck chassis and bodies, truck trailer and semitrailer chassis and bodies, and tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer. The tax is not limited to commercial vehicles. Thus, a vehicle may be subject to tax even if sold for use or used as a recreational or private tow vehicle rather than for commercial purposes.

Section 145.4051–1(e)(1)(i) of the Temporary Excise Tax Regulations Under the Highway Revenue Act of 1982 (Pub. L. 97–424) defines "tractor" as a highway vehicle primarily designed to tow a vehicle, such as a trailer or semitrailer, but does not carry cargo on the same chassis as the engine. A vehicle equipped with air brakes and/or towing package will be presumed to be primarily designed as a tractor.

Section 145.4051–1(e)(2) defines "truck" as a highway vehicle that is primarily designed to transport its load on the same chassis as the engine even if it is also equipped to tow a vehicle, such as a trailer or semitrailer.

"Primarily" means "principally" or "of first importance." See *Malat v. Riddle*, 383 U.S. 569 (1966), 1966–1 C.B. 184. "Primarily" does not mean "exclusive." See Rev. Rul. 77–36, 1977–1 C.B. 347. Therefore, in the context of the primarily designed test, the reference in § 145.4051–1(e)(1)(i) to vehicles not carrying cargo on the same chassis as the engine does not require an absolute inability to carry any cargo on the vehicle's chassis. This limitation may be satisfied even if the vehicle can carry incidental items of cargo when towing a trailer or semitrailer or is capable of carrying limited amounts of cargo when not engaged in its primary function of towing a trailer or semitrailer.

Under the primarily designed test, a vehicle that can both carry cargo on its chassis and tow a trailer is characterized as either a truck or tractor depending on which function is of greater importance. The function for which a vehicle is primarily designed is evidenced by physical characteristics such as the vehicle's capacity to tow a vehicle, carry cargo, and operate (including brake) safely when towing or carrying a cargo. Cargo carrying capacity depends on the vehicle's GVW rating and the configuration of the vehicle's bed or platform. Towing capacity depends on the vehicle's GVW and GCW ratings and whether the vehicle is configured to tow a trailer or semitrailer.

Some characteristics of the vehicle such as its chassis cab with a GVW rating of 23,000 pounds, a 300 horsepower engine, a front axle with an 8,000 pound rating, and a rear axle with a 15,000 pound rating are consistent with either a cargo carrying or a towing function. In this case, however, the vehicle also has a GCW rating of 43,000 pounds and its engine, brakes, transmission, axle ratings, electric trailer brake control, trailer hook up lights, and hitches enable it to tow a 20,000 pound trailer that may exceed 35 feet in length.

When the vehicle's bed hitches are used to tow, the cargo carrying capacity of the vehicle is limited to the storage boxes behind the cab and is minimal in comparison to the GVW of the towed trailer or semitrailer. Neither the steel stake bed rails nor the tie down hooks significantly increase cargo carrying capacity when either of the bed hitches is used. Even if neither of the vehicle's two bed hitches is used, the design of the vehicle significantly reduces its cargo carrying capacity when compared to the cargo carrying capacity of a pickup truck body or a flatbed truck body installed on a comparable chassis. The significant reduction in cargo carrying capacity resulting from the vehicle's platform with its rectangular well and sloping platform at the rear of the rectangular well is evidence that the vehicle is not primarily designed to carry cargo. By accommodating the bed hitches, however, this platform configuration increases the vehicle's towing capacity and, in conjunction with the other features described above, makes it possible to safely tow a 20,000 pound trailer.

The vehicle's physical characteristics, which maximize towing capacity at the expense of carrying capacity, establish that the vehicle is primarily designed to tow a vehicle, such as a trailer or semitrailer, rather than to carry cargo on its chassis.

HOLDING

The vehicle is a tractor for purposes of § 4051.

DRAFTING INFORMATION

The principal author of this revenue ruling is Celia Gabrysh of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Celia Gabrysh at (202) 622–3130 (not a toll-free call).

Section 6321.—Definitions and Special Rules

26 CFR 301.6231(a)–1(a)(2): Pass-thru partner disqualifies a partnership from the "small partnership" exception to the unified audit and litigation procedures of I.R.C. §§ 6221 through 6234.
Also, § 301.6231(a)(7)–1(b); 301.7701–1; 301.7701–3.

TEFRA partnership; disregarded entity; pass-thru partner; tax matter partner. This ruling addresses whether a disregarded entity partner will disqualify a partnership from being a "small partnership" excluded from the TEFRA partnership provisions. The ruling also addresses whether a disregarded entity may be designated as the tax matters partner of a partnership.

Rev. Rul. 2004–88

ISSUE

1. Is a partnership that has a disregarded entity as a partner considered a "small partnership" that is excluded from the unified partnership audit and litigation procedures set forth in I.R.C. §§ 6221 through 6234 (the TEFRA partnership provisions)?

2. May a disregarded entity be designated the tax matters partner (TMP) of a partnership subject to the TEFRA partnership provisions?

FACTS

P is a limited partnership with one general partner and four limited partners. The sole general partner is a Limited Liability Company (LLC) that is treated as a disregarded entity under section 301.7701–3(b)(1)(ii). LLC is owned by A, an individual who is not a nonresident alien. The four limited partners in P are individuals who are not nonresident aliens. On its partnership return for the 2002 taxable year, P designates LLC as its TMP.

LAW AND ANALYSIS

Issue 1

Section 6231(a)(3) defines a partnership item as any item required to be taken into account for the partnership's taxable year under subtitle A, to the extent regulations provide that the item is more appropriately determined at the partnership level than at the partner level. Under section 6221, the tax treatment of any partnership item shall be determined at the partnership level under the TEFRA partnership provisions. As a general rule, the TEFRA partnership provisions apply to any partnership required to file a return of partnership income under section 6031. Section 6231(a)(1)(A). The TEFRA partnership provisions do not apply to a partnership that qualifies as a small partnership under section 6231(a)(1)(B) unless the partnership elects to apply those provisions. For partnership taxable years ending after August 5, 1997, section 6231(a)(1)(B) defines a small partnership as a partnership in which there are ten or fewer partners, each of whom is an individual (other than a nonresident alien), an estate of a deceased partner, or a C corporation.

Section 6231(a)(2) defines a "partner" as including both a partner in the partnership and any other person whose income tax liability under subtitle A is determined in whole or in part by taking into account directly or indirectly partnership items of the partnership.

Section 301.6231(a)(1)–1(a)(2) provides that the small partnership exception does not apply if any partner during the taxable year is a "pass-thru partner" as defined in section 6231(a)(9). A "pass-thru partner" is defined in section 6231(a)(9) as "a partnership, estate, trust, S corporation, *nominee or other similar person through whom other persons hold an interest in the partnership*. . . ." (Emphasis added). If legal title to a partnership interest is held in the name of a person other than the ultimate owner, the holder of legal title is considered a pass-thru partner within the meaning of section 6231(a)(9). *Compare White v. Commissioner*, T.C. Memo. 1991–552 (custodian for minor children was not a pass-thru partner because, under state Gift to Minors Act, the children held legal title to partnership interests rather than custodian; small partnership exception applicable) *with Primco Management Co. v. Commissioner*, *T.C. Memo. 1997–332* (grantor trust holding legal title to an interest in an S corporation was a "pass-thru shareholder"; small S corporation exception under the parallel provisions of section 301.6241–1T(c)(2)(iii) inapplicable).

Section 6231(a)(10) defines an indirect partner as a person holding an interest in a partnership through one or more pass-thru partners.

Section 301.7701–3(a) provides rules for the classification of certain business entities for federal tax purposes. A business entity that is not classified as a corporation is a "domestic eligible entity" and, in the absence of an election, the domestic eligible entity is "[d]isregarded as an entity separate from its owner if it has a single owner." Section 301.7701–3(b)(1)(ii). If the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner. Section 301.7701–2(a).

Under the facts of this ruling, although LLC is a disregarded entity for federal tax purposes, LLC is a partner of P under the law of the state in which P is organized. Similarly, although A, LLC's owner, is a partner of P for purposes of the TEFRA partnership provisions under section 6231(a)(2)(B) because A's income tax liability is determined by taking into account indirectly the partnership items of P, A is not a partner of P under state law. Because A holds an interest in P through LLC, A is an indirect partner and LLC, the disregarded entity, is a pass-thru partner under the TEFRA partnership provisions. Consequently, the small partnership exception does not apply to P because P has a partner that is a pass-thru partner.

Issue 2

Section 6231(a)(7) provides that the TMP of any partnership is (A) the general partner designated as the tax matters partner, or (B) if there is no general partner who has been so designated, the general partner having the largest profits interest in the partnership. If no general partner has been designated as the TMP and the Secretary determines that it is impracticable to apply the largest profits interest rule, the partner selected by the Secretary shall be treated as the tax matters partner.

Section 301.6231(a)(7)–1(b) provides that the partnership may designate a person as the TMP of a partnership if that person (i) was a general partner in the partnership at some time during the taxable year for which the designation is made, or (ii) is a general partner in the partnership at the time the designation is made. A partnership may designate only a general partner as the TMP because only a general partner is authorized to bind the partnership. A partner's status as a general partner is determined under state law for this purpose. *Transpac Drilling Venture, 1983–63 v. United States*, 26 Cl. Ct. 1245, 1247 (1992).

Although the regulations under sections 301.7701–1 through 301.7701–3 provide that a disregarded entity is disregarded for all federal tax purposes, these regulations do not alter state law, which determines a partner's status as a general partner.

Under the facts of this ruling, A, LLC's owner, does not become a general partner under state law by operation of sections 301.7701–1 through 301.7701–3. Although LLC is a disregarded entity for federal tax purposes, LLC remains a part-

ner in P and is the sole general partner authorized to bind the partnership under state law. A has no power to bind other partners as a general partner under state law. Accordingly, A cannot step into the shoes of LLC, the disregarded entity, as the TMP. *See Transpac Drilling Venture, 1983–63*, 26 Cl. Ct. at 1248 (limited partner could not be the TMP because limited partner was not a general partner under Delaware law). *See also Montana Sapphire Associates, Ltd. v. Commissioner*, 95 T.C. 477, 481 (1990) (partnership could not designate a person who was not a member of the partnership as the TMP). Thus, only LLC, the disregarded entity, is eligible to be designated by P as its TMP or to become the TMP under the largest profits interest rule.

HOLDINGS

1. LLC, a disregarded entity for federal tax purposes, is a pass-thru partner under section 6231(a)(9). Consequently, because P has a pass-thru partner, LLC, as a partner, the small partnership exception to the TEFRA partnership provisions does not apply to the partnership.

2. LLC, a disregarded entity for federal tax purposes, but a general partner of P under state law, may be designated the TMP of P, a partnership subject to the TEFRA partnership provisions.

DRAFTING INFORMATION

The principal author of this revenue ruling is William Heard of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact Mr. Heard at (202) 622–7950 (not a toll-free call).

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Section 7701.—Definitions

26 CFR 301.7701–1: Classification of organizations for federal tax purposes.
26 CFR 301.7701–2: Business entities; definitions.
26 CFR 301.7701–3: Classification of business entities.

Under what circumstances can an eligible entity request relief for a late S corporation election when the entity also fails to timely file an election to be classified as an association taxable as a corporation? See Rev. Proc. 2004-48, page 172.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2004. See Rev. Rul. 2004-84, page 163.

Part III. Administrative, Procedural, and Miscellaneous

Request for Information About Credit Default Swaps

Notice 2004–52

I. PURPOSE

This notice requests further information regarding certain financial transactions commonly known as credit default swaps in connection with the consideration by Treasury and the IRS of taxpayer requests for specific guidance on the tax treatment of credit default swaps.

II. BACKGROUND

A credit default swap (CDS) generally refers to a contractual arrangement in which one party (the protection buyer) buys from a counterparty (the protection seller) protection against default by a particular obligor (the reference entity) with respect to a particular obligation (the reference obligation). Typically the protection buyer either pays a single lump sum, or it pays periodical regular fees either until a defined credit event occurs or until the maturity of the CDS if no credit event occurs. Following the occurrence of a credit event, the protection seller typically either pays the protection buyer an amount reflecting the reference obligation's loss in value from the date the CDS was established or purchases from the protection buyer at a pre-determined price an obligation (the deliverable obligation) that is expected to approximate the post-credit-event value of the reference obligation. Although certain standard contractual terms and conditions may be used, the reference obligation, the deliverable obligation, the credit events covered, and the protection seller's obligation upon the occurrence of a credit event are all matters of negotiation between the parties.

A large international market for CDSs has developed. Market participants include commercial banks, broker-dealers, insurance companies, hedge funds, and special-purpose securitization vehicles such as synthetic collateralized debt obligations. Commercial banks may buy protection in order to manage credit risk associated with a particular loan and may sell protection in order to acquire synthetic exposure to other loans. Broker-dealers may buy and sell protection in the course of providing market liquidity. Insurance companies may buy and sell protection both in the conduct of their investment activities and in the conduct of their insurance activities. Hedge funds may buy and sell protection in order to manage risk, speculate, or acquire synthetic exposure. Securitization vehicles may sell protection in order to acquire synthetic exposure.

Recent news reports suggest that market participants are considering the creation of CDS indexes through which participants could buy and sell protection on a defined basket of credit exposures on standardized terms.

Several market participants have requested specific guidance regarding the tax treatment of CDSs. Treasury and the IRS recognize the significance of the CDS market and are aware that the market is rapidly evolving. Treasury and the IRS believe that CDSs deserve careful study so that appropriate guidance can be issued.

III. TAXPAYER REQUESTS FOR GUIDANCE

Several taxpayers and industry groups have requested guidance on the tax treatment of CDSs and the taxpayers that enter into them. Among the questions they have raised are:

- whether amounts paid by a U.S. protection buyer to a foreign protection seller constitute income that is subject neither to withholding nor to the insurance-premium excise tax;
- whether a protection seller could be considered to be engaged in a trade or business within the United States by virtue of entering into CDS agreements;
- whether a CDS gives rise to:
  - passive income for purposes of the passive foreign investment company rules;
  - qualifying income for purposes of the publicly traded partnership rules; or
  - unrelated business taxable income; and
- the timing of recognition of income for the protection seller and expense for the protection buyer.

The concerns raised relate particularly, although not exclusively, to the treatment of payments from a protection buyer within the United States to a protection seller outside the United States. In response to these taxpayer requests, Treasury and the IRS are thoroughly analyzing all of the tax issues raised by CDSs and expect to issue guidance.

Submissions generally have argued that the legal rights and obligations under a CDS are sufficiently analogous to those in other types of existing financial transaction that the tax treatment of the analogous transactions should govern the tax treatment of a CDS for all purposes of the Code. See, *e.g.*, *Bank of America v. United States*, 680 F.2d 142, 149–50 (Ct. Cl. 1982) (commissions for bankers' acceptances sourced for foreign tax credit purposes in same manner as interest because predominant feature of acceptance is substitution of credit and because interest is closest analogy in source rules).

Some possible analogies for a CDS include a derivative financial instrument such as a contingent option or notional principal contract, a financial guarantee or standby letter of credit, and an insurance contract. A variety of theories have been advanced in the existing literature both for and against these analogies. Other commentary recommends an alternative to the analogue approach. Following is a brief survey of some of the theories that have been advanced.

A CDS has been analogized to a contingent put option that the option buyer is entitled to settle either for cash value or by physical exercise with respect to the deliverable obligation following the occurrence of a credit event. Option premium generally is not subject to withholding. Trading in such options may not give rise to a "trade or business within the United States" pursuant to the securities-trading safe harbor under section 864(b).

A CDS has been analogized to certain notional principal contracts providing for

contingent nonperiodic payments. Some commentators have argued that CDSs with periodic payments, among other features, meet the definition of a notional principal contract; however, commentators disagree about the scope of CDSs that may fall within the definition of notional principal contract. Payments with respect to a notional principal contract generally are not subject to withholding. Trading in such notional principal contracts may not give rise to a trade or business within the United States. Special timing rules may apply to notional principal contracts.

A CDS has been analogized to a guarantee. Guarantee fees have been analogized to commissions for letters of credit, which are sourced in the same manner as interest. See *Centel Communications Co. v. Commissioner*, 920 F.2d 1335, 1343–1344 (7th Cir. 1990) (citing *Bank of America*). In addition, guaranteeing obligations and issuing standby letters of credit from within the United States could constitute engaging in a trade or business within the United States. Some commentators have distinguished CDSs from guarantees on the basis that a credit event under a CDS requires performance by the protection seller without regard to whether the protection buyer sustains an actual loss. A relevant factor in this regard may be how much of the CDS protection-buying market consists of persons who do not have or expect to be exposed to credit risk.

A CDS has been analogized to a form of insurance. Insurance premiums paid to a foreign person with respect to a U.S. risk are subject to excise tax. Moreover, insuring risks from within the United States could constitute engaging in a trade or business within the United States. Some commentators have distinguished CDSs from insurance on the basis, as described above, that no actual loss need be sustained in order to give rise to an obligation under a CDS. Some commentators have noted the Supreme Court's opinion in *Helvering v. LeGierse*, 312 U.S. 531 (1941), that the essence of insurance activity is the shifting and distribution of insurance risk. These commentators have suggested that many protection sellers do not shift or distribute risk with respect to CDSs in this way, and that it is not clear how a protection buyer could know how its counterparty manages risk with respect to a particular CDS.

Some commentators have suggested consideration of an approach to determine the tax treatment of CDSs other than classification by analogy to other types of financial transaction. Instead, they have proposed that the tax treatment of payments with respect to a CDS could be determined by analyzing various elements of the CDS transaction, including the nature of the reference obligation and whether a party to the CDS provides financial services to customers.

IV. REQUEST FOR COMMENTS

The foregoing brief overview indicates that the economic similarity of a CDS to various financial transactions tends to blur the distinctions between possible analogies and that the various analogies correspond to significantly different tax treatment.

Treasury and the IRS believe that additional information is needed in order to respond to taxpayer requests for specific guidance regarding the appropriate tax treatment of amounts paid and received with respect to a CDS. Treasury and the IRS are particularly interested in information regarding:

- CDS contractual terms, both standard and negotiated, particularly with respect to credit events, subrogation rights, security interests in collateral, and collateralization requirements in general;
- CDS pricing, particularly with respect to guarantees, contingent options, and insurance;
- operation of the CDS market, particularly with respect to price quotation and dissemination;
- market practice regarding hedging, the management of basis risk, and the timing of CDS transactions relative to the assumption and disposition of analogous risks; and
- the regulatory capital, GAAP, and internal booking treatment of CDSs by various market participants.

Treasury and the IRS also welcome any other information that market participants believe may be relevant.

V. SUBMISSION OF COMMENTS

Taxpayers may submit written comments to: CC:PA:LPD:PR (Notice 2004–52), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2004–52), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by submitting comments electronically via the following e-mail address: *Notice.Comments@irscounsel.treas.gov*. Please include: Notice 2004–52 in the subject line of any electronic communications.

DRAFTING INFORMATION

The principal authors of this notice are Paul Epstein, Theodore Setzer, and Steven Jensen of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Epstein, Mr. Setzer, or Mr. Jensen at (202) 622–3870 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters. (Also, Part I, §§ 2056, 2652; 26.2632–1, 26.2652–1, 26.2652–2, 301.9100–3.)

Rev. Proc. 2004–47

SECTION 1. PURPOSE

This revenue procedure provides a simplified alternate method for certain executors of estates and trustees of trusts to request relief to make a late reverse qualified terminable interest property (QTIP) election under § 2652 of the Internal Revenue Code. This alternate method may be used in lieu of the normal letter ruling process. No user fee is charged for requests filed under this revenue procedure.

SECTION 2. BACKGROUND

.01 Under § 2001(a), the estate tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States. Section 2056(a) provides that for purposes of § 2001, the value of the taxable estate

shall, except as limited by § 2056(b), be determined by deducting from the value of the gross estate the value of any interest in property that passes or has passed from the decedent to the decedent's surviving spouse. Section 2056(b) generally provides that no deduction is allowed for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail. Section 2056(b)(7) provides an exception for property meeting the QTIP requirements in § 2056(b)(7)(B).

.02 Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" as property: (1) that passes from the decedent; (2) in which the surviving spouse has a qualifying income interest for life; and (3) to which an election under § 2056(b)(7) applies. Property for which a QTIP election is made is treated as passing to the surviving spouse for purposes of determining the decedent's taxable estate. The value of any property that was deducted under § 2056(b)(7) from the decedent's gross estate and that remains on the surviving spouse's death will be included in the surviving spouse's gross estate under § 2044. If the surviving spouse makes a lifetime disposition of all or a portion of the qualifying income interest, § 2519 provides that the surviving spouse is treated for estate and gift tax purposes as transferring all interests in the property other than the qualifying income interest. Furthermore, the transfer of the qualifying income interest is subject to the gift tax under § 2511 and § 25.2511–2.

.03 Chapter 13 imposes a generation-skipping transfer (GST) tax on all transfers, whether made directly or indirectly, to skip persons. Under § 2613(a), a skip person is a person who is two or more generations younger than the transferor or is a trust if all of the interests are held by skip persons. Under § 2652, the transferor generally is the individual who transfers property in a transaction subject to the federal gift or estate tax. Under § 2611(a), transfers that are subject to the GST tax include direct skips, taxable distributions, and taxable terminations.

.04 Section 2631 allows every transferor a GST tax exemption of $1,000,000 that may be allocated by the individual (or the individual's executor) to any property with respect to which the individual is the transferor. For calendar years after 1998, this exemption amount has been indexed for inflation. For transfers made between January 1, 2004, and December 31, 2009 (inclusive), the GST exemption will equal the amount that is exempted from transfer tax by the applicable credit amount described in § 2010. With respect to transfers made at death, the allocation of a decedent's GST tax exemption is made on the decedent's Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*. A decedent's unused GST tax exemption is automatically allocated on the due date for filing the decedent's Form 706 to the extent not otherwise allocated by the decedent's executor on or before that date.

.05 Section 2632(e) and § 26.2632–1(d)(2) of the Generation-Skipping Transfer Tax Regulations supply the method for the automatic allocation of any unused GST tax exemption. The exemption is first allocated *pro rata* to direct skips treated as occurring on death on the basis of the value of property as finally determined for federal estate tax purposes. The balance, if any, is then allocated *pro rata*, on the basis of estate tax value, to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. In the case of trusts that are not included in the gross estate, the GST tax exemption is allocated on the basis of the date of death value of the trust. No automatic allocation is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the trust. The automatic allocation of GST tax exemption is irrevocable.

.06 With respect to QTIP, the decedent's surviving spouse will become the new transferor with respect to the entire trust before the occurrence of any GST from the trust. Accordingly, a decedent's GST tax exemption is not automatically allocated to property for which a QTIP election was made. Section 2652(a)(3) provides, however, that if an election is made to treat property as QTIP under § 2056(b)(7), the person making the election may, for purposes of chapter 13, elect to treat the property as if the QTIP election had not been made (reverse QTIP election). As a result of the reverse QTIP election, the decedent remains, for GST tax purposes, the transferor of the QTIP trust or property. The decedent's GST tax exemption, accordingly, may be allocated to the QTIP trust or property, either by an affirmative allocation or by the automatic allocation of the decedent's remaining GST tax exemption. The reverse QTIP election is made on the same return on which the QTIP election is made.

.07 To date, the Internal Revenue Service has issued several private letter rulings providing relief to taxpayers who failed to make a reverse QTIP election on a timely filed Form 706 and who have satisfied the requirements of § 301.9100–3 of the Procedure and Administration Regulations. Section 301.9100–3(a) generally provides that requests for extensions of time for regulatory elections will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the Government.

SECTION 3. SCOPE

.01 *In General*. Except as otherwise provided in sections 3.02 and 3.03 of this revenue procedure, the alternate simplified procedure authorized in this revenue procedure for obtaining permission to file a late reverse QTIP election is available if the requirements of sections 4.02 and 4.03 of this revenue procedure are met.

.02 *Certain Late Reverse QTIP Elections*. This revenue procedure does not apply to intervivos transfers to or for the benefit of a spouse, or to transfers to or for the benefit of a non-citizen spouse in the form of a qualified domestic trust. Relief under this revenue procedure does not include or grant permission to make a late severance of a trust included in the gross estate or to allocate GST exemption. Accordingly, permission to file a late reverse QTIP election in conjunction with a late severance or an allocation of GST exemption must be requested through the letter ruling process as described in section 3.03 of this revenue procedure.

.03 *Failure to Qualify for Relief Under This Revenue Procedure*. An executor who is denied relief or is otherwise outside the scope of this revenue procedure may request relief under § 301.9100–3 by requesting a letter ruling. The procedural

requirements for requesting a letter ruling are described in Rev. Proc. 2004–1, 2004–1 I.R.B. 1 (or its successor). If a letter ruling is requested after relief has been denied under this revenue procedure, the letter ruling request must indicate that relief was requested and denied under this revenue procedure. Rev. Proc. 2004–1, Appendix C, 2004–1 I.R.B. 1, 70.

SECTION 4. RELIEF FOR UNTIMELY REVERSE QTIP ELECTIONS

.01 *Definitions*.

(1) *Executor*. Solely for purposes of this revenue procedure, the term executor includes: an executor of an estate as defined in § 2203 and §§ 20.2203–1 and § 20.2056(b)–7(b)(3) of the Estate Tax Regulations; the trustee of the QTIP trust; or any other person in actual or constructive possession of the property, for which the reverse QTIP election will be made.

(2) *Decedent*. For purposes of this revenue procedure, the term decedent refers to the individual for whose estate the reverse QTIP election was not timely made.

(3) *Reverse QTIP Election*. For purposes of this revenue procedure, a reverse QTIP election refers to the affirmative indication on Schedule R of Form 706 by the executor to treat the decedent as the transferor for GST purposes of the QTIP trust or property to which the election pertains. As a result of this election, the decedent's GST tax exemption may be allocated to the QTIP trust or property. This is the case even though the surviving spouse or the surviving spouse's estate will be subject to the gift or estate tax with respect to the property before the property passes to a skip person.

(4) *Due Date of the Reverse QTIP Election*. Section 26.2652–2(b) provides that the reverse QTIP election is made on the return on which the QTIP election is made. Section 20.2056(b)–7(b)(4)(i) provides that the QTIP election under § 2056(b)(7) must be made on the last estate tax return filed by the executor on or before the due date of the return, including extensions (if any). If a timely return is not filed, the election must be made on the first estate tax return filed by the executor after the due date. Estate tax returns must be filed within 9 months after the date of the decedent's death, not including extensions.

.02 *Eligibility for Relief*. Relief is available under section 4.02 of this revenue procedure if, on the date of the filing of the request described in 4.03 of this revenue procedure, the following requirements are met:

(1) A valid QTIP election under § 2056(b)(7) was made for the property or trust on the federal estate tax return filed for the decedent's estate;

(2) The reverse QTIP election was not made on the estate tax return as filed because the taxpayer relied on the advice and counsel of a qualified tax professional and that qualified tax professional failed to advise the taxpayer of the need, advisability, or proper method to make a reverse QTIP election;

(3) The decedent has a sufficient amount of unused GST exemption, after the automatic allocation of the GST exemption under § 2632(e) and § 26.2632–1(d)(2), to result in a zero-inclusion ratio for the reverse QTIP trust or property;

(4) The estate is not eligible under § 301.9100–2(b) for an automatic 6-month extension;

(5) The surviving spouse has not made a lifetime disposition of all or any part of the qualifying income interest for life in the QTIP trust or property;

(6) The surviving spouse is alive or no more than 6 months have passed since the death of the surviving spouse; and

(7) Relief is requested by the executor in accordance with section 4.03 of this revenue procedure.

.03 *Procedural Requirements for Relief*.

(1) The estate must file with the Internal Revenue Service a request for an extension of time to make a reverse QTIP election. The request should have a cover sheet requesting relief that states at the top of the document "REQUEST FOR EXTENSION FILED PURSUANT TO REV. PROC. 2004–47." The following items must be attached to the request for relief:

(a) Copies of Parts 1 through 5 and Schedule M of the original estate tax return filed with the Service;

(b) A properly completed Schedule R as required to make the reverse QTIP election;

(c) A statement describing why the reverse QTIP election was not made on the estate tax return as filed;

(d) A statement affirming that all of the requirements in section 4.02 of this revenue procedure have been met;

(e) A dated declaration, signed by the executor of the estate (as defined above), that states: "Under penalties of perjury, I declare that, to the best of my knowledge and belief, the facts presented in support of this election are true, correct, and complete. In addition, all attachments provided in support of this request for relief are true and correct copies of the original documents."; and

(f) A signed statement from the qualified tax professional on whom the taxpayer relied when preparing the original estate tax return. The statement should establish the tax professional's qualifications as a qualified tax professional and must include a dated declaration that states: "Under penalties of perjury, I declare that, to the best of my knowledge and belief, the facts presented in support of this request for relief are true, correct, and complete."

(2) Subject to any contrary instructions in future forms, instructions, or guidance published by the Service, the request should be sent to the Cincinnati Service Center for processing.

(a) If a private delivery service is used, the request should be sent to:

Internal Revenue Service Center
201 W. Rivercenter Blvd.
Covington, KY 41012;

(b) If a private delivery service is not used, the request should be sent to:

Internal Revenue Service Center
Cincinnati, OH 45999.

.04 *Relief for Late Reverse QTIP Election*. Upon receipt of a request for relief under section 4.03 of this revenue procedure, the Service Center will determine whether the requirements for granting additional time to file the reverse QTIP election under this revenue procedure have been satisfied and will notify the executor of the result of this determination.

.05 *Effect of Relief*. An extension of time to make the reverse QTIP election under § 2652(a)(3) does not extend the time to make an allocation of any remaining GST exemption. However, once the election is made, the decedent remains, for GST tax purposes, the transferor of the

QTIP trust or property. As a result, the decedent's remaining GST tax exemption will be automatically allocated pursuant to § 2632(e) and § 26.2632–1(d)(2) to the QTIP trust or property for which the reverse QTIP election was made, based on the value of the trust or property as finally determined for federal estate tax purposes. The relief provided by this revenue procedure does not include or grant permission to allocate retroactively the decedent's remaining GST exemption or to make a late severance of a trust included in the gross estate.

SECTION 5. EFFECTIVE DATE

.01 *In General*. This revenue procedure is effective August 9, 2004.

.02 *Transition Rule for Pending Letter Ruling Requests*. If an executor has filed a request for a letter ruling seeking relief to file a reverse QTIP election under § 301.9100–3 and that letter ruling request is pending in the national office on August 9, 2004, the executor may withdraw the letter ruling request and receive a refund of its user fee if prior to September 23, 2004, the executor notifies the national office that it will withdraw the letter ruling request. If the executor does not so notify the national office by September 23, 2004, the national office will process letter ruling requests pending on August 9, 2004, and will retain the user fee paid.

SECTION 6. 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 1545–1898.

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 in this revenue procedure is in section 4. This information is required to be submitted to the applicable service center in order to obtain an extension of time to make a late reverse QTIP election. This information will be used to determine whether the eligibility requirements for obtaining relief have been met. The collection of information is required to obtain a benefit. The likely respondents are estates and trusts.

The estimated total annual reporting burden is 54 hours.

The estimated average annual burden per respondent is 9 hours to complete the statements required under this revenue procedure. The estimated number of respondents is 6.

There is no estimated annual frequency of responses as the reverse QTIP election is a one-time election.

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 DeAnn K. Malone of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact DeAnn K. Malone at (202) 622–7830 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement.
(Also §§ 1361, 1362; 301.7701–1, 301.7701–2, 301.7701–3, 301.9100–1, 301.9100–3.)

Rev. Proc. 2004–48

SECTION 1. PURPOSE

This revenue procedure provides a simplified method for taxpayers to request relief for a late S corporation election and a late corporate classification election which was intended to be effective on the same date that the S corporation election was intended to be effective. Generally, this revenue procedure provides that certain eligible entities may be granted relief if the entity satisfies the requirements of section 4 of this revenue procedure.

SECTION 2. BACKGROUND

.01 *S Corporation Elections.*

(1) *In general*. Section 1361(a)(1) of the Internal Revenue Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for that year.

Section 1362(b)(1) provides that a corporation may make an election to be treated as an S corporation for any taxable year (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before the 15th day of the 3rd month of the taxable year.

Section 1362(b)(3) provides that if (A) a small business corporation makes an election under § 1362(a) for any taxable year, and (B) the election is made after the 15th day of the 3rd month of the taxable year and on or before the 15th day of the 3rd month of the following taxable year, then the election shall be treated as made for the following taxable year.

(2) *Late S corporation elections*. Section 1362(b)(5) provides that if (A) an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)) after the date prescribed by § 1362(b) for making the election for the taxable year or no election is made for any taxable year, and (B) the Secretary determines that there was reasonable cause for the failure to timely make the election, the Secretary may treat the election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

.02 *Entity Classification Elections*.

(1) *In general*. Section 301.7701–2(a) of the Procedure and Administration Regulations defines a "business entity" as any entity recognized for federal tax purposes that is not properly classified as a trust under § 301.7701–4 or otherwise subject to special treatment under the Code.

Section 301.7701–3(a) provides that a business entity that is not classified as a corporation under § 301.7701–2(b)(1), (3), (4), (5), (6), (7), or (8) (an "eligible entity") can elect its classification for federal tax purposes as provided in this section.

Section 301.7701–3(b)(1) provides that, except as otherwise provided in paragraph (b)(3) of that section, unless the entity elects otherwise, a domestic eligible entity is (i) a partnership if it has two or more members; or (ii) disregarded as an entity separate from its owner if it has a single owner.

Section 301.7701–3(c)(1) provides that an eligible entity may elect to be classified other than as provided in § 301.7701–3(b)

by filing Form 8832, *Entity Classification Election*, with the service center designated on Form 8832.

Section 301.7701–3(c)(iii) provides that the entity classification election will be effective on the date specified by the entity on the Form 8832 or on the date filed if no date is specified on the election form. The effective date specified on Form 8832 cannot be more than 75 days before or more than 12 months after the date the election is filed. If an election specifies a date more than 75 days prior to the date it was filed, the election will be effective 75 days prior to the date it was filed. If an election specifies a date more than 12 months after the date it was filed, the election will be effective 12 months after it is filed.

(2) *Late Entity Classification Elections*. Under § 301.9100–1(c) the Commissioner may grant a reasonable extension of time under the rules set forth in § 301.9100–2 and 301.9100–3 to make a regulatory election, or a statutory election (but no more than six months except in the case of a taxpayer who is abroad), under all subtitles of the Code, except subtitles E, G, H, and I.

Section 301.9100–1(b) defines the term "regulatory election" as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

Section 301.9100–3 provides that requests for relief under that section will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the Government.

Rev. Proc. 2002–59, 2002–2 C.B. 615, provides relief for an entity newly formed under local law that requests relief for a late initial classification election filed by the due date of the entity's first federal income tax return (excluding extensions).

Rev. Proc. 2003–43, 2003–1 C.B. 998 provides a simplified method for taxpayers to request relief for late S corporation elections where the entity fails to qualify as an S corporation solely because of the failure to file the election timely with the applicable service center. Under the revenue procedure, certain eligible entities may be granted relief for failing to file these elections in a timely manner if the request for relief is filed within 24 months of the due date of the election.

Under § 301.7701–3T(c)(1)(v)(C), an eligible entity that timely elects to be an S corporation under section 1362(a)(1) is treated as also having made an election to be classified as an association, provided that (as of the effective date of the election under section 1362(a)(1)) the entity meets all other requirements to qualify as a small business corporation under section 1361(b). Section 301.7701–3T(c)(1)(v)(C) further provides that the deemed election to be classified as an association generally is effective as of the effective date of the S corporation election and will remain in effect until the entity makes another entity classification election under § 301.7701–3(c)(1)(i).

SECTION 3. SCOPE

.01 *In General*. An eligible entity that seeks to be classified as a subchapter S corporation must elect to be classified as an association under § 301.7701–3(c)(1)(i) by filing Form 8832 and must elect to be an S corporation under § 1362(a) by filing Form 2553, *Election by a Small Business Corporation*. In many situations, an entity may timely file Form 2553 but fail to file the Form 8832. Section 301.7701–3T(c)(1)(v)(C) applies to these situations and deems an eligible entity that timely files a Form 2553 to also have filed a Form 8832. In other situations, an eligible entity fails to file a timely Form 2553. In these situations, § 301.7701–3T(c)(1)(v)(C) does not apply and the entity would be required to obtain relief in a letter ruling. This revenue procedure provides a simplified method for requesting relief for those situations not covered by § 301.7701–3T, provided that the requirements of sections 4.01 and 4.02 of this revenue procedure are satisfied. The method provided in this revenue procedure is in lieu of the letter ruling process ordinarily used to obtain relief for late elections under §§ 1362(b)(5), 301.9100–1, and 301.9100–3. Accordingly, user fees do not apply to corrective action under this revenue procedure.

.02 *Relief if this Revenue Procedure is not Applicable*. An entity that does not meet the requirements for relief or is denied relief under this revenue procedure may seek relief by requesting a letter ruling. The procedural requirements for requesting a letter ruling are described in Rev. Proc. 2004–1, 2004–1 I.R.B. 1, or its successors.

SECTION 4. RELIEF FOR LATE S CORPORATION ELECTION AND LATE CORPORATE CLASSIFICATION ELECTION

.01 *Eligibility for Relief*. An entity may request relief under this revenue procedure if the following requirements are met:

(1) The entity is an eligible entity as defined in § 301.7701–3(a);

(2) The entity intended to be classified as a corporation as of the intended effective date of the S corporation status;

(3) The entity fails to qualify as a corporation solely because Form 8832 was not timely filed under § 301.7701–3(c)(1)(i), or Form 8832 was not deemed to have been filed under § 301.7701–3T(c)(1)(v)(C);

(4) In addition to section 4.01(3) of this section, the entity fails to qualify as an S corporation on the intended effective date of the S corporation status solely because the S corporation election was not filed timely pursuant to § 1362(b); and

(5) The entity has reasonable cause for its failure to file timely the S corporation election and the entity classification election.

.02 *Procedural Requirements for Relief*. Within 6 months after the due date for the tax return, excluding extensions, for the first year the entity intended to be an S corporation), the corporation must file a properly completed Form 2553 with the applicable service center. The Form 2553 must state at the top of the document "FILED PURSUANT TO REV. PROC. 2004–48." Attached to the Form 2553 must be a statement explaining the reason for the failure to file timely the S corporation election and a statement explaining the reason for the failure to file timely the entity classification election.

.03 *Relief for Late S Corporation Election and Relief for a Late Corporate Classification Election*. Upon receipt of a completed application requesting relief under section 4 of this revenue procedure, the Service will determine whether the requirements for granting additional time to file the elections have been satisfied and

will notify the entity of the result of this determination. An entity receiving relief under this revenue procedure is treated as having made an election to be classified as an association taxable as a corporation under § 301.7701–3(c) as of the effective date of the S corporation election.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective July 20, 2004. Any entity that meets the requirements of this revenue procedure as of July 20, 2004, may seek relief under this revenue procedure. This revenue procedure applies to requests pending with the Service on July 20, 2004.

SECTION 6. 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 1545–1548.

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 collections of information in this revenue procedure are in section 4.02. This information is required to be submitted to the applicable service center in order to obtain relief for a late Election Under Subchapter S. This information will be used to determine whether the eligibility requirements for obtaining relief have been met. The collection of information is required to obtain a benefit. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting burden is 25,000 hours.

The estimated annual burden per respondent varies from .5 hours to 1 hour, depending on individual circumstances, with an estimated average burden of 1 hour to complete the statement. The estimated number of respondents is 25,000.

The estimated annual frequency of responses is on occasion.

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 Rebekah A. Myers of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Ms. Myers at (202) 622–3050 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Section 1045 Application to Partnerships

REG–150562–03

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the application of section 1045 of the Internal Revenue Code (Code) to partnerships and their partners. These regulations provide rules regarding the deferral of gain on a partnership's sale of qualified small business stock and deferral of gain on a partner's sale of qualified small business stock distributed by a partnership. The proposed regulations affect partnerships that invest in qualified small business stock and their partners. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written or electronic comments and requests to speak and outlines of topics to be discussed at the public hearing scheduled for Tuesday, November 2, 2004, at 10 a.m. must be received by October 11, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–150562–03), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–150562–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington DC, or sent electronically, via the IRS Internet site at: *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS and REG–150562–03). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Charlotte Chyr, (202) 622–3070, or Jian H. Grant, (202) 622–3050; concerning submissions, the hearing, and/or placement on the building access list to attend the hearing, Sonya Cruse, (202) 622–4693 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP Washington, DC 20224. Comments on the collection of information should be received no later than September 13, 2004. Comments are specifically requested concerning:

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

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

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

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

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

The collection of information in this proposed regulation is in §1.1045–1(b)(4)(ii). This information is required to inform the IRS of partnerships and partners making the section 1045 election. The collection of information is required to obtain a benefit, that is, to elect to apply section 1045 treatment for qualified small business stock that is sold by the partnership. This information will be used by the partner to permit the partner to defer its allocable share of gain on the partnership's sale of qualified small business stock and by partnerships to make necessary adjustments to the basis of replacement qualified small business stock. The likely respondents are individuals, businesses or other for-profit institutions, and small businesses or organizations.

The estimated burden for the collection of information in §1.1045–1(b)(4)(ii) is as follows:

Estimated total annual reporting burden: 1,000 hours.

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

Estimated number of respondents: 1000

Estimated annual frequency of responses: On occasion

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

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.

Background

Section 1045 and section 1202 both provide for special treatment of gain on the sale of QSB stock held by non-corporate taxpayers. Under section 1202 of the Internal Revenue Code (Code), a taxpayer other than a corporation (a non-corporate taxpayer) excludes 50 percent of gain on the sale of qualified small business (QSB) stock (as defined in section 1202(c)) from gross income if the taxpayer holds the stock for more than five years. Section

1045 permits a non-corporate taxpayer that holds QSB stock (relinquished QSB stock) for more than six months and sells it after August 5, 1997, to elect to defer recognizing gain on the sale. To qualify for such deferral, the taxpayer must purchase QSB stock (replacement QSB stock) within a 60-day period beginning on the date of the sale of the relinquished QSB stock. Any gain not recognized reduces the cost basis of the replacement QSB stock. Section 1045(b)(3). The taxpayer recognizes gain to the extent the amount realized on the sale of the relinquished QSB stock exceeds the cost basis of the replacement QSB stock. Section 1045(a). Section 1045 does not apply to any gain treated as ordinary income. *Id*.

Section 6005(f)(2) of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105–206 (112 Stat. 6005(f)(2)), July 22, 1998, (the 1998 Act) added section 1045(b)(5). That section provides that rules similar to the rules in section 1202(f), (g), (h), (i), (j), and (k) apply for purposes of section 1045. The legislative history accompanying the 1998 Act provides that the benefit of deferred recognition of gain with respect to the sale of QSB stock by a partnership will flow through to a partner who is not a corporation if the partner held the partnership interest at all times the partnership held the QSB stock. See H.R. Conf. Rep. 105–599, 105th Cong., 2d Sess. 339 (1998). The legislative history further provides that there are no limitations on the types of partners that a partnership may have in order for the benefits of section 1045 to apply. *Id*. at 340.

Under section 1202(g), a non-corporate taxpayer applies section 1202 to the taxpayer's share of a passthrough entity's gain from the sale of QSB stock if two requirements are met. First, the passthrough entity must have held the QSB stock for more than five years. Second, the taxpayer must have held an interest in the passthrough entity on the date the passthrough entity acquired the QSB stock and at all times thereafter before the disposition of the stock. For purposes of section 1202, passthrough entities include partnerships, S corporations, regulated investment companies (RICs), and common trust funds. Section 1202(g)(4).

QSB stock must generally be acquired by the taxpayer at its original issue. However, section 1202(h) provides that, in the case of certain transfers of QSB stock, the transferee is treated as having acquired such stock in the same manner as the transferor and as having held such stock during any continuous period immediately preceding the transfer during which it was held by the transferor. Section 1202(h) applies to transfers from a partnership to a partner of stock with respect to which requirements similar to the requirements of section 1202(g) are met at the time of the transfer (without regard to the 5-year holding period requirement) as well as to transfers by gift or at death.

The committee reports underlying the enactment of section 1202 explain that, under section 1202(h),

> [q]ualified small business stock ... may be distributed by a partnership to one or more of its partners, as long as (1) all eligibility requirements with respect to qualified small business stock are met, and (2) the partner held its interest in the partnership on the date the partnership acquired the stock and at all times thereafter and before the disposition of the stock. In addition, a partner cannot treat stock distributed by a partnership as qualified small business stock to the extent that the partner's share of the stock distributed by the partnership exceeded the partner's interest in the partnership at the time the partnership acquired the stock.

H. R. Rep. No. 103–111, 103d Cong., lst Sess. 602 (1993).

The committee report goes on to explain that transferees in cases not described in section 1202(h) are not eligible for partial exclusion of gain under section 1202(a). Thus, for example, if qualified small business stock is transferred to a partnership and the partnership disposes of the stock, any gain from the disposition will not be eligible for the exclusion. *Id.*

Rev. Proc. 98–48, 1998–2 C.B. 367, generally provides procedures for taxpayers (including passthrough entities and individuals holding interests in a passthrough entity) to elect to apply section 1045. The background section of the revenue procedure explains that, under section 1045(b)(5), a passthrough entity that sells QSB stock held for more than 6 months may make a section 1045 election if the entity purchases replacement QSB stock during the 60-day period beginning on the date of the sale. Section 2.03, Rev. Proc. 98–48. The benefit of the section 1045 election flows through to a non-corporate taxpayer that held an interest in the passthrough entity for as long as the entity held the QSB stock. The background section of the revenue procedure also explains that, under section 1045(b)(5), if a passthrough entity sells QSB stock held for more than six months, a non-corporate taxpayer who has held an interest in the entity during the period in which the entity held the QSB stock and who purchases replacement QSB stock during the 60-day statutory period may elect to apply section 1045 to the non-corporate taxpayer's share of any gain on the sale that the entity does not defer under section 1045. Section 2.03, Rev. Proc. 98–48.

Since Rev. Proc. 98–48 was published, the IRS and Treasury Department have received inquiries regarding the application of section 1045 to partnerships and their partners. In response to these inquiries, the proposed regulations provide rules relating to sales and purchases of interests in a partnership that owns QSB stock, partnership dispositions of QSB stock, partnership distributions of QSB stock, and contributions of QSB stock to a partnership. Partners and partnerships wishing to elect section 1045 must continue to follow the procedures of Rev. Proc. 98–48 for rules regarding the time and manner for making the election, the scope of the election, and revocation of the election.

Explanation of Provisions

A. *General Rules and Definitions*

1. *QSB stock*

Section 1045(b)(1) provides that the term *QSB stock* has the same meaning given such term by section 1202(c). Section 1202(c) provides that the term *QSB stock* is any stock in a C corporation that is originally issued after the date of the enactment of the Revenue Reconciliation Act of 1993, if (A) as of the date of issuance, the corporation is a qualified small business, and (B) except as provided in section 1202(f) and (h), the stock is acquired by the taxpayer at its original issue in exchange for money or other property

(not including stock), or as compensation for services provided to the corporation.

Some taxpayers have asked if a partner may treat a sale of a partnership interest as a sale of QSB stock or an acquisition of a partnership interest as an acquisition of QSB stock. Sections 1045 and 1202 do not adopt a look-though approach to the sale and acquisition of partnership interests. Under the plain language of section 1202(c), an investment in a partnership that holds or purchases QSB stock is not treated as an investment in QSB stock. This plain language interpretation is further supported by the structure of sections 1045 and 1202. Congress clearly contemplated partnership transactions when enacting section 1202, as several of its provisions address such transactions. In light of this, Congress's failure to provide for section 1202(a) treatment for acquisitions and dispositions of partnership interests appears to have been intentional. Such a decision by Congress would be consistent with the approach taken by section 1202(g). That section allows partners to qualify for section 1202(a) treatment with respect to gain recognized by reason of holding a partnership interest only if the partner held the interest in the partnership on the date of the partnership's acquisition of QSB stock and at all times thereafter before the disposition of the stock by the partnership. If a partner were to sell its partnership interest while the partnership still held QSB stock, then the partner would not have held the partnership interest from the date of the acquisition of that stock until the date of the disposition of the stock by the partnership. For these reasons, the proposed regulations provide that the term *QSB stock* does not include an interest in a partnership that holds or purchases QSB stock.

2. *Eligible partner*

Under the proposed regulations, only an eligible partner may defer gain recognized by a partnership on the sale of QSB stock. Consistent with section 1202(g) and (h), the proposed regulations define an eligible partner as a non-corporate partner who held an interest in the partnership at all times that the partnership held the QSB stock or a non-corporate partner who acquired an interest in a partnership from an existing eligible partner by gift or death.

The proposed regulations provide special rules for determining eligible partners if a partnership (upper-tier partnership) holds an interest in a partnership (lower-tier partnership) that holds QSB stock. The proposed rules disregard the upper-tier partnership's ownership of the lower-tier partnership and treat each partner of the upper-tier partnership as owning the interest in the lower-tier partnership directly. A partner of the upper-tier partnership is treated as owning an interest in the lower-tier partnership during the period in which both the partner of the upper-tier partnership held an interest in the upper-tier partnership and the upper-tier partnership held an interest in the lower-tier partnership.

The IRS and the Treasury Department are concerned that, although the current look-through treatment for tiered partnerships may be the simplest approach, the application of the proposed rules presents the following potential problems: (1) the proposed rules prohibit an upper-tier partnership from making a section 1045 election at the partnership level; (2) the eligible partners of the upper-tier partnership may not have the necessary information to benefit from the proposed rules; and (3) notification from the lower-tier partnership to the upper-tier partnerships and their partners and vice versa may be difficult if multiple tiers of partnerships are involved. Accordingly, the IRS and Treasury Department request comments specifically on the application of the proposed rules with respect to tiered partnerships.

3. *Nonrecognition limitation*

Under the proposed regulations, the amount of gain that an eligible partner may defer under section 1045 (whether the election to apply section 1045 is made at the partnership or the partner level) may not exceed: (A) the partner's smallest percentage interest in the partnership's income, gain, or loss with respect to the relinquished QSB stock, multiplied by (B) the partnership's realized gain from the sale of such stock. For this purpose, the partnership's realized gain from the sale of the QSB stock is determined without regard to any basis adjustment under section 734(b) or 743(b). This rule follows section 1202(g)(2) and (3) by ensuring that the partner can defer recognition of only the gain that relates to the partner's continuous economic interest in the relinquished QSB stock.

B. *Partnership Election Under Section 1045*

1. *General rule*

Consistent with Rev. Proc. 98–48, the proposed regulations allow a partnership to elect to apply section 1045 if the partnership held QSB stock for more than six months, sold such QSB stock, and purchased other QSB stock (replacement QSB stock) within 60 days of the sale. If the partnership makes an election under section 1045, all eligible partners of the partnership must defer their distributive shares of the partnership section 1045 gain from the partnership's sale of the QSB stock. No separate election is required of the partners. Partnership section 1045 gain equals the partnership's gain from the sale of the QSB stock reduced by the greater of: (A) the gain from the sale of the QSB stock that is treated as ordinary income, or (B) the excess of the amount realized by the partnership on the sale over the cost of any replacement QSB stock purchased by the partnership during the 60-day period beginning on the date of the sale.

2. *Election procedures and notification*

The proposed regulations require the partnership to make the section 1045 election on the partnership's timely filed return (including extensions) for the taxable year during which the partnership sells the QSB stock. In addition, the partnership must follow the procedures of Rev. Proc. 98–48.

When a partnership makes the election, the proposed regulations require the partnership to notify all partners that it has made the election, and separately state each partner's distributive share of the partnership section 1045 gain under section 702. Each partner must determine if it is an eligible partner and report the partner's distributive share of gain, including gain not recognized, on Schedule D of the partner's federal income tax return.

C. *Partner Election Under Section 1045*

1. *General rule*

Also consistent with Rev. Proc. 98–48, the proposed regulations allow an eligible partner to make a section 1045 election with respect to the partner's share of gain from the partnership's sale of QSB stock if the partnership does not make a section 1045 election or purchase replacement QSB stock within the statutory time period. The election may be made if the partnership either replaces none of the relinquished QSB stock or replaces some but not all of the relinquished QSB stock. For example, relinquished QSB stock can be partially replaced by the partnership and partially replaced by the partner if section 1045 elections are made by both the partnership and the partner. If a partner makes a section 1045 election, the partner recognizes its distributive share of the gain from the sale of the relinquished QSB stock only to the extent of the greater of: (1) the gain that is treated as ordinary income, or (2) the excess of the partner's share of the amount realized by the partnership on the sale of the QSB stock over the cost of any replacement QSB stock purchased by the partner during the 60-day statutory period.

A partnership that has sold QSB stock should promptly notify its partners when it does not intend to make a section 1045 election with respect to the sale. Prompt notification will allow partners who intend to make separate section 1045 elections time to purchase replacement QSB stock within 60 days of the sale of the relinquished QSB stock and to make timely section 1045 elections. However, the proposed regulations do not impose a requirement on partnerships to provide such notification. The IRS and Treasury Department believe that it is more appropriate for the partners to decide (for example, in the partnership agreement) whether, and to what extent, the partnership must provide such notification.

2. *Election procedures*

The proposed regulations provide that a partner making an election under section 1045 with respect to its distributive share of gain on the partnership's sale of QSB stock must do so on the partner's timely filed federal income tax return (including extensions) for the taxable year in which such gain is taken into account. In addition, the partner must follow the procedures of Rev. Proc. 98–48.

D. *Basis Adjustments*

The proposed regulations provide rules regarding adjustments to the eligible partner's basis in the partnership interest and the partnership's basis in the replacement QSB stock. Under these rules, if the partnership makes a section 1045 election, then the eligible partner may not increase its outside basis by the amount of gain that is not recognized under section 1045. In addition, the partnership is required to reduce its basis in the replacement QSB stock by the amount of gain that is not recognized by its partners. The adjustment to the partnership's inside basis in the replacement QSB stock is similar to a basis adjustment under section 743(b). These rules are necessary to preserve (in the replacement QSB stock and the partnership interest) the deferred gain on the sale of the relinquished QSB stock.

As explained above, a partner's basis in a partnership interest is not increased by any gain that is deferred by reason of a *partnership* section 1045 election. In contrast, a partner's basis in a partnership interest is increased by any gain that is deferred by reason of a *partner* section 1045 election. A partner must reduce the basis of any replacement QSB stock the partner purchases by the amount of gain that is not recognized by reason of a *partner* section 1045 election.

To allow the partnership to make the appropriate adjustments to the basis of the replacement QSB stock, the proposed regulations require any partner who recognizes all or part of the partner's distributive share of partnership section 1045 gain to notify the partnership of the amount of the partnership section 1045 gain that was recognized. In the absence of notification, the partnership must presume that the partner deferred recognition of the partnership section 1045 gain and decrease its basis in the replacement QSB stock by the partner's distributive share of partnership section 1045 gain until such time as the partner provides notification of the amount recognized by the partner. However, if the partnership knows that one of its partners was, during any period in which the partnership held the QSB stock, classified as a corporation for federal tax purposes, then the partnership may presume that the partner did not defer recognition of the partnership section 1045 gain even in the absence of a notification by the partner.

E. *Distribution of QSB Stock*

Consistent with section 1202(h) and the legislative history underlying that section, the proposed regulations provide that, if a partnership distributes QSB stock to an eligible partner, then the eligible partner is treated as having acquired such stock in the same manner as the partnership and having held such stock during any continuous period immediately preceding the distribution during which it was held by the partnership. However, the amount of gain on the sale of such distributed QSB stock that the partner can defer cannot exceed the distribution nonrecognition limitation. For this purpose, the distribution nonrecognition limitation is equal to the partner's section 1045 amount realized, reduced by the partner's section 1045 adjusted basis. The proposed regulations provide rules for determining the partner's section 1045 amount realized and the partner's section 1045 adjusted basis in the case of a liquidating distribution, a nonliquidating distribution of all of the QSB stock (of the same type), and other nonliquidating distributions.

These rules follow the legislative history's directive that a partner may not treat stock distributed by a partnership as QSB stock to the extent that the partner's share of the distributed stock exceeds the partner's interest in the partnership at the time the partnership acquired the stock. Under the proposed regulations, the amount of gain that a distributee partner may defer on the sale of distributed QSB stock will be no more than (but in the case of QSB stock received in certain nonliquidating distributions may be less than) the amount of gain that the partner would have been able to defer in the absence of the distribution.

The IRS and Treasury Department considered an alternative approach for determining the distribution nonrecognition limitation for sales of QSB stock following a nonliquidating distribution to a partner. Under this alternative approach, the distribution nonrecognition limitation would be determined by reference to the

maximum amount of gain that the partner would have been able to defer if the partnership had not distributed any QSB stock of the type sold, but instead had sold all of that QSB stock for a per share price equal to the per share price received on the actual sale of the distributed QSB stock by the partner. Due to the complexity of this alternative approach, it was rejected and is not included in the proposed regulations. The IRS and Treasury Department request comments on the extent to which refinements of the distribution nonrecognition limitation applicable to sales of distributed QSB stock are appropriate.

F. *Contribution of QSB Stock*

The proposed regulations provide that a contribution of QSB stock to a partnership in a transaction to which section 721(a) applies does not cause the contributing partner to recognize any gain that was previously deferred under section 1045. However, the QSB stock, once contributed, is no longer QSB stock in the hands of the partnership because the partnership has not acquired the stock at original issue within the meaning of section 1202(c)(1)(B). See also H.R. Rep. No. 103–111, 103d Cong., 1st Sess. 602 (1993).

G. *Proposed Effective Date*

The regulations are proposed to apply to sales of QSB stock on or after the date final regulations are published in the **Federal Register**.

Effect on Other Documents

The following publication will be amplified for partners and partnerships beginning on or after the date these regulations are published as final regulations in the **Federal Register**:

Rev. Proc. 98–48, 1998–2 C.B. 367.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that QSB stock is not held by a substantial number of small entities and that the time required to make the election is estimated to average 1 hour. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, 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 (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Tuesday, November 2, 2004, at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, D.C. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 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 or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 11, 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 Charlotte Chyr and Jian H. Grant, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

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

§1.1045–1 Application to partnerships.

(a) *General rules*—(1) *Definition of QSB stock—In general.* For purposes of section 1045 and this section, *qualified small business stock* (QSB stock) has the meaning provided in section 1202(c). For purposes of section 1045 and this section, the term *QSB stock* does not include an interest in a partnership that purchases or holds QSB stock. (For further guidance, see *Example 1* and *Example 2* of paragraph (g) of this section.)

(2) *Eligible partner*—(i) *In general.* For purposes of this section, an eligible partner with respect to QSB stock is a taxpayer other than a corporation who holds an interest in a partnership on the date the partnership acquires the QSB stock and at all times thereafter before the partnership sells or distributes the QSB stock.

(ii) *Acquisition by gift or at death.* For purposes of this section, a taxpayer who acquires from an eligible partner by gift or at death an interest in a partnership that holds QSB stock is treated as having held the acquired interest in the partnership during the period the eligible partner held the interest in the partnership. (For further guidance, see *Example 6* of paragraph (g) of this section.)

(iii) *Tiered partnership*—(A) *Generally*. If a partnership (upper-tier partnership), holds an interest in another partnership (lower-tier partnership) that holds QSB stock, then, for purposes of this paragraph (a)(2), the upper-tier partnership's ownership of the lower-tier partnership is ignored and each partner of the upper-tier partnership is treated as owning the interest in the lower-tier partnership directly. The partner of the upper-tier partnership is treated as owning the interest in the lower-tier partnership during the period in which both—

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

(*2*) The upper-tier partnership held an interest in the lower-tier partnership. (For further guidance, see *Example 3* of paragraph (g) of this section.)

(B) *Multiple tiers of partnership*. Principles similar to those described in paragraph (a)(2)(iii)(A) of this section apply where a taxpayer holds the interest in the lower-tier partnership through multiple tiers of partnerships.

(3) *Nonrecognition limitation*—(i) *In general*. For purposes of this section, the amount of gain that an eligible partner does not recognize under paragraphs (b)(1) and (c)(1) of this section cannot exceed the nonrecognition limitation. For this purpose, the nonrecognition limitation is equal to the product of—

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

(B) The eligible partner's smallest percentage interest in the partnership's income, gain, or loss with respect to the QSB stock that was sold. (For further guidance, see *Example 4* of paragraph (g) of this section.)

(ii) *Eligible partner's smallest percentage interest*. In determining an eligible partner's smallest percentage interest in the partnership's income, gain, or loss with respect to QSB stock, reductions in the partner's interest that occur solely as a result of a distribution of QSB stock to the partner are not taken into account.

(b) *Partnership election*—(1) *General rule*. A partnership that holds QSB stock for more than six months, sells such QSB stock, and purchases other QSB stock (replacement QSB stock), within 60 days beginning on the date of the sale may elect to apply section 1045. For purposes of this paragraph (b)(1), a purchase of replacement QSB stock by a partner is not treated as a purchase of replacement QSB stock by the partnership. If the partnership elects to apply section 1045, then, subject to the provisions of paragraph (a)(3) of this section, each eligible partner does not recognize the partner's distributive share of any partnership section 1045 gain. For this purpose, partnership section 1045 gain equals the partnership's gain from the sale of the QSB stock reduced by the greater of—

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

(ii) The excess of the amount realized by the partnership on the sale over the cost of any replacement QSB stock purchased by the partnership during the 60-day period beginning on the date of the sale (excluding the cost of any replacement QSB stock that is otherwise taken into account under section 1045).

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

(3) *Basis adjustments*—(i) *Partner's interest in a partnership*. Notwithstanding section 705(a)(1), the adjusted basis of a partner's interest in a partnership is not increased by gain from a partnership's sale of QSB stock that is not recognized by the partner under paragraph (b)(1) of this section.

(ii) *Partnership's replacement QSB stock*. The basis of a partnership's replacement QSB stock is reduced (in the order acquired) by the amount of gain from the partnership's sale of QSB stock that is not recognized by an eligible partner. The basis adjustment with respect to any amount described in this paragraph (b)(3)(ii) constitutes an adjustment to the basis of the partnership's replacement QSB stock with respect to that partner only. The effect of such a basis adjustment is determined under the principles of §1.743–1(g), (h), and (j). For purposes of this paragraph (b)(3)(ii), the partnership must presume that a partner did not recognize that partner's distributive share of QSB gain until such time as the partner provides to the partnership the notification described in paragraph (b)(4)(ii) of this section. However, if the partnership knows that a particular partner is classified, for Federal tax purposes, as a corporation during any period in which the partnership held the QSB stock, then the partnership may presume that the partner did not defer recognition of the partnership section 1045 gain, even in the absence of a notification by the partner.

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

(ii) *Partner notification to partnership*. Any partner that must recognize all or part of the partner's distributive share of partnership section 1045 gain must notify the partnership, in writing, of the amount of partnership section 1045 gain that is recognized by the partner. (For further guidance concerning paragraph (b) of this section, see *Example 4* through *Example 7* of paragraph (g) of this section.)

(c) *Partner election*—(1) *In general*. If an eligible partner of a partnership that sells QSB stock purchases replacement QSB stock during the 60-day period beginning on the date of the partnership's sale of the QSB stock, then the partner may elect to apply section 1045. For purposes of this paragraph (c)(1), a purchase of replacement QSB stock by the partnership is not treated as a purchase of replacement QSB stock by a partner. An eligible partner that elects to apply section

1045 must recognize its distributive share of gain from the partnership's sale of QSB stock only to the extent of the greater of—

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

(ii) The excess of the partner's share of the amount realized by the partnership on the sale of the QSB stock (excluding any QSB stock that was replaced by the partnership) over the cost of any replacement QSB stock purchased by the partner during the 60-day period beginning on the date of the partnership's sale of the QSB stock (excluding the cost of any replacement QSB stock that is otherwise taken into account under section 1045).

(2) *Partner's share of amount realized by partnership*. The partner's share of the amount realized by the partnership shall bear the same proportion to the amount realized by the partnership on the sale of the QSB stock (excluding the cost of any replacement QSB stock) as the partner's distributive share of the partnership's realized gain from the sale of the QSB stock bears to the partnership's realized gain on the sale of the QSB stock. For this purpose, the partnership's realized gain from the sale of QSB stock and the partner's distributive share of that gain are determined without regard to basis adjustments under section 743(b) and paragraph (b)(3)(ii) of this section.

(3) *Basis adjustments*—(i) *Partner's interest in a partnership*. Under section 705(a)(1), the adjusted basis of a partner's interest in a partnership is increased by the amount of gain that is not recognized by an eligible partner pursuant to paragraph (c)(1) of this section.

(ii) *Partner's replacement QSB stock*. A partner's basis in any replacement QSB stock that is purchased by the partner during the 60-day period described in paragraph (c)(1) of this section must be reduced (in the order acquired) by the partner's distributive share of the gain on the sale of the partnership's QSB stock that is not recognized by the partner pursuant to paragraph (c)(1) of this section. (For further guidance concerning this paragraph (c), see *Example 8* through *Example 10* of paragraph (g) of this section.)

(d) *Partnership distribution of QSB stock to an eligible partner*—(1) *In general*. Subject to paragraphs (d)(2) and (3) of this section, in the case of a partnership distribution of QSB stock to an eligible partner within the meaning of paragraph (a)(2) of this section, the eligible partner shall be treated as—

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

(ii) Having held such stock during any continuous period immediately preceding the distribution during which it was held by the partnership. (For further guidance concerning this paragraph (d), see *Example 11* and *Example 12* of paragraph (g) of this section.)

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

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

(A) The partner's section 1045 amount realized; reduced by

(B) The partner's section 1045 adjusted basis.

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

(*1*) The numerator of which is the partner's smallest percentage interest (prior to the distribution) in the partnership's income, gain, or loss with respect to the type of QSB stock sold by the partner; and

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

(B) *QSB stock received in other distributions*. If a partner receives relinquished QSB stock in a distribution from the partnership that is not described in paragraph (d)(3)(ii)(A) of this section, the partner's section 1045 amount realized is the partner's amount realized from the sale of the relinquished QSB stock multiplied by the partner's smallest interest (prior to the distribution) in the partnership's income, gain, or loss with respect to such stock.

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

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

(*2*) The partner's smallest interest (prior to the distribution) in the partnership's income, gain, or loss with respect to such stock; and

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

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

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

(*2*) The partner's smallest interest (prior to the distribution) in the partnership's income, gain, or loss with respect to such stock.

(iv) *Partner's percentage interest in distributed QSB stock*. For purposes of this paragraph (d)(3), a partner's percentage interest in a type of QSB stock immedi-

ately after a partnership distribution is the value (as of the date of the distribution) of the QSB stock distributed to the partner divided by the value (as of the date of the distribution) of all of that type of QSB stock that was acquired by the partnership.

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

(e) *Contribution of QSB stock or replacement QSB stock to a partnership*. Section 721 applies to a contribution of QSB stock to a partnership by a taxpayer other than a corporation. Except as provided in section 721(b), any gain that was not recognized by the taxpayer under section 1045 is not recognized when the taxpayer contributes QSB stock to a partnership in exchange for a partnership interest in the hands of the taxpayer. Stock that is contributed to a partnership is not QSB stock in the hands of the partnership because the partnership did not acquire the stock at original issue. (For further guidance, see *Example 13* of paragraph (g) of this section.)

(f) *Time and manner of making election*. A partnership making an election under section 1045 (as described under paragraph (b)(1) of this section) must do so on the partnership's timely filed (including extensions) return for the taxable year during which the sale of QSB stock occurs. A partner making an election under section 1045 (as described under paragraph (c)(1) of this section) must do so on the partner's timely filed (including extensions) federal income tax return for the taxable year during which the partner's distributive share of the partnership's gain from the sale of the QSB stock is taken into account under section 706. In addition, a partnership or partner making an election under section 1045 must follow the administrative procedures issued for making such elections. (For further guidance, see Rev. Proc. 98–48, 1998–2 C.B. 367, and §601.601(d)(2)(ii)(b) of this chapter.)

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

Example 1. Acquisition of a partnership interest as replacement property. On January 1, 2006, A, an individual, X, a corporation, and Y, a corporation, form PRS, a partnership. A, X, and Y each contribute $25 to PRS and agree to share all partnership items equally. PRS purchases QSB stock on February 1, 2006, and subsequently sells the QSB stock on November 4, 2006, for $150. PRS realizes $75 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $25 of gain to each of A, X, and Y. On November 30, 2006, A contributes $50 to ABC, a partnership, in exchange for an interest in ABC (instead of purchasing QSB stock). ABC then purchases QSB stock for $50 on December 1, 2006. A's acquisition of the additional partnership interest is not treated as a purchase of replacement QSB stock for purposes of section 1045.

Example 2. Sale of a partnership interest. The facts are the same as in *Example 1*, except that PRS does not sell its QSB stock. Instead, on November 4, 2006, A sells the PRS interest for $50x, realizing $25 of capital gain. On November 30, 2006, A purchases $50 of new QSB stock. Under paragraph (a)(1) of this section, the sale of an interest in a partnership that holds QSB stock is not treated as a sale of QSB stock. Therefore, A may not elect to apply section 1045 with respect to A's $25 of gain from the sale of the PRS interest.

Example 3. Eligible and non-eligible partners of tiered partnership. On January 1, 2006, A, an individual, and B, an individual, contribute cash to UTP, (upper-tier partnership) for equal partnership interests. On February 1, 2006, UTP and C, an individual, contribute cash to LTP, (lower-tier partnership) for equal partnership interests. On March 1, 2006, LTP purchases QSB stock. On April 1, 2006, D, an individual, joins UTP by contributing cash to UTP for a 1/3 interest in UTP. On December 1, 2006, LTP sells the QSB stock. Under paragraph (a)(2)(iii) of this section, A, B, and D are treated as owning an interest in LTP during the period in which each of the partners held an interest in UTP and UTP held an interest in LTP. Therefore, under paragraph (a)(2)(i) of this section, A and B are eligible partners, and D is not an eligible partner.

Example 4. Partnership sale of QSB stock and purchase and sale of replacement QSB stock. (i) Assume the same facts as in *Example 1*, except that PRS purchases replacement QSB stock for $135 on December 15, 2006. On its timely filed return for the taxable year during which the sale of the relinquished QSB stock occurs, PRS makes an election to apply section 1045. PRS knows that X and Y are corporations. On March 30, 2007, PRS sells the replacement QSB stock for $165. PRS realizes $30 of capital gain from the sale of the replacement QSB stock and allocates $10 of gain to each of A, X, and Y.

(ii) Under paragraph (b)(1) of this section, the partnership section 1045 gain is $60 ($75 gain less $15 ($150 amount realized on the sale of the relinquished QSB stock less $135 cost of the replacement QSB stock)). This amount must be allocated among the partners in the same proportions as the entire gain from the sale of the QSB stock is allocated to the partners, 1/3 ($20) to A, 1/3 ($20) to X, and 1/3 ($20) to Y.

(iii) Because neither X nor Y are eligible partners under paragraph (a)(2) of this section, X and Y must each recognize its $25 distributive share of partnership gain from the sale of the QSB stock. Because A is an eligible partner under paragraph (a)(2) of this section, and because A is bound by the election by PRS to apply section 1045, A defers recognition of A's $20 distributive share of partnership section 1045 gain. A is not required to separately elect to apply section 1045. A must recognize A's remaining $5 distributive share of the partnership's gain from the sale of the QSB stock.

(iv) Under section 705(a)(1)(A), the adjusted bases of X's and Y's interests in PRS are each increased by $25. Under section 705(a)(1)(A) and paragraph (b)(3)(i) of this section, the adjusted basis of A's interest in PRS is not increased by the $20 of partnership section 1045 gain that was not recognized by A, but is increased by A's remaining $5 distributive share of gain.

(v) PRS must decrease its basis in the replacement QSB stock by the $20 of partnership section 1045 gain that was allocated to A. This basis reduction is a reduction with respect to A only. PRS then adjusts A's distributive share of gain from the sale of the replacement QSB stock to reflect the effect of A's basis adjustment under paragraph (b)(3)(ii) of this section. In accordance with the principles of §1.743–1(j)(3), the amount of A's gain from the sale of the replacement QSB stock in which A has a $20 negative basis adjustment equals $30 (A's share of PRS's gain from the sale of the replacement QSB stock ($10), increased by the amount of A's negative basis adjustment for the replacement stock ($20)). Accordingly, upon the sale of the replacement QSB stock, A recognizes $30 of gain, and X and Y each recognize $10 of gain.

Example 5. Sale of partnership interest while partnership holds QSB stock. Assume the same facts as in *Example 4*, except that A sells A's interest in PRS to B, an individual, on March 1, 2006. B is not an eligible partner under paragraph (a)(2)(i) of this section, because B did not hold an interest in PRS on the date PRS originally acquired the QSB stock. Therefore, B must recognize B's distributive share of partnership section 1045 gain.

Example 6. Death of partner while partnership holds QSB stock. Assume the same facts as in *Example 4*, except that A dies on March 1, 2006, and B inherits A's interest in PRS. Under paragraph (a)(2)(ii) of this section, B is treated as holding the interest in PRS during the period that A held the interest in PRS. Therefore, B is an eligible partner under paragraph (a)(2)(i) of this section. Accordingly, B defers recognition of B's distributive share of the partnership section 1045 gain on the sale of the QSB stock.

Example 7. Partnership sale of QSB stock and partner purchase of replacement QSB stock. (i) Assume the same facts as in *Example 4*, except that PRS does not make an election under section 1045 with respect to the sale of the QSB stock. On November 30, 2006, A, an eligible partner under paragraph (a)(2) of this section, purchases replacement QSB stock for $50. A elects to apply section 1045 on A's timely filed return for the taxable year that A is required to include A's distributive share of PRS's gain from the sale of the relinquished QSB stock.

(ii) Under paragraph (c)(2) of this section, A's share of the amount realized from PRS's sale of the QSB stock is $50 (the amount which bears the same proportion to the total amount realized by the partnership on the sale of the QSB stock ($150) as A's share of the gain from the sale of the QSB stock ($25) bears to the total gain realized by the partnership on the sale of the QSB stock ($75)). Because A purchased,

within 60 days of PRS's sale of the QSB stock, replacement QSB stock for a cost equal to A's share of the partnership's amount realized on the sale of the QSB stock, and because A made a valid election to apply section 1045, A defers recognition of A's $25 distributive share of gain from PRS's sale of the QSB stock. Under section 705(a)(1) and paragraph (c)(3)(i) of this section, the adjusted basis of A's interest in PRS is increased by $25. Under paragraph (c)(3)(ii) of this section, A's basis in the replacement QSB stock is $25 ($50 cost minus $25 nonrecognition amount).

Example 8. Election by partner; replacement by partnership. Assume the same facts as in *Example 7*, except that PRS purchases replacement QSB stock on December 31, 2006, but does not make an election to apply section 1045. A makes an election to apply section 1045, but does not purchase any replacement QSB stock during the 60-day period beginning on the date of PRS's sale of the QSB stock. Because the requirements of neither paragraph (b)(1) nor paragraph (c)(1) of this section has been satisfied, A must recognize all of A's distributive share of the gain from PRS's sale of the QSB stock.

Example 9. Partial replacement by partnership; partial replacement by partner. (i) On January 1, 2006, A, an individual, and X, a corporation, form PRS, a partnership. A and X each contribute $50 to PRS and agree to share all partnership items equally. PRS purchases QSB stock on February 1, 2006, for $100 and subsequently sells the QSB stock on January 31, 2008, for $300. PRS realizes $200 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $100 of gain to each of A and X. On February 10, 2008, PRS purchases replacement QSB stock for $220. On March 20, 2008, A purchases replacement QSB stock for $40. Both A and PRS make valid elections to apply section 1045.

(ii) Under paragraph (b)(1) of this section, partnership section 1045 gain is $120 ($200 less $80 ($300 amount realized on the sale of the relinquished QSB stock minus $220 cost of the replacement QSB stock)). This amount is allocated among the partners in the same proportions as the entire gain from the sale of the QSB stock is allocated to the partners, 1/2 to A ($60), and 1/2 to X ($60). Because A is an eligible partner, A defers recognition of A's $60 distributive share of partnership section 1045 gain.

(iii) A also made a valid section 1045 election and purchased, within 60 days of PRS's sale of the QSB stock, replacement QSB stock. Therefore, under paragraph (c)(1) of this section, A may defer a portion of A's distributive share of the remaining gain from the partnership's sale of the QSB stock. A must recognize that remaining gain, however, to the extent that A's share of the amount realized by PRS on the sale of the QSB stock (excluding the QSB stock that was replaced by PRS) exceeds the cost of the replacement QSB stock purchased by A during the 60-day period following the sale of the QSB stock. The amount realized by PRS on the sale of the QSB stock (excluding the QSB stock that was replaced by PRS) is $80 ($300 minus $220). Under paragraph (c)(2) of this section, A's share of that amount realized is $40 (50/100 (A's share of the gain from the sale of the QSB stock) multiplied by $80). Because the replacement QSB stock purchased by A cost $40, A defers recognition of all of the remaining gain from the sale of the QSB stock.

(iv) The adjusted basis of A's interest in PRS is not increased by the gain that was not recognized pursuant to paragraph (b)(1) of this section, $60, but is increased by the gain that was not recognized pursuant to paragraph (c)(1) of this section, $40. See paragraphs (b)(3)(i) and (c)(3)(i) of this section. PRS must decrease its basis in the replacement QSB stock by the $60 of partnership section 1045 gain that was allocated to A. See paragraph (b)(3)(ii) of this section. A must decrease A's basis in the replacement QSB stock purchased by A by the $40 not recognized pursuant to paragraph (c)(1) of this section. See paragraph (c)(3)(ii) of this section.

Example 10. Change in partner's interest in partnership while partnership holds QSB stock. (i) Assume the same facts as in *Example 9*, except that, on August 2, 2006, A sells a 25 percent interest in PRS to Z. On July 10, 2007, A repurchases the 25 percent interest from Z for $50. Assume that PRS makes a timely election under section 754 for the taxable year during which A purchases Z's PRS interest and that, under section 743(b), A has a positive basis adjustment of $25.

(ii) PRS allocates the $200 of realized gain from the sale of the QSB stock $100 to A and $100 to X. However, A has a positive basis adjustment of $25; therefore, A's share of the gain is reduced to $75. Because A is an eligible partner under paragraph (a)(2) of this section, A may defer recognition of A's distributive share of gain from the sale of the QSB stock subject to the nonrecognition limitation described in paragraph (a)(3) of this section. The smallest interest that A held in PRS during the time that PRS held the QSB stock is 25 percent. Under the nonrecognition limitation, A may not defer more than 25 percent of the partnership gain realized from the sale of the QSB stock (determined without regard to any basis adjustment under section 734(b) or section 743(b), other than a basis adjustment described in paragraph (b)(3)(ii) of this section). Because the partnership's realized gain determined without regard to A's basis adjustment under section 743(b) is $200, A may defer recognition of $50 (25% of $200) of the gain from the sale of the QSB stock. A must recognize the remaining $25 of that gain.

Example 11. Sale by partner of QSB stock received in a liquidating distribution. (i) On January 1, 2006, A, an individual, and X, a corporation, form PRS, a partnership. A and X each contribute $150 to PRS and agree to share all partnership items equally. PRS purchases QSB stock on February 1, 2006, for $300. On May 1, 2006, when the QSB stock has appreciated in value to $400, A contributes $100 to PRS, increasing A's interest in PRS's income, gains, losses, deductions, and credits to 60 percent. On June 1, 2009, when the QSB stock is still worth $400, PRS makes a liquidating distribution of $300 worth of QSB stock to A. Under section 732, A's basis in the distributed QSB stock is $250. A sells the QSB stock on August 4, 2009, for $600, realizing a gain of $350 (none of which is treated as ordinary income). A purchases replacement QSB stock on August 30, 2009, for $550, and makes a valid election under section 1045 with respect to the QSB stock.

(ii) A is an eligible partner under paragraph (a)(2)(i) of this section. Therefore, under paragraph (d)(1) of this section, A is treated as having acquired the distributed QSB stock in the same manner as PRS and as having held the QSB stock since February 1, 2006, its original issue date. Because A purchased, within 60 days of A's sale of the QSB stock, replacement QSB stock, A is eligible to defer a portion of A's gain from the sale of the QSB stock. A must recognize gain, however, to the extent that A's amount realized on the sale of the QSB stock, $600, exceeds the cost of the replacement QSB stock purchased by A during the 60-day period beginning on the date of the sale of the relinquished QSB stock, $550. Accordingly, A must recognize $50 of the gain from the sale of the QSB stock. A defers recognition of the remaining $300 of gain to the extent that such gain does not exceed the distribution nonrecognition limitation.

(iii) Under paragraph (d)(3)(ii) of this section, A's nonrecognition limitation with respect to the sale of the QSB stock is A's section 1045 amount realized with respect to the stock, reduced by A's section 1045 adjusted basis with respect to the stock. A's amount realized from the sale is the product of A's amount realized from the sale, $600; and a fraction:

(*1*) the numerator of which is A's smallest percentage interest in PRS's income, gain, or loss with respect to such stock, 50%; and

(*2*) the denominator of which is A's percentage interest in that type of partnership QSB stock immediately after the distribution, 75% (the value of the stock distributed to A, $300, divided by the value of all QSB stock of that type acquired by PRS, $400).

Therefore, A's section 1045 amount realized is $400 ($600 multiplied by 50/75). Because PRS distributed the QSB stock to A in liquidation of A's interest in PRS, A's section 1045 adjusted basis is the product of PRS's basis in all of the QSB stock of the type distributed, $300; A's smallest interest (prior to the distribution) in PRS's income, gain, or loss with respect to QSB stock of the type distributed, 50%; and the percentage of the distributed QSB stock that was sold by A, 100%. Therefore, A's section 1045 adjusted basis is $150 (the product of $300, 50%, and 100%)) and A's nonrecognition limitation amount on the sale of the QSB stock is $250 ($400 section 1045 amount realized minus $150 section 1045 adjusted basis). Accordingly, A defers recognition of $250 of the remaining $300 gain from the sale of the QSB stock.

(iv) A's basis in the replacement QSB stock is $300 (cost of the replacement stock, $550, reduced by the gain not recognized under section 1045, $250).

Example 12. Sale by partner of QSB stock received in a nonliquidating distribution. (i) The facts are the same as in *Example 11*, except that, on June 1, 2009, PRS distributes only $200 of the QSB stock to A, reducing A's interest in PRS from 60% to 33%. PRS's basis in the distributed QSB stock is $150. On November 1, 2009, A sells for $250 the QSB stock distributed by PRS to A and purchases, within 60 days of the date of sale of the relinquished QSB stock, replacement QSB stock for $250. On December 1, 2009, PRS sells all of its QSB stock for $250 and purchases, within 60 days of the date of the sale of the relinquished QSB stock, replacement QSB stock for $250. A makes a timely election to apply section 1045 with respect to its sale of the distributed QSB stock and PRS makes a timely election to apply section 1045 with respect to its sale of the QSB stock.

(ii) Under section 732, A's basis in the distributed QSB stock is $150. Therefore, A realizes a gain on the sale of the distributed QSB stock of $100. Because A made a valid election to apply section 1045 to the sale, and because A purchased, within 60 days of A's sale of the QSB stock, replacement QSB stock at a cost equal to the amount realized on the sale of the distributed QSB stock, A defers recognition of the gain from the sale of the QSB stock to the extent that such gain does not exceed the distribution nonrecognition limitation.

(iii) Under paragraph (d)(3) of this section, the nonrecognition limitation with respect to A's sale of the QSB stock is A's section 1045 amount realized reduced by A's section 1045 adjusted basis. Because PRS did not distribute all of a particular type of QSB stock and the distribution of the QSB stock to A was not in liquidation of A's interest in PRS, A's section 1045 amount realized is $125 (A's amount realized from the sale of the distributed QSB stock, $250, multiplied by A's smallest percentage interest (prior to the distribution) in PRS's income, gain, or loss with respect to such stock, 50%). A's section 1045 adjusted basis is the product of the partnership's basis in the QSB stock sold by the partner, $150, and A's smallest percentage interest (prior to the distribution) in the partnership's income, gain, or loss with respect to such stock, 50%. Therefore, A's section 1045 adjusted basis is $75 (50% of $150), and A's nonrecognition limitation amount on the sale of the QSB stock is $50 ($125 section 1045 amount realized minus $75 section 1045 adjusted basis). As this amount is less than the amount of gain that A is eligible to defer under section 1045, $100, A defers recognition of only $50 of the gain from the sale of the QSB stock. A must recognize the remaining $50 of that gain.

(iv) The partnership realizes gain of $100 ($250 amount realized minus $150 remaining basis in QSB stock) on the sale of its QSB stock. Because the partnership reinvested its entire amount realized in new QSB stock and because the partnership made a timely election to apply section 1045, the partnership may treat all of this gain as section 1045 gain. A's share of the partnership section 1045 gain is $50 (50% of $100). Because A is an eligible partner under paragraph (a)(2) of this section, A can defer recognition of this gain subject to the nonrecognition limitation described in paragraph (a)(3) of this section. The smallest percentage interest that A held in PRS during the time that PRS held the QSB stock (determined without regard to the reduction that occurred as a result of PRS's distribution of QSB stock to A) is 50%. See paragraph (a)(3)(ii) of this section. Therefore, under the nonrecognition limitation, A can defer recognition of all $50 (50% of $100) of the gain allocated to A.

Example 13. Contribution of replacement QSB stock to a partnership. (i) On January 1, 2006, A, an individual, B, an individual, and X, a corporation, form PRS, a partnership. A, B, and X each contribute $25 to PRS and agree to share all partnership items equally. On February 1, 2006, PRS purchases Stock 1, which is QSB stock in the hands of the partnership. PRS sells Stock 1 on November 4, 2006, for $150. PRS realizes $75 of gain from the sale of Stock 1 (none of which is treated as ordinary income) and allocates $25 of gain to each of its partners. PRS informs the partners that it does not intend to make an election under section 1045 with respect to the sale of Stock 1. Each partner's share of the amount realized from the sale of Stock 1 is $50. On November 30, 2006, A, an eligible partner within the meaning of paragraph (a)(2) of this section, purchases Stock 2, which is also QSB stock, for $50 and makes a valid section 1045 election under paragraph (c)(1) of this section. Subsequently, A transfers Stock 2 to ABC, a partnership.

(ii) Because A purchased, within 60 days of PRS's sale of Stock 1, replacement QSB stock for a cost equal to A's share of the partnership's amount realized on the sale of Stock 1, and because A made a valid election to apply section 1045 with respect to A's share of the gain from PRS's sale of Stock 1, A does not recognize A's $25 distributive share of the gain from PRS's sale of Stock 1. Before the contribution of Stock 2 to ABC, A's adjusted basis in Stock 2 is $25 ($50 cost minus $25 nonrecognition amount). Upon the contribution of Stock 2 to ABC, A's basis in the ABC partnership interest is $25, and ABC's basis in Stock 2 is $25. However, Stock 2 does not qualify as QSB stock in ABC's hands because it was not acquired at original issue. Neither A nor ABC will be eligible for section 1045 treatment on a subsequent sale of Stock 2.

(h) *Effective date.* This section applies to sales of QSB stock on or after the date final regulations are published in the **Federal Register**.

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

(Filed by the Office of the Federal Register on July 14, 2004, 8:45 a.m., and published in the issue of the Federal Register for July 15, 2004, 69 F.R. 42370)

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

Announcement 2004-63

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
Banister, Joseph R.	San Jose, CA	CPA	June 25, 2004

Suspensions 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 placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Stukes, Donald A.	Pound Ridge, NY	CPA	May 13, 2004 to May 11, 2005
Moore, Earl	Riverview, FL	CPA	March 26, 2004 to March 24, 2006

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
Bell, Don W.	Grand Junction, CO	Enrolled Agent	Indefinite from April 1, 2004
Lentz, Carole A.	Mastic, NY	Enrolled Agent	Indefinite from April 23, 2004
Cummiskey Jr., Edward R.	Warwick, NY	Enrolled Agent	Indefinite from April 23, 2004

Name	Address	Designation	Date of Suspension
Goble, Dennis R.	Valparaiso, IN	CPA	Indefinite from April 26, 2004
Grant, Elaine C.	Woodway, WA	Enrolled Agent	May 1, 2004 to October 31, 2004
Rivera, Eduardo M.	Torrence, CA	Attorney	May 1, 2004 to October 29, 2006
Masengale, Thomas J.	Indianapolis, IN	Enrolled Agent	Indefinite from May 1, 2004
Cohick, Jeffrey S.	Newville, PA	Enrolled Agent	May 1, 2004 to October 30, 2004
Bach, Royce E.	Deer Park, TX	Enrolled Agent	Indefinite from May 27, 2004
McMillin, Juanell	Austin, TX	Enrolled Agent	Indefinite from May 28, 2004
Silva, Hesmeregildo V.	Livermore, CA	Enrolled Agent	Indefinite from May 28, 2004
Grossman, Richard	Durham, NC	Attorney	Indefinite from June 1, 2004
Schnieders, Joseph A.	St. Louis, MO	Enrolled Agent	Indefinite from June 1, 2004
Rahn, Miriam C.	Hutchinson, MN	Enrolled Agent	Indefinite from June 8, 2004
Tarantur, Dale B.	Glenview, IL	CPA	Indefinite from June 15, 2004
Derby, Mark	West Newton, MA	CPA	Indefinite from June 15, 2004
Miller, Winfred J.	Harrisonburg, VA	CPA	Indefinite from June 30, 2004
Croom, John A.	Austin, TX	CPA	Indefinite from July 1, 2004

Name	Address	Designation	Date of Suspension
Dion, Paul	Middletown, RI	CPA	Indefinite from July 8, 2004
Todd, Debra R.	Leander, TX	Enrolled Agent	Indefinite from August 30, 2004

Expedited Suspensions From Practice Before the Internal Revenue Service

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

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

Name	Address	Designation	Date of Suspension
Somerville, Sally L.	Havre de Grace, MD	Attorney	Indefinite from May 3, 2004
Simon, Laurence M.	Englishtown, NJ	CPA	Indefinite from May 10, 2004
Taylor, Joelle T.	Carolina Beach, NC	CPA	Indefinite from May 10, 2004
Becker, Joseph C.	Austin, TX	CPA	Indefinite from May 10, 2004
Maffongelli Jr., Joseph	Montclair, NJ	Attorney	Indefinite from May 10, 2004
Lence, John A.	Kalispell, MT	CPA	Indefinite from May 21, 2004
McWade, Kenneth W.	Kaliua, HI	Attorney	Indefinite from June 9, 2004
Sims, William A.	Sausalito, CA	Attorney	Indefinite from June 9, 2004
Sommer, Peter J.	Baltimore, MD	Attorney	Indefinite from June 21, 2004

Name	Address	Designation	Date of Suspension
Eisenberg, Alan D.	Whitefish Bay, WI	Attorney	Indefinite from June 21, 2004
Litwin, Martin E.	Highland Park, IL	Attorney	Indefinite from June 21, 2004
Kiernat, Bruce E.	St. Paul, MN	Attorney	Indefinite from July 1, 2004

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the 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 resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Resignation
Murphy, Claire A.	Viera, FL	May 10, 2004
Murphy, John W.	Viera, FL	May 10, 2004

Censure Issued by Consent

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

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

Name	Address	Designation	Date of Censure
Clifton, Michael J.	Augusta, KS	CPA	May 12, 2004
Flaherty, Patrick J.	Traverse City, MI	CPA	May 19, 2004
Monroy, Frances	Petaluma, CA	Enrolled Agent	May 27, 2004
Pearson, Michael N.	Houston, TX	Enrolled Agent	June 7, 2004

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 2004–1 through 2004–26 is in Internal Revenue Bulletin 2004–26, dated June 28, 2004.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2004–1 through 2004–26 is in Internal Revenue Bulletin 2004–26, dated June 28, 2004.

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