

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. 2005-25, page 971.

Health Savings Accounts (HSAs); non-high deductible health plan (HDHP). This ruling provides guidance on eligibility and contribution rules under section 223 of the Code for a married individual whose spouse has non-high deductible health plan (HDHP) coverage. A married individual may contribute to a Health Savings Account (HSA) even though his or her spouse has non-HDHP coverage, so long as the individual is not covered by the spouse's non-HDHP. The maximum amount that an eligible individual may contribute to an HSA is based on whether the individual has self-only or family HDHP coverage.

T.D. 9197, page 985.

REG-148521-04, page 995.

Final, temporary, and proposed regulations under section 7701 of the Code add to the list of foreign business entities that are always classified as corporations, per se corporations, and, therefore, are not eligible to check the box to change their classification. A public hearing on the proposed regulations is scheduled for July 27, 2005.

T.D. 9198, page 972.

Final regulations under section 355(e) of the Code relate to the recognition of gain on certain distributions of stock or securities in connection with an acquisition. The regulations provide guidance on whether an acquisition and a distribution are part of a plan (or series of related transactions).

Rev. Proc. 2005-20, page 990.

This procedure describes how a regulated investment company (RIC) that holds a partnership interest is treated. A RIC that is a consenting partner in a partnership, that has in effect a monthly

closing election under Rev. Proc. 2003-84, 2003-2 C.B. 1159, is treated as if directly invested in the assets held by the partnership. Rev. Proc. 2003-32 amplified and superseded.

Announcement 2005-31, page 996.

This document contains corrections to final regulations (T.D. 9165, 2005-4 I.R.B. 357) under section 330 of Title 31 of the U.S. Code governing practice before the Internal Revenue Service (Circular 230).

EMPLOYEE PLANS

Rev. Proc. 2005-23, page 991.

Retroactive payment of benefits; remedial amendment period; determination letters. This document contains procedures to limit the retroactive application of the decision in *Central Laborers' Pension Fund v. Heinz*, 124 S.Ct. 2230 (2004), for affected retirement plans qualified under section 401(a) of the Code.

TAX CONVENTIONS

Announcement 2005-30, page 988.

Mutual Agreement on U.K. pension arrangements. A copy of the news release issued by the Director, International (U.S. Competent Authority), on April 13, 2005 (IR-2005-44), is set forth.

(Continued on the next page)

Finding Lists begin on page ii.



ADMINISTRATIVE

T.D. 9197, page 985.

REG-148521-04, page 995.

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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.

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

Section 223.—Health Savings Accounts

Health Savings Accounts (HSAs); non-high deductible health plan (HDHP). This ruling provides guidance on eligibility and contribution rules under section 223 of the Code for a married individual whose spouse has non-high deductible health plan (HDHP) coverage. A married individual may contribute to a Health Savings Account (HSA) even though his or her spouse has non-HDHP coverage, so long as the individual is not covered by the spouse's non-HDHP. The maximum amount that an eligible individual may contribute to an HSA is based on whether the individual has self-only or family HDHP coverage.

Rev. Rul. 2005–25

ISSUES

1. Is a married individual who otherwise qualifies as an “eligible individual” eligible to contribute to a Health Savings Account (HSA) under section 223 of the Internal Revenue Code (the Code) if the individual's spouse has non-HDHP family coverage that does not cover the individual?

2. If the individual is eligible to contribute to an HSA, what is the maximum contribution limit?

FACTS

Situation 1

H and W are a married couple and both are age 35. Throughout 2005, H has self-only coverage under a high deductible health plan (HDHP) as defined in section 223(c)(2) with an annual deductible of \$2,000. H has no other health coverage, is not enrolled in Medicare and may not be claimed as a dependent on another taxpayer's return. W has non-HDHP family coverage for W and H's and W's two dependents, but H is excluded from W's coverage.

Situation 2

The same facts as *Situation 1*, except that H has HDHP family coverage as defined in section 223(c)(2) for H and one of H's and W's dependents with an annual deductible of \$5,000. W has non-HDHP family coverage for W and H's and W's other dependent. H is excluded from W's coverage.

Situation 3

The same facts as *Situation 1*, except that H has HDHP family coverage for H and H's and W's two dependents with an annual deductible of \$5,000. W is not covered under H's health plan and has no other health plan coverage.

LAW AND ANALYSIS

Section 223(a) allows a deduction for contributions to an HSA for an “eligible individual.” Section 223(c)(1)(A) defines “eligible individual” with respect to any month, as an individual who, in addition to other requirements, is covered under an HDHP on the first day of such month and is not, while covered under an HDHP, “covered under any health plan which is not a high deductible health plan, and which provides coverage for any benefit which is covered under the high deductible health plan.” An eligible individual may also have permitted insurance, and certain disregarded coverage in addition to an HDHP. A plan does not fail to be treated as an HDHP merely because it covers preventive care without a deductible.

An HDHP is a health plan that satisfies certain requirements with respect to minimum annual deductibles and maximum annual out-of-pocket expenses. Section 223(c)(2)(A). Family coverage is any coverage other than self-only coverage (e.g., an HDHP covering one eligible individual and at least one other individual (whether or not the other individual is an eligible individual)). Section 223(c)(4); Q&A–12 of Notice 2004–50, 2004–33 I.R.B. 196.

Only eligible individuals may contribute to an HSA. The maximum annual contribution limit is the sum of the limits determined separately for each month. For

an individual who is eligible during the entire calendar year 2005, the contribution limit is the lesser of the annual deductible under the HDHP (minimum of \$1,000 for self-only coverage and \$2,000 for family coverage) or \$2,650 for self-only coverage and \$5,250 for family coverage. Rev. Proc. 2004–71, 2004–50 I.R.B. 970, § 3.22.

Section 223(b)(5) provides special rules for married individuals. In general, if either spouse has family coverage, both spouses are treated as having only such family coverage. Also, if each spouse has family coverage under different health plans, both spouses are treated as having family coverage under the plan with the lowest deductible. However, if a spouse has HDHP family coverage and the other spouse has non-HDHP self-only coverage, the spouse with the HDHP family coverage is an eligible individual and may contribute to an HSA up to the amount of the annual contribution limit. Because the other spouse is covered by a non-HDHP and is therefore not an eligible individual, the other spouse may not contribute to an HSA, notwithstanding the special rule in section 223(b)(5) treating both spouses as having family coverage. Q&A–31 of Notice 2004–50.

An eligible individual who attains age 55 before the close of the calendar year may make a catch-up HSA contribution (up to \$600 in 2005). Section 223(b)(3).

In *Situation 1*, H has HDHP self-only coverage and no other health coverage, is not enrolled in Medicare and may not be claimed as a dependent on another taxpayer's return. Although W has non-HDHP family coverage, H is not covered under that health plan. H is therefore an eligible individual as defined in section 223(c)(1). The special rules for married individuals under section 223(b)(5) do not apply because W's non-HDHP family coverage does not cover H. Thus, H remains an eligible individual and H may contribute up to \$2,000 to an HSA (lesser of the HDHP deductible for self-only coverage or \$2,650) for 2005. H may not make the catch-up contribution under section 223(b)(3) because H is not age 55 in

2005. W has non-HDHP coverage and is therefore not an eligible individual.

In *Situation 2*, H has HDHP family coverage for one of H's and W's dependents and W has non-HDHP family coverage for W and H's and W's other dependent. Because the non-HDHP family coverage does not cover H, the special rules in section 223(b)(5) do not affect H's eligibility to make HSA contributions up to H's annual HSA contribution limit. H may therefore contribute up to \$5,000 to an HSA (the lesser of the family HDHP deductible or \$5,250). W has non-HDHP coverage and is therefore not an eligible individual.

In *Situation 3*, H has HDHP family coverage for H and H's and W's two dependents. H may contribute to up to \$5,000 to an HSA (the lesser of the family HDHP deductible or \$5,250). Because H's family coverage does not cover W, the special rules under section 223(b)(5) do not apply to treat W as having family coverage. W has no health plan coverage and is therefore not an eligible individual.

HOLDINGS

1. An individual who otherwise qualifies as an eligible individual does not fail to be an eligible individual merely because the individual's spouse has non-HDHP family coverage, if the spouse's non-HDHP does not cover the individual. Accordingly, that individual may contribute to an HSA.

2. The maximum amount under section 223(b) that an eligible individual may contribute to an HSA is based on whether the individual has self-only or family HDHP coverage.

DRAFTING INFORMATION

The principal author of this revenue ruling is Elizabeth Purcell of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Purcell at (202) 622-6080 (not a toll-free call).

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355-7: Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

T.D. 9198

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Guidance Under Section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities in Connection With an Acquisition

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under section 355(e) of the Internal Revenue Code relating to the recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. Changes to the applicable law were made by the Taxpayer Relief Act of 1997. These regulations affect corporations and are necessary to provide them with guidance needed to comply with those changes.

DATES: *Effective Date:* These regulations are effective April 19, 2005.

Applicability Date: For dates of applicability, see §1.355-7(k).

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

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains amendments to 26 CFR part 1 under section 355(e) of the Internal Revenue Code (Code). Section 355(e) provides that the stock of a

controlled corporation will not be qualified property under section 355(c)(2) or 361(c)(2) if the stock is distributed as "part of a plan (or series of related transactions) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation."

On April 26, 2002, temporary regulations (T.D. 8988, 2002-1 C.B. 929) (the 2002 temporary regulations) were published in the **Federal Register** (67 FR 20632). The 2002 temporary regulations provide guidance concerning the interpretation of the phrase "plan (or series of related transactions)." A notice of proposed rulemaking (REG-163892-01, 2002-1 C.B. 968) (the 2002 proposed regulations) cross-referencing the 2002 temporary regulations was published in the **Federal Register** for the same day (67 FR 20711).

The 2002 temporary regulations provide that whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances and set forth a nonexclusive list of factors that are relevant in making that determination. The 2002 temporary regulations also provide that a distribution and a post-distribution acquisition not involving a public offering can be part of a plan only if there was an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition at some time during the two-year period preceding the distribution (the post-distribution acquisition rule). Finally, the 2002 temporary regulations set forth seven safe harbors. The satisfaction of any one of these safe harbors confirms that a distribution and an acquisition are not part of a plan.

No public hearing was requested or held for the 2002 proposed regulations. Written and electronic comments responding to the notice of proposed rulemaking were received. After consideration of the comments, the 2002 proposed regulations are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed. The more significant comments and revisions are discussed below.

A. Pre-Distribution Acquisitions Not Involving a Public Offering

The 2002 temporary regulations include a safe harbor, Safe Harbor IV, that may be available for a pre-distribution acquisition. That safe harbor provides that an acquisition and a distribution that occurs more than two years after the acquisition are not part of a plan if there was no agreement, understanding, arrangement, or substantial negotiations concerning the distribution at the time of the acquisition or within six months thereafter. In addition to Safe Harbor IV, the 2002 temporary regulations identify a number of factors that are relevant in determining whether a distribution and a pre-distribution acquisition not involving a public offering are part of a plan. Among the factors tending to show that a distribution and a pre-distribution acquisition not involving a public offering are not part of a plan is the absence of discussions by the distributing corporation (Distributing) or the controlled corporation (Controlled) with the acquirer regarding a distribution during the two-year period before the acquisition (the no-discussions factor). The absence of such discussions, however, will not tend to show that a distribution and an acquisition are not part of a plan if the acquisition occurs after the date of the public announcement of the planned distribution (the public announcement restriction).

Commentators have suggested that, under the 2002 temporary regulations, it is more difficult to establish that a distribution and a pre-distribution acquisition not involving a public offering are not part of a plan than it is to establish that a distribution and a post-distribution acquisition are not part of a plan. This suggestion is based in part on the fact that the 2002 temporary regulations include the post-distribution acquisition rule for post-distribution acquisitions but no analogous rule for pre-distribution acquisitions.

Commentators have proposed extending the availability of Safe Harbor IV by reducing the period between the acquisition and the distribution from two years to one year. They have also suggested adopting a new safe harbor that would be available for acquisitions of Distributing that occur before a *pro rata* distribution. Finally, commentators have suggested that the public announcement restriction

on the no-discussions factor be eliminated because a public announcement, as a practical matter, commits Distributing to attempt the distribution and, thus, is strong evidence that the distribution would have occurred regardless of the acquisition.

The IRS and Treasury Department believe that it is desirable to provide for additional bright-line rules for determining whether a distribution and a pre-distribution acquisition not involving a public offering are part of a plan. Accordingly, these final regulations amend Safe Harbor IV, add a new safe harbor for acquisitions of Distributing prior to a *pro rata* distribution, and amend the no-discussions factor.

1. Revisions to Safe Harbor IV of the 2002 temporary regulations

The IRS and Treasury Department generally believe that if an acquirer had no knowledge of Distributing's intention to effect a distribution and had no intention or ability to cause a distribution, a pre-distribution acquisition and a distribution should not be considered part of a plan, regardless of whether the distribution occurs more than two years after the acquisition. The IRS and Treasury Department, however, are concerned that conditioning the availability of a safe harbor on an absence of knowledge may be inadministrable and lead to uncertainty. Accordingly, these final regulations amend Safe Harbor IV of the 2002 temporary regulations to provide that a distribution and a pre-distribution acquisition not involving a public offering will not be considered part of a plan if the acquisition occurs before the first disclosure event regarding the distribution. The final regulations define a disclosure event as any communication by an officer, director, controlling shareholder, or employee of Distributing, Controlled, or a corporation related to Distributing or Controlled, or an outside advisor of any of those persons (where such advisor makes the communication on behalf of such person), regarding the distribution, or the possibility thereof, to the acquirer or any other person (other than an officer, director, controlling shareholder, or employee of Distributing, Controlled, or a corporation related to Distributing or Controlled, or an outside advisor of any of those persons).

To ensure that Safe Harbor IV of the 2002 temporary regulations is not avail-

able for acquisitions by persons who could participate in the decision to effect a distribution, these final regulations provide that Safe Harbor IV is not available for acquisitions by a person that was a controlling shareholder or a ten-percent shareholder of the acquired corporation at any time during the period beginning immediately after the acquisition and ending on the date of the distribution. The safe harbor is also unavailable if the acquisition occurs in connection with a transaction in which the aggregate acquisitions represent 20 percent or more of the stock of the acquired corporation by vote or value.

2. New safe harbor for acquisitions before a *pro rata* distribution

The IRS and Treasury Department believe that acquisitions of Distributing not involving a public offering that occur before a *pro rata* distribution are not likely to be part of a plan including the distribution where there has been a public announcement of the distribution prior to the acquisition, there were no discussions regarding the acquisition prior to the public announcement, and the acquirer did not have the ability to participate in or influence the distribution decision. The facts that the distribution was publicly announced prior to discussions regarding the acquisition and that the acquisition was small in size suggest that the distribution would have occurred regardless of the acquisition. Moreover, the fact that a pre-distribution shareholder of Distributing has the same interest in both Distributing and Controlled, directly or indirectly, both immediately before and immediately after a *pro rata* distribution reduces the likelihood that the acquisition and the distribution were part of a plan. Accordingly, these final regulations include a new safe harbor, Safe Harbor V, that applies to acquisitions of Distributing not involving a public offering that occur prior to a *pro rata* distribution. That safe harbor provides that a distribution that is *pro rata* among the Distributing shareholders and a pre-distribution acquisition of Distributing not involving a public offering will not be considered part of a plan if the acquisition occurs after the date of a public announcement regarding the distribution and there were no discussions by Distributing or Controlled with the acquirer regarding a distribution

on or before the date of the first public announcement regarding the distribution. A public announcement regarding the distribution is any communication by Distributing or Controlled regarding Distributing's intention to effect the distribution where the communication is generally available to the public. A public announcement includes, for example, a press release issued by Distributing announcing the distribution. It also includes a conversation between an officer of Distributing and stock analysts in which the officer communicates Distributing's intention to effect a distribution. New Safe Harbor V is intended to apply only to acquisitions by persons that do not have the ability to effect the distribution. Therefore, new Safe Harbor V is unavailable for acquisitions by persons that were controlling shareholders or ten-percent shareholders of Distributing at any time during the period beginning immediately after the acquisition and ending on the date of the distribution. In addition, new Safe Harbor V is unavailable if the acquisition occurs in connection with a transaction in which the aggregate acquisitions represent 20 percent or more of the stock of Distributing by vote or value.

3. *No-discussions factor*

As discussed above, the IRS and Treasury Department believe that the occurrence of a public announcement of a distribution before the discussion of an acquisition not involving a public offering suggests that the distribution would have occurred regardless of the acquisition. Therefore, these final regulations amend the no-discussions factor to remove the public announcement restriction.

B. *Public Offerings*

The 2002 temporary regulations distinguish between acquisitions not involving a public offering and acquisitions involving a public offering. A number of commentators have suggested that it is difficult to apply the 2002 temporary regulations to acquisitions involving public offerings and have requested (1) clarification of the definition of public offering, (2) additional safe harbors for acquisitions involving public offerings, and (3) guidance regarding when an acquisition is similar to a potential acquisition involving a public

offering. These final regulations address these requests.

1. *Definition of public offering*

Questions have arisen regarding whether a public offering includes stock issuances that are not for cash, including stock issuances for assets or stock in tax-free reorganizations. These final regulations define an acquisition involving a public offering as a stock acquisition for cash where the terms of the acquisition are established by the acquired corporation (Distributing or Controlled) or the seller with the involvement of one or more investment bankers, and the potential acquirers have no opportunity to negotiate the terms of the acquisition. Under this definition, while an initial public offering and a secondary offering will be treated as public offerings, a private placement involving bilateral discussions and a stock issuance for assets or stock in a tax-free reorganization will not be treated as public offerings.

2. *New safe harbor for public offerings*

These final regulations add new Safe Harbor VI. Under new Safe Harbor VI, a distribution and an acquisition involving a public offering occurring before the distribution will not be considered part of a plan if the acquisition occurs before the first disclosure event regarding the distribution in the case of an acquisition of stock that is not listed on an established market, or before the date of the first public announcement regarding the distribution in the case of an acquisition of stock that is listed on an established market. The new safe harbor is based on the view of the IRS and Treasury Department that a public offering and a distribution are not likely to be part of a plan if the acquirers in the offering are unaware that a distribution will occur.

3. *Similar acquisitions involving public offerings*

In the plan and non-plan factors and a number of safe harbors, the 2002 temporary regulations refer to acquisitions that are similar to the actual acquisition. The 2002 temporary regulations provide that an acquisition involving a public offering may be similar to another acquisition involving a public offering even though there

are changes in the terms of the stock, the class of stock being offered, the size of the offering, the timing of the offering, the price of the stock, or the participants in the offering. This provision is intended to ensure that certain changes in the terms of the offering that is intended at the time of the distribution do not prevent the distribution and the offering that actually occurs from being considered part of a plan.

Commentators have requested further guidance regarding when an acquisition will be treated as similar to another acquisition involving a public offering. The IRS and Treasury Department believe, and these final regulations provide, that more than one actual acquisition may be similar to a potential acquisition involving a public offering. However, the IRS and Treasury Department also believe, and these final regulations provide that, if there is an actual acquisition involving a public offering (the first public offering) that is the same as, or similar to, a potential acquisition involving a public offering, then another actual acquisition involving a public offering (the second public offering) cannot be similar to the potential acquisition unless the purpose of the second public offering is similar to that of the potential acquisition and occurs close in time to the first public offering. The final regulations include three new examples that illustrate the application of this rule.

C. *Acquisitions Pursuant to Publicly Offered Options*

The IRS and Treasury Department believe that, in certain cases, whether an acquisition that is pursuant to an option and a distribution are part of a plan should be determined pursuant to the rules related to acquisitions involving a public offering. In particular, suppose that, after consulting with its investment banker, Distributing issues options to acquire its stock. The options are marketed and sold through a distribution process that is similar to that utilized in a public offering. In these cases, the acquirer may never discuss the acquisition with Distributing. The investment banker, however, will discuss the acquisition with Distributing. Therefore, it seems more appropriate to analyze whether a distribution and an acquisition of stock pursuant to such an option are part of a plan under the rules that apply to acquisitions

involving a public offering, rather than the rules that apply to acquisitions not involving a public offering. Accordingly, these final regulations provide that, if an option is issued for cash, the terms of the acquisition of the option and the terms of the option are established by the corporation the stock of which is subject to the option (Distributing or Controlled) or the writer with the involvement of one or more investment bankers, and the potential acquirers of the option have no opportunity to negotiate the terms of the acquisition of the option or the terms of the option, then an acquisition pursuant to that option will be treated as an acquisition involving a public offering occurring after a distribution if the option is exercised after the distribution or an acquisition involving a public offering occurring before the distribution if the option is exercised before the distribution. Otherwise, an acquisition pursuant to an option will be treated as an acquisition not involving a public offering.

D. Agreement, Understanding, or Arrangement

Throughout the 2002 temporary regulations reference is made to the phrase “agreement, understanding, or arrangement.” The 2002 temporary regulations provide that whether an agreement, understanding, or arrangement exists depends on the facts and circumstances. One commentator questioned whether an agreement by a person who does not actively participate in the management of the acquired corporation should be treated as an agreement, understanding, or arrangement. The IRS and Treasury Department believe that the activities of those who have the authority to act on behalf of Distributing or Controlled as well as the activities of the controlling shareholders of Distributing and Controlled are relevant to the determination of whether a distribution and an acquisition are part of a plan. Therefore, these final regulations provide that an agreement, understanding, or arrangement generally requires either (1) an agreement, understanding, or arrangement by one or more officers or directors acting on behalf of Distributing or Controlled, by a controlling shareholder of Distributing or Controlled, or by another person with the implicit or explicit permission of one or more of such persons, with the

acquirer or with a person or persons with the implicit or explicit permission of the acquirer; or (2) an agreement, understanding, or arrangement by an acquirer that is a controlling shareholder of Distributing or Controlled immediately after the acquisition that is the subject of the agreement, understanding, or arrangement, or by a person or persons with the implicit or explicit permission of such acquirer, with the transferor or with a person or persons with the implicit or explicit permission of the transferor. These final regulations also make conforming changes to the rules related to when an option will be treated as an agreement, understanding, or arrangement to acquire stock, and the definition of substantial negotiations.

E. Substantial Negotiations and Discussions

Under the 2002 temporary regulations, the presence or absence of “substantial negotiations” or “discussions” regarding an acquisition or a distribution is relevant to the determination of whether a distribution and an acquisition are part of a plan. The 2002 temporary regulations provide that, in the case of an acquisition other than a public offering, substantial negotiations generally require discussions of significant economic terms by one or more officers, directors, or controlling shareholders of Distributing or Controlled, or another person or persons with the implicit or explicit permission of one or more officers, directors, or controlling shareholders of Distributing or Controlled, with the acquirer or a person or persons with the implicit or explicit permission of the acquirer. In addition, the 2002 temporary regulations provide that (i) discussions by Distributing or Controlled generally require discussions by one or more officers, directors, or controlling shareholders of Distributing or Controlled, or another person or persons with the implicit or explicit permission of one or more officers, directors, or controlling shareholders of Distributing or Controlled; and (ii) discussions with the acquirer generally require discussions with the acquirer or a person or persons with the implicit or explicit permission of the acquirer.

Commentators have requested that final regulations clarify that, where the acquirer is a corporation, substantial nego-

tiations and discussions must involve one or more officers, directors, or controlling shareholders of the acquirer, or another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders. These final regulations reflect those clarifications.

F. Safe Harbor VI of the 2002 Temporary Regulations

1. Asset reorganizations involving Distributing or Controlled

Safe Harbor VI of the 2002 temporary regulations generally provides that if stock of Distributing or Controlled is acquired by a person in connection with such person’s performance of services as an employee, director, or independent contractor for Distributing, Controlled, or a related person in a transaction to which section 83 or section 421(a) applies, the acquisition and the distribution will not be considered part of a plan. Questions have arisen regarding whether this safe harbor is available for an acquisition of Distributing or Controlled stock to which section 83 or section 421(a) applies when the acquirer performed services for a corporation other than Distributing, Controlled, or a person related to Distributing or Controlled. For example, assume that X, a corporation unrelated to Distributing and Controlled, grants A, an employee, an incentive stock option in connection with A’s performance of services as an employee of X. Before A exercises the option, Distributing acquires the assets of X in a reorganization under section 368(a)(1)(A) and A’s incentive stock option to acquire stock of X is substituted within the meaning of §1.424–1(a) with an incentive stock option to acquire stock of Distributing. Commentators have asked whether Safe Harbor VI of the 2002 temporary regulations applies to A’s exercise of the option to acquire stock of Distributing, even though A performed services for X rather than Distributing. These final regulations modify this safe harbor (Safe Harbor VIII of these final regulations) to ensure its availability in this and similar situations.

2. Disqualifying dispositions

As described above, Safe Harbor VI of the 2002 temporary regulations may

be available for acquisitions of stock in a transaction to which section 421(a) applies. In order to qualify as a transaction to which section 421(a) applies, the acquirer must satisfy the requirements of section 422(a) or section 423(a), including the holding period requirements of section 422(a)(1) or section 423(a)(1). In particular, the acquirer must not dispose of the acquired stock within two years from the date of the granting of the option or within one year after the transfer of such stock to the acquirer. The IRS and Treasury Department do not believe that a disposition of stock acquired pursuant to an option that otherwise satisfies the requirements of section 422 or section 423 prior to the period prescribed in section 422(a)(1) or 423(a)(1) evidences that the acquisition of stock pursuant to the option and the distribution are part of a plan. Therefore, these final regulations extend the application of Safe Harbor VI of the 2002 temporary regulations to not only transactions to which section 421(a) applies, but also transactions to which section 421(b) applies.

G. Safe Harbor VII of the 2002 Temporary Regulations

Safe Harbor VII of the 2002 temporary regulations generally provides that if stock of Distributing or Controlled is acquired by an employer's retirement plan that qualifies under section 401(a) or 403(a), the acquisition and the distribution will not be considered part of a plan. That safe harbor, however, does not apply to the extent that the stock acquired by all of the employer's qualified plans during the four-year period beginning two years before the distribution, in the aggregate, represents ten percent or more of the total combined voting power of all classes of stock entitled to vote, or ten percent or more of the total value of shares of all classes of stock, of the acquired corporation. Questions have arisen regarding whether this safe harbor is available at all if the acquisitions by the employer's retirement plans exceed ten percent of the acquired corporation's stock during the prescribed period.

These final regulations revise Safe Harbor VII of the 2002 temporary regulations (Safe Harbor IX of these final regulations) to clarify that, if the acquisitions by an employer's retirement plan total in excess of

ten percent, the safe harbor is available for the first ten percent acquired during the prescribed period. These final regulations also revise this safe harbor to reflect that it is only available for acquisitions by a retirement plan of Distributing, Controlled, or any person that is treated as the same employer as Distributing or Controlled under section 414(b), (c), (m), or (o).

H. Compensatory Options

The 2002 temporary regulations include special rules that treat an option as an agreement, understanding, or arrangement to acquire the stock subject to the option on the earliest of the date the option was written, transferred, or modified, if on that date the option was more likely than not to be exercised. The 2002 temporary regulations except compensatory options from these rules. For this purpose, a compensatory option is an option to acquire stock in Distributing or Controlled with customary terms and conditions provided to a person in connection with such person's performance of services as an employee, director, or independent contractor for the corporation or a related person (and that is not excessive by reference to the services performed), provided that the transfer of stock pursuant to such option is described in section 421(a) or the option is nontransferable within the meaning of §1.83-3(d) and does not have a readily ascertainable fair market value as defined in §1.83-7(b).

The IRS and Treasury Department have become aware that arrangements using compensatory options have been structured to prevent an acquisition of stock from being treated as part of a plan that includes a distribution in avoidance of section 355(e). Accordingly, these final regulations revise the 2002 temporary regulations to treat compensatory options as options.

Special Analysis

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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because these regulations do not impose a

collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

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

* * * * *

Adoption of Amendments to Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.355-7T and adding the following entry to read, in part, as follows:

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

Section 1.355-7 also issued under 26 U.S.C. 355(e)(5). * * *

Par. 2. Section 1.355-0 is amended as follows:

1. Revise the introductory text.
2. Remove the entries for §1.355-7T and add the entries for §1.355-7.

The revision and addition read as follows:

§1.355-0 Outline of sections.

In order to facilitate the use of §§1.355-1 through 1.355-7, this section lists the major paragraphs in those sections as follows:

* * * * *

§1.355-7 Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

- (a) In general.
- (b) Plan.
- (1) In general.

- (2) Certain post-distribution acquisitions.
- (3) Plan factors.
- (4) Non-plan factors.
- (c) Operating rules.
 - (1) Internal discussions and discussions with outside advisors evidence of business purpose.
 - (2) Takeover defense.
 - (3) Effect of distribution on trading in stock.
 - (4) Consequences of section 355(e) disregarded for certain purposes.
 - (5) Multiple acquisitions.
 - (d) Safe harbors.
 - (1) Safe Harbor I.
 - (2) Safe Harbor II.
 - (i) In general.
 - (ii) Special rule.
 - (3) Safe Harbor III.
 - (4) Safe Harbor IV.
 - (i) In general.
 - (ii) Special rules.
 - (5) Safe Harbor V.
 - (i) In general.
 - (ii) Special rules.
 - (6) Safe Harbor VI.
 - (7) Safe Harbor VII.
 - (i) In general.
 - (ii) Special rules.
 - (8) Safe Harbor VIII.
 - (i) In general.
 - (ii) Special rule.
 - (9) Safe Harbor IX.
 - (i) In general.
 - (ii) Special rule.
 - (e) Options, warrants, convertible obligations, and other similar interests.
 - (1) Treatment of options.
 - (i) General rule.
 - (ii) Agreement, understanding, or arrangement to write, transfer, or modify an option.
 - (iii) Substantial negotiations related to options.
 - (2) Stock acquired pursuant to options.
 - (3) Instruments treated as options.
 - (4) Instruments generally not treated as options.
 - (i) Escrow, pledge, or other security agreements.
 - (ii) Options exercisable only upon death, disability, mental incompetency, or separation from service.
 - (iii) Rights of first refusal.
 - (iv) Other enumerated instruments.
 - (f) Multiple controlled corporations.
 - (g) Valuation.

- (h) Definitions.
 - (1) Agreement, understanding, arrangement, or substantial negotiations.
 - (2) Controlled corporation.
 - (3) Controlling shareholder.
 - (4) Coordinating group.
 - (5) Disclosure event.
 - (6) Discussions.
 - (7) Established market.
 - (8) Five-percent shareholder.
 - (9) Implicit permission.
 - (10) Public announcement.
 - (11) Public offering.
 - (12) Similar acquisition (not involving a public offering).
 - (13) Similar acquisition involving a public offering.
 - (i) One public offering.
 - (ii) More than one public offering.
 - (iii) Potential acquisition involving a public offering.
 - (14) Ten-percent shareholder.
 - (i) [Reserved].
 - (j) Examples.
 - (k) Effective dates.

Par. 3. Section 1.355-7 is added to read as follows:

§1.355-7 Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

(a) *In general.* Except as provided in section 355(e) and in this section, section 355(e) applies to any distribution—

(1) To which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) That is part of a plan (or series of related transactions) (hereinafter, plan) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation (Distributing) or any controlled corporation (Controlled).

(b) *Plan*—(1) *In general.* Whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances. The facts and circumstances to be considered in demonstrating whether a distribution and an acquisition are part of a plan include, but are not limited to, the facts and circumstances set forth in paragraphs (b)(3) and (4) of this section. In general, the weight to be given each of the facts and circumstances depends on the particular case. Whether a distribution and an acquisition are part of a

plan does not depend on the relative number of facts and circumstances set forth in paragraph (b)(3) that evidence that a distribution and an acquisition are part of a plan as compared to the relative number of facts and circumstances set forth in paragraph (b)(4) that evidence that a distribution and an acquisition are not part of a plan.

(2) *Certain post-distribution acquisitions.* In the case of an acquisition (other than involving a public offering) after a distribution, the distribution and the acquisition can be part of a plan only if there was an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition at some time during the two-year period ending on the date of the distribution. In the case of an acquisition (other than involving a public offering) after a distribution, the existence of an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition at some time during the two-year period ending on the date of the distribution tends to show that the distribution and the acquisition are part of a plan. See paragraph (b)(3)(i) of this section. However, all facts and circumstances must be considered to determine whether the distribution and the acquisition are part of a plan. For example, in the case of an acquisition (other than involving a public offering) after a distribution, if the distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of §1.355-2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled (see paragraph (b)(4)(v) of this section) and would have occurred at approximately the same time and in similar form regardless of whether the acquisition or a similar acquisition was effected (see paragraph (b)(4)(vi) of this section), the taxpayer may be able to establish that the distribution and the acquisition are not part of a plan.

(3) *Plan factors.* Among the facts and circumstances tending to show that a distribution and an acquisition are part of a plan are the following:

(i) In the case of an acquisition (other than involving a public offering) after a distribution, at some time during the two-year period ending on the date of the distribution, there was an agreement, under-

standing, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition. The weight to be accorded this fact depends on the nature, extent, and timing of the agreement, understanding, arrangement, or substantial negotiations. The existence of an agreement, understanding, or arrangement at the time of the distribution is given substantial weight.

(ii) In the case of an acquisition involving a public offering after a distribution, at some time during the two-year period ending on the date of the distribution, there were discussions by Distributing or Controlled with an investment banker regarding the acquisition or a similar acquisition. The weight to be accorded this fact depends on the nature, extent, and timing of the discussions.

(iii) In the case of an acquisition (other than involving a public offering) before a distribution, at some time during the two-year period ending on the date of the acquisition, there were discussions by Distributing or Controlled with the acquirer regarding a distribution. The weight to be accorded this fact depends on the nature, extent, and timing of the discussions. In addition, in the case of an acquisition (other than involving a public offering) before a distribution, the acquirer intends to cause a distribution and, immediately after the acquisition, can meaningfully participate in the decision regarding whether to make a distribution.

(iv) In the case of an acquisition involving a public offering before a distribution, at some time during the two-year period ending on the date of the acquisition, there were discussions by Distributing or Controlled with an investment banker regarding a distribution. The weight to be accorded this fact depends on the nature, extent, and timing of the discussions.

(v) In the case of an acquisition either before or after a distribution, the distribution was motivated by a business purpose to facilitate the acquisition or a similar acquisition.

(4) *Non-plan factors.* Among the facts and circumstances tending to show that a distribution and an acquisition are not part of a plan are the following:

(i) In the case of an acquisition involving a public offering after a distribution, during the two-year period ending on the date of the distribution, there were no

discussions by Distributing or Controlled with an investment banker regarding the acquisition or a similar acquisition.

(ii) In the case of an acquisition after a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the distribution that resulted in the acquisition that was otherwise unexpected at the time of the distribution.

(iii) In the case of an acquisition (other than involving a public offering) before a distribution, during the two-year period ending on the date of the earlier to occur of the acquisition or the first public announcement regarding the distribution, there were no discussions by Distributing or Controlled with the acquirer regarding a distribution. Paragraph (b)(4)(iii) of this section does not apply to an acquisition where the acquirer intends to cause a distribution and, immediately after the acquisition, can meaningfully participate in the decision regarding whether to make a distribution.

(iv) In the case of an acquisition before a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the acquisition that resulted in a distribution that was otherwise unexpected.

(v) In the case of an acquisition either before or after a distribution, the distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of §1.355-2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition.

(vi) In the case of an acquisition either before or after a distribution, the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition.

(c) *Operating rules.* The operating rules contained in this paragraph (c) apply for all purposes of this section.

(1) *Internal discussions and discussions with outside advisors evidence of business purpose.* Discussions by Distributing or Controlled with outside advisors and internal discussions may be indicative of one or more business purposes for the distribution and the relative importance of such purposes.

(2) *Takeover defense.* If Distributing engages in discussions with a potential acquirer regarding an acquisition of Dis-

tributing or Controlled and distributes Controlled stock intending, in whole or substantial part, to decrease the likelihood of the acquisition of Distributing or Controlled by separating it from another corporation that is likely to be acquired, Distributing will be treated as having a business purpose to facilitate the acquisition of the corporation that was likely to be acquired.

(3) *Effect of distribution on trading in stock.* The fact that the distribution made all or a part of the stock of Controlled available for trading or made Distributing's or Controlled's stock trade more actively is not taken into account in determining whether the distribution and an acquisition of Distributing or Controlled stock were part of a plan.

(4) *Consequences of section 355(e) disregarded for certain purposes.* For purposes of determining the intentions of the relevant parties under this section, the consequences of the application of section 355(e), and the existence of any contractual indemnity by Controlled for tax resulting from the application of section 355(e) caused by an acquisition of Controlled, are disregarded.

(5) *Multiple acquisitions.* All acquisitions of stock of Distributing or Controlled that are considered to be part of a plan with a distribution pursuant to paragraph (b) of this section will be aggregated for purposes of the 50-percent test of paragraph (a)(2) of this section.

(d) *Safe harbors*—(1) *Safe Harbor I.* A distribution and an acquisition occurring after the distribution will not be considered part of a plan if—

(i) The distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of §1.355-2(b)), other than a business purpose to facilitate an acquisition of the acquired corporation (Distributing or Controlled); and

(ii) The acquisition occurred more than six months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition or a similar acquisition during the period that begins one year before the distribution and ends six months thereafter.

(2) *Safe Harbor II*—(i) *In general.* A distribution and an acquisition occurring

after the distribution will not be considered part of a plan if—

(A) The distribution was not motivated by a business purpose to facilitate the acquisition or a similar acquisition;

(B) The acquisition occurred more than six months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition or a similar acquisition during the period that begins one year before the distribution and ends six months thereafter; and

(C) No more than 25 percent of the stock of the acquired corporation (Distributing or Controlled) was either acquired or the subject of an agreement, understanding, arrangement, or substantial negotiations during the period that begins one year before the distribution and ends six months thereafter.

(ii) *Special rule.* For purposes of paragraph (d)(2)(i)(C) of this section, acquisitions of stock that are treated as not part of a plan pursuant to Safe Harbor VII, Safe Harbor VIII, or Safe Harbor IX are disregarded.

(3) *Safe Harbor III.* If an acquisition occurs after a distribution, there was no agreement, understanding, or arrangement concerning the acquisition or a similar acquisition at the time of the distribution, and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition or a similar acquisition within one year after the distribution, the acquisition and the distribution will not be considered part of a plan.

(4) *Safe Harbor IV—(i) In general.* A distribution and an acquisition (other than involving a public offering) occurring before the distribution will not be considered part of a plan if the acquisition occurs before the date of the first disclosure event regarding the distribution.

(ii) *Special rules.* (A) Paragraph (d)(4)(i) of this section does not apply to a stock acquisition if the acquirer or a coordinating group of which the acquirer is a member is a controlling shareholder or a ten-percent shareholder of the acquired corporation (Distributing or Controlled) at any time during the period beginning immediately after the acquisition and ending on the date of the distribution.

(B) Paragraph (d)(4)(i) of this section does not apply to an acquisition that occurs in connection with a transaction in which

the aggregate acquisitions are of stock possessing 20 percent or more of the total voting power of the stock of the acquired corporation (Distributing or Controlled) or stock having a value of 20 percent or more of the total value of the stock of the acquired corporation (Distributing or Controlled).

(5) *Safe Harbor V—(i) In general.* A distribution that is *pro rata* among the Distributing shareholders and an acquisition (other than involving a public offering) of Distributing stock occurring before the distribution will not be considered part of a plan if—

(A) The acquisition occurs after the date of a public announcement regarding the distribution; and

(B) There were no discussions by Distributing or Controlled with the acquirer regarding a distribution on or before the date of the first public announcement regarding the distribution.

(ii) *Special rules.* (A) Paragraph (d)(5)(i) of this section does not apply to a stock acquisition if the acquirer or a coordinating group of which the acquirer is a member is a controlling shareholder or a ten-percent shareholder of Distributing at any time during the period beginning immediately after the acquisition and ending on the date of the distribution.

(B) Paragraph (d)(5)(i) of this section does not apply to an acquisition that occurs in connection with a transaction in which the aggregate acquisitions are of stock possessing 20 percent or more of the total voting power of the stock of Distributing or stock having a value of 20 percent or more of the total value of the stock of Distributing.

(6) *Safe Harbor VI.* A distribution and an acquisition involving a public offering occurring before the distribution will not be considered part of a plan if the acquisition occurs before the date of the first disclosure event regarding the distribution in the case of an acquisition of stock that is not listed on an established market immediately after the acquisition, or before the date of the first public announcement regarding the distribution in the case of an acquisition of stock that is listed on an established market immediately after the acquisition.

(7) *Safe Harbor VII—(i) In general.* An acquisition (other than involving a public offering) of Distributing or Controlled

stock that is listed on an established market is not part of a plan if, immediately before or immediately after the transfer, none of the transferor, the transferee, and any coordinating group of which either the transferor or the transferee is a member is—

(A) The acquired corporation (Distributing or Controlled);

(B) A corporation that the acquired corporation (Distributing or Controlled) controls within the meaning of section 368(c);

(C) A member of a controlled group of corporations within the meaning of section 1563 of which the acquired corporation (Distributing or Controlled) is a member;

(D) A controlling shareholder of the acquired corporation (Distributing or Controlled); or

(E) A ten-percent shareholder of the acquired corporation (Distributing or Controlled).

(ii) *Special rules.* (A) Paragraph (d)(7)(i) of this section does not apply to a transfer of stock by or to a person if the corporation the stock of which is being transferred knows, or has reason to know, that the person or a coordinating group of which such person is a member intends to become a controlling shareholder or a ten-percent shareholder of the acquired corporation (Distributing or Controlled) at any time after the acquisition and before the date that is two years after the distribution.

(B) If a transfer of stock to which paragraph (d)(7)(i) of this section applies results immediately, or upon a subsequent event or the passage of time, in an indirect acquisition of voting power by a person other than the transferee, paragraph (d)(7)(i) of this section does not prevent an acquisition of stock (with the voting power such stock represents after the transfer to which paragraph (d)(7)(i) of this section applies) by such other person from being treated as part of a plan.

(8) *Safe Harbor VIII—(i) In general.* If, in a transaction to which section 83 or section 421(a) or (b) applies, stock of Distributing or Controlled is acquired by a person in connection with such person's performance of services as an employee, director, or independent contractor for Distributing, Controlled, a related person, a corporation the assets of which Distributing, Controlled, or a related person acquires in a reorganization under section

368(a), or a corporation that acquires the assets of Distributing or Controlled in such a reorganization (and the stock acquired is not excessive by reference to the services performed), the acquisition and the distribution will not be considered part of a plan. For purposes of this paragraph (d)(8)(i), a related person is a person related to Distributing or Controlled under section 355(d)(7)(A).

(ii) *Special rule.* Paragraph (d)(8)(i) of this section does not apply to a stock acquisition if the acquirer or a coordinating group of which the acquirer is a member is a controlling shareholder or a ten-percent shareholder of the acquired corporation (Distributing or Controlled) immediately after the acquisition.

(9) *Safe Harbor IX*—(i) *In general.* If stock of Distributing or Controlled is acquired by a retirement plan of Distributing or Controlled (or a retirement plan of any other person that is treated as the same employer as Distributing or Controlled under section 414(b), (c), (m), or (o)) that qualifies under section 401(a) or 403(a), the acquisition and the distribution will not be considered part of a plan.

(ii) *Special rule.* Paragraph (d)(9)(i) of this section does not apply to the extent that the stock acquired pursuant to acquisitions by all of the qualified plans of the persons described in paragraph (d)(9)(i) of this section during the four-year period beginning two years before the distribution, in the aggregate, represents more than ten percent of the total combined voting power of all classes of stock entitled to vote, or more than ten percent of the total value of shares of all classes of stock, of the acquired corporation (Distributing or Controlled).

(e) *Options, warrants, convertible obligations, and other similar interests*—(1) *Treatment of options*—(i) *General rule.* For purposes of this section, if stock of Distributing or Controlled is acquired pursuant to an option that is written by Distributing, Controlled, or a person that is a controlling shareholder of Distributing or Controlled at the time the option is written, or that is acquired by a person that is a controlling shareholder of Distributing or Controlled immediately after the option is written, the option will be treated as an agreement, understanding, or arrangement to acquire the stock on the earliest of the following dates: the date that the option is

written, if the option was more likely than not to be exercised as of such date; the date that the option is transferred if, immediately before or immediately after the transfer, the transferor or transferee was Distributing, Controlled, a corporation that Distributing or Controlled controls within the meaning of section 368(c), a member of a controlled group of corporations within the meaning of section 1563 of which Distributing or Controlled is a member, or a controlling shareholder or a ten-percent shareholder of Distributing or Controlled and the option was more likely than not to be exercised as of such date; and the date that the option is modified in a manner that materially increases the likelihood of exercise, if the option was more likely than not to be exercised as of such date; provided, however, if the writing, transfer, or modification had a principal purpose of avoiding section 355(e), the option will be treated as an agreement, understanding, arrangement, or substantial negotiations to acquire the stock on the date of the distribution. The determination of whether an option was more likely than not to be exercised is based on all the facts and circumstances, taking control premiums and minority and blockage discounts into account in determining the fair market value of stock underlying an option.

(ii) *Agreement, understanding, or arrangement to write, transfer, or modify an option.* If there is an agreement, understanding, or arrangement to write an option, the option will be treated as written on the date of the agreement, understanding, or arrangement. If there is an agreement, understanding, or arrangement to transfer an option, the option will be treated as transferred on the date of the agreement, understanding, or arrangement. If there is an agreement, understanding, or arrangement to modify an option in a manner that materially increases the likelihood of exercise, the option will be treated as so modified on the date of the agreement, understanding, or arrangement.

(iii) *Substantial negotiations related to options.* If an option is treated as an agreement, understanding, or arrangement to acquire the stock on the date that the option is written, substantial negotiations to acquire the option will be treated as substantial negotiations to acquire the stock subject to such option. If an option is treated as an agreement, understanding, or arrangement

to acquire the stock on the date that the option is transferred, substantial negotiations regarding the transfer of the option will be treated as substantial negotiations to acquire the stock subject to such option. If an option is treated as an agreement, understanding, or arrangement to acquire the stock on the date that the option is modified in a manner that materially increases the likelihood of exercise, substantial negotiations regarding such modifications to the option will be treated as substantial negotiations to acquire the stock subject to such option.

(2) *Stock acquired pursuant to options.* For purposes of this section, if an option is issued for cash, the terms of the acquisition of the option and the terms of the option are established by the corporation the stock of which is subject to the option (Distributing or Controlled) or the writer with the involvement of one or more investment bankers, and the potential acquirers of the option have no opportunity to negotiate the terms of the acquisition of the option or the terms of the option, then an acquisition pursuant to such option shall be treated as an acquisition involving a public offering occurring after the distribution if the option is exercised after the distribution or an acquisition involving a public offering before a distribution if the option is exercised before the distribution. Otherwise, an acquisition pursuant to an option shall be treated as an acquisition not involving a public offering.

(3) *Instruments treated as options.* For purposes of this section, except to the extent provided in paragraph (e)(4) of this section, call options, warrants, convertible obligations, the conversion feature of convertible stock, put options, redemption agreements (including rights to cause the redemption of stock), any other instruments that provide for the right or possibility to issue, redeem, or transfer stock (including an option on an option), or any other similar interests are treated as options.

(4) *Instruments generally not treated as options.* For purposes of this section, the following are not treated as options unless (in the case of paragraphs (e)(4)(i), (ii), and (iii) of this section) written, transferred (directly or indirectly), modified, or listed with a principal purpose of avoiding the application of section 355(e) or this section.

(i) *Escrow, pledge, or other security agreements.* An option that is part of a security arrangement in a typical lending transaction (including a purchase money loan), if the arrangement is subject to customary commercial conditions. For this purpose, a security arrangement includes, for example, an agreement for holding stock in escrow or under a pledge or other security agreement, or an option to acquire stock contingent upon a default under a loan.

(ii) *Options exercisable only upon death, disability, mental incompetency, or separation from service.* Any option entered into between shareholders of a corporation (or a shareholder and the corporation) that is exercisable only upon the death, disability, or mental incompetency of the shareholder, or, in the case of stock acquired in connection with the performance of services for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed), the shareholder's separation from service.

(iii) *Rights of first refusal.* A *bona fide* right of first refusal regarding the corporation's stock with customary terms, entered into between shareholders of a corporation (or between the corporation and a shareholder).

(iv) *Other enumerated instruments.* Any other instrument the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

(f) *Multiple controlled corporations.* Only the stock or securities of a controlled corporation in which one or more persons acquire directly or indirectly stock representing a 50-percent or greater interest as part of a plan involving the distribution of that corporation will be treated as not qualified property under section 355(e)(1) if—

(1) The stock or securities of more than one controlled corporation are distributed in distributions to which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) One or more persons do not acquire, directly or indirectly, stock representing a 50-percent or greater interest in Distributing pursuant to a plan involving any of those distributions.

(g) *Valuation.* Except as provided in paragraph (e)(1)(i) of this section, for purposes of section 355(e) and this section, all shares of stock within a single class are considered to have the same value. Thus, control premiums and minority and blockage discounts within a single class are not taken into account.

(h) *Definitions.* For purposes of this section, the following definitions shall apply:

(1) *Agreement, understanding, arrangement, or substantial negotiations.* (i) An agreement, understanding, or arrangement generally requires either—

(A) an agreement, understanding, or arrangement by one or more officers or directors acting on behalf of Distributing or Controlled, by controlling shareholders of Distributing or Controlled, or by another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders, with the acquirer or with a person or persons with the implicit or explicit permission of the acquirer; or

(B) an agreement, understanding, or arrangement by an acquirer that is a controlling shareholder of Distributing or Controlled immediately after the acquisition that is the subject of the agreement, understanding, or arrangement, or by a person or persons with the implicit or explicit permission of such acquirer, with the transferor or with a person or persons with the implicit or explicit permission of the transferor.

(ii) In the case of an acquisition by a corporation, an agreement, understanding, or arrangement with the acquiring corporation generally requires an agreement, understanding, or arrangement with one or more officers or directors acting on behalf of the acquiring corporation, with controlling shareholders of the acquiring corporation, or with another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders.

(iii) Whether an agreement, understanding, or arrangement exists depends on the facts and circumstances. The parties do not necessarily have to have entered into a binding contract or have reached agreement on all significant economic terms to have an agreement, understanding, or arrangement. However, an agreement, understanding, or arrangement

clearly exists if a binding contract to acquire stock exists.

(iv) Substantial negotiations in the case of an acquisition (other than involving a public offering) generally require discussions of significant economic terms, *e.g.*, the exchange ratio in a reorganization, either—

(A) by one or more officers or directors acting on behalf of Distributing or Controlled, by controlling shareholders of Distributing or Controlled, or by another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders, with the acquirer or with a person or persons with the implicit or explicit permission of the acquirer; or

(B) if the acquirer is a controlling shareholder of Distributing or Controlled immediately after the acquisition that is the subject of substantial negotiations, by the acquirer or by a person or persons with the implicit or explicit permission of the acquirer, with the transferor or with a person or persons with the implicit or explicit permission of the transferor.

(v) In the case of an acquisition (other than involving a public offering) by a corporation, substantial negotiations generally require discussions of significant economic terms with one or more officers or directors acting on behalf of the acquiring corporation, with controlling shareholders of the acquiring corporation, or with another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders.

(vi) In the case of an acquisition involving a public offering, the existence of an agreement, understanding, arrangement, or substantial negotiations will be based on discussions by one or more officers or directors acting on behalf of Distributing or Controlled, by controlling shareholders of Distributing or Controlled, or by another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders, with an investment banker.

(2) *Controlled corporation.* A controlled corporation is a corporation the stock of which is distributed in a distribution to which section 355 (or so much of section 356 as relates to section 355) applies.

(3) *Controlling shareholder.* (i) A controlling shareholder of a corporation the stock of which is listed on an established market is a five-percent shareholder who actively participates in the management or operation of the corporation. For purposes of this paragraph (h)(3)(i), a corporate director will be treated as actively participating in the management of the corporation.

(ii) A controlling shareholder of a corporation the stock of which is not listed on an established market is any person that owns stock possessing voting power representing a meaningful voice in the governance of the corporation. For purposes of determining whether a person owns stock possessing voting power representing a meaningful voice in the governance of the corporation, the person shall be treated as owning the stock that such person owns actually and constructively under the rules of section 318 (without regard to section 318(a)(4)). In addition, if the exercise of an option (whether by itself or in conjunction with the deemed exercise of one or more other options) would cause the holder to own stock possessing voting power representing a meaningful voice in the governance of the corporation, then the option will be treated as exercised.

(iii) If a distribution precedes an acquisition, Controlled's controlling shareholders immediately after the distribution and Distributing are included among Controlled's controlling shareholders at the time of the distribution.

(4) *Coordinating group.* A coordinating group includes two or more persons that, pursuant to a formal or informal understanding, join in one or more coordinated acquisitions or dispositions of stock of Distributing or Controlled. A principal element in determining if such an understanding exists is whether the investment decision of each person is based on the investment decision of one or more other existing or prospective shareholders. A coordinating group is treated as a single shareholder for purposes of determining whether the coordinating group is treated as a controlling shareholder, a five-percent shareholder, or a ten-percent shareholder.

(5) *Disclosure event.* A disclosure event regarding the distribution means any communication by an officer, director, controlling shareholder, or employee of Distributing, Controlled, or a corporation related to Distributing or Controlled,

or an outside advisor of any of those persons (where such advisor makes the communication on behalf of such person), regarding the distribution, or the possibility thereof, to the acquirer or any other person (other than an officer, director, controlling shareholder, or employee of Distributing, Controlled, or a corporation related to Distributing or Controlled, or an outside advisor of any of those persons). For purposes of this paragraph (h)(5), a corporation is related to Distributing or Controlled if it is a member of an affiliated group (as defined in section 1504(a) without regard to section 1504(b)) that includes either Distributing or Controlled or it is a member of a qualified group (as defined in §1.368-1(d)(4)(ii)) that includes either Distributing or Controlled.

(6) *Discussions.* Discussions by Distributing or Controlled generally require discussions by one or more officers or directors acting on behalf of Distributing or Controlled, by controlling shareholders of Distributing or Controlled, or by another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders. Discussions with the acquirer generally require discussions with the acquirer or with a person or persons with the implicit or explicit permission of the acquirer. In the case of an acquisition by a corporation, discussions with the acquiring corporation generally require discussions with one or more officers or directors acting on behalf of the acquiring corporation, with controlling shareholders of the acquiring corporation, or with another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders.

(7) *Established market.* An established market is—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f);

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Act of 1934 (15 U.S.C. 78o-3); or

(iii) Any additional market that the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

(8) *Five-percent shareholder.* A person will be considered a five-percent shareholder of a corporation the stock of which is listed on an established market if the person owns five percent or more of any class of stock of the corporation whose stock is transferred. For purposes of determining whether a person owns five percent or more of any class of stock of the corporation whose stock is transferred, the person shall be treated as owning the stock that such person owns actually and constructively under the rules of section 318 (without regard to section 318(a)(4)). In addition, if the exercise of an option (whether by itself or in conjunction with the deemed exercise of one or more other options) would cause the holder to become a five-percent shareholder, then the option will be treated as exercised. Absent actual knowledge that a person is a five-percent shareholder, a corporation can rely on Schedules 13D and 13G (or any similar schedules) filed with the Securities and Exchange Commission to identify its five-percent shareholders.

(9) *Implicit permission.* A corporation is treated as having the implicit permission of its shareholders when it engages in discussions or negotiations, or enters into an agreement, understanding, or arrangement.

(10) *Public announcement.* A public announcement regarding the distribution means any communication by Distributing or Controlled regarding Distributing's intention to effect the distribution where the communication is generally available to the public.

(11) *Public offering.* An acquisition involving a public offering means an acquisition of stock for cash where the terms of the acquisition are established by the acquired corporation (Distributing or Controlled) or the seller with the involvement of one or more investment bankers and the potential acquirers have no opportunity to negotiate the terms of the acquisition. For example, a public offering includes an underwritten offering of registered stock for cash.

(12) *Similar acquisition (not involving a public offering).* In general, an actual acquisition (other than involving a public offering) is similar to another potential acquisition if the actual acquisition effects a direct or indirect combination of all or a significant portion of the same business

operations as the combination that would have been effected by such other potential acquisition. Thus, an actual acquisition may be similar to another acquisition even if the timing or terms of the actual acquisition are different from the timing or terms of the other acquisition. For example, an actual acquisition of Distributing by shareholders of another corporation in connection with a merger of such other corporation with and into Distributing is similar to another acquisition of Distributing by merger into such other corporation or into a subsidiary of such other corporation. However, in general, an actual acquisition (other than involving a public offering) is not similar to another acquisition if the ultimate owners of the business operations with which Distributing or Controlled is combined in the actual acquisition are substantially different from the ultimate owners of the business operations with which Distributing or Controlled was to be combined in such other acquisition.

(13) *Similar acquisition involving a public offering*—(i) *One public offering.* In general, an actual acquisition involving a public offering may be similar to a potential acquisition involving a public offering, even though there are changes in the terms of the stock, the class of stock being offered, the size of the offering, the timing of the offering, the price of the stock, or the participants in the offering.

(ii) *More than one public offering.* More than one actual acquisition involving a public offering may be similar to a potential acquisition involving a public offering. If there is an actual acquisition involving a public offering (the first public offering) that is the same as, or similar to, a potential acquisition involving a public offering, then another actual acquisition involving a public offering (the second public offering) cannot be similar to the potential acquisition unless the purpose of the second public offering is similar to that of the potential acquisition and occurs close in time to the first public offering.

(iii) *Potential acquisition involving a public offering.* For purposes of paragraph (h)(13)(i) and (ii) of this section, as the context may require, a potential acquisition involving a public offering means a potential acquisition involving a public offering that was discussed by Distributing or Controlled with an investment banker, that motivated the distribution, or that was

the subject of an agreement, understanding, arrangement, or substantial negotiations.

(14) *Ten-percent shareholder.* A person will be considered a ten-percent shareholder of a corporation the stock of which is listed on an established market if the person owns, actually or constructively under the rules of section 318 (without regard to section 318(a)(4)), ten percent or more of any class of stock of the corporation whose stock is transferred. A person will be considered a ten-percent shareholder of a corporation the stock of which is not listed on an established market if the person owns stock possessing ten percent or more of the total voting power of the stock of the corporation whose stock is transferred or stock having a value equal to ten percent or more of the total value of the stock of the corporation whose stock is transferred. For purposes of determining whether a person owns ten percent or more of the total voting power or value of the stock of the corporation whose stock is transferred, the person shall be treated as owning the stock that such person owns actually and constructively under the rules of section 318 (without regard to section 318(a)(4)). In addition, if the exercise of an option (whether by itself or in conjunction with the deemed exercise of one or more other options) would cause the holder to become a ten-percent shareholder, then the option will be treated as exercised. Absent actual knowledge that a person is a ten-percent shareholder, a corporation the stock of which is listed on an established market can rely on Schedules 13D and 13G (or any similar schedules) filed with the Securities and Exchange Commission to identify its ten-percent shareholders.

(i) [Reserved]

(j) *Examples.* The following examples illustrate paragraphs (a) through (h) of this section. Throughout these examples, assume that Distributing (D) owns all of the stock of Controlled (C). Assume further that D distributes the stock of C in a distribution to which section 355 applies and to which section 355(d) does not apply. Unless otherwise stated, assume the corporations do not have controlling shareholders. No inference should be drawn from any example concerning whether any requirements of section 355 other than those of section 355(e) are satisfied. The examples are as follows:

Example 1. Unwanted assets. (i) D is in business 1. C is in business 2. D is relatively small in its industry. D wants to combine with X, a larger corporation also engaged in business 1. X and D begin negotiating for X to acquire D, but X does not want to acquire C. To facilitate the acquisition of D by X, D agrees to distribute all the stock of C *pro rata* before the acquisition. Prior to the distribution, D and X enter into a contract for D to merge into X subject to several conditions. One month after D and X enter into the contract, D distributes C and, on the day after the distribution, D merges into X. As a result of the merger, D's former shareholders own less than 50 percent of the stock of X.

(ii) The issue is whether the distribution of C and the merger of D into X are part of a plan. No Safe Harbor applies to this acquisition. To determine whether the distribution of C and the merger of D into X are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (b) of this section.

(iii) The following tends to show that the distribution of C and the merger of D into X are part of a plan: X and D had an agreement regarding the acquisition during the two-year period ending on the date of the distribution (paragraph (b)(3)(i) of this section), and the distribution was motivated by a business purpose to facilitate the merger (paragraph (b)(3)(v) of this section). Because the merger was agreed to at the time of the distribution, the fact described in paragraph (b)(3)(i) of this section is given substantial weight.

(iv) None of the facts and circumstances listed in paragraph (b)(4) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(v) The distribution of C and the merger of D into X are part of a plan under paragraph (b) of this section.

Example 2. Public offering. (i) D's managers, directors, and investment banker discuss the possibility of offering D stock to the public. They decide a public offering of 20 percent of D's stock with D as a stand-alone corporation would be in D's best interest. One month later, to facilitate a stock offering by D of 20 percent of its stock, D distributes all the stock of C *pro rata* to D's shareholders. D issues new shares amounting to 20 percent of its stock to the public in a public offering seven months after the distribution.

(ii) The issue is whether the distribution of C and the public offering by D are part of a plan. No Safe Harbor applies to this acquisition. Safe Harbor VII, relating to public trading, does not apply to public offerings (see paragraph (d)(7)(i) of this section). To determine whether the distribution of C and the public offering by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (b) of this section.

(iii) The following tends to show that the distribution of C and the public offering by D are part of a plan: D discussed the public offering with its investment banker during the two-year period ending on the date of the distribution (paragraph (b)(3)(ii) of this section), and the distribution was motivated by a business purpose to facilitate the public offering (paragraph (b)(3)(v) of this section).

(iv) None of the facts and circumstances listed in paragraph (b)(4) of this section, tending to show that

a distribution and an acquisition are not part of a plan, exist in this case.

(v) The distribution of C and the public offering by D are part of a plan under paragraph (b) of this section.

Example 3. Hot market. (i) D is a widely-held corporation the stock of which is listed on an established market. D announces a distribution of C and distributes C *pro rata* to D's shareholders. By contract, C agrees to indemnify D for any imposition of tax under section 355(e) caused by the acts of C. The distribution is motivated by a desire to improve D's access to financing at preferred customer interest rates, which will be more readily available if D separates from C. At the time of the distribution, although neither D nor C has been approached by any potential acquirer of C, it is reasonably certain that soon after the distribution either an acquisition of C will occur or there will be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C. Corporation Y acquires C in a merger described in section 368(a)(1)(A) by reason of section 368(a)(2)(E) within six months after the distribution. The C shareholders receive less than 50 percent of the stock of Y in the exchange.

(ii) The issue is whether the distribution of C and the acquisition of C by Y are part of a plan. No Safe Harbor applies to this acquisition. Under paragraph (b)(2) of this section, because prior to the distribution neither D nor C and Y had an agreement, understanding, arrangement, or substantial negotiations regarding the acquisition or a similar acquisition, the distribution of C by D and the acquisition of C by Y are not part of a plan under paragraph (b) of this section.

Example 4. Unexpected opportunity. (i) D, the stock of which is listed on an established market, makes a public announcement that it will distribute all the stock of C *pro rata* to D's shareholders. After the public announcement but before the distribution, widely-held X becomes available as an acquisition target. There were no discussions by D or C with X before the date of the public announcement. D negotiates with X and X merges into D before the distribution. In the merger, X's shareholders receive ten percent of D's stock. D distributes the stock of C *pro rata* within six months after the acquisition of X. No shareholder of X was a controlling shareholder or a ten-percent shareholder of D at any time during the period beginning immediately after the merger and ending on the date of the distribution.

(ii) The issue is whether the acquisition of X by D and the distribution of C are part of a plan. Safe Harbor V applies to this acquisition because the distribution is *pro rata* among D's shareholders, the acquisition occurs after the date of a public announcement regarding the distribution, there were no discussions by D or C with X on or before the date of the public announcement, no acquirer was a controlling shareholder or a ten-percent shareholder of D during the period beginning immediately after the merger and ending on the date of the distribution, and not more than 20 percent of D's stock was acquired by the X shareholders in the merger.

Example 5. Vote shifting transaction. (i) D is in business 1. C is in business 2. D wants to combine with X, which is also engaged in business 1. The stock of X is closely held. X and D begin negotiating for D to acquire X, but the X shareholders do not want to acquire an indirect interest in C. To facilitate

the acquisition of X by D, D agrees to distribute all the stock of C *pro rata* before the acquisition of X. D and X enter into a contract for X to merge into D subject to several conditions. Among those conditions is that D will amend its corporate charter to provide for two classes of stock: Class A and Class B. Under all circumstances, each share of Class A stock will be entitled to ten votes in the election of each director on D's board of directors. Upon issuance, each share of Class B stock will be entitled to ten votes in the election of each director on D's board of directors; however, a disposition of such share by its original holder will result in such share being entitled to only one vote, rather than ten votes, in the election of each director. Immediately after the merger, the Class B shares will be listed on an established market. One month after D and X enter into the contract, D distributes C. Immediately after the distribution, the shareholders of D exchange their D stock for the new Class B shares. On the day after the distribution, X merges into D. In the merger, the former shareholders of X exchange their X stock for Class A shares of D. Immediately after the merger, D's historic shareholders own stock of D representing 51 percent of the total combined voting power of all classes of stock of D entitled to vote and more than 50 percent of the total value of all classes of stock of D. During the 30-day period following the merger, none of the Class A shares are transferred, but a number of D's historic shareholders sell their Class B stock of D in public trading with the result that, at the end of that 30-day period, the Class A shares owned by the former X shareholders represent 52 percent of the total combined voting power of all classes of stock of D entitled to vote.

(ii) *X acquisition.* (A) The issue is whether the distribution of C and the merger of X into D are part of a plan. No Safe Harbor applies to this acquisition. To determine whether the distribution of C and the merger of X into D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (b) of this section.

(B) The following tends to show that the distribution of C and the merger of X into D are part of a plan: X and D had an agreement regarding the acquisition during the two-year period ending on the date of the distribution (paragraph (b)(3)(i) of this section), and the distribution was motivated by a business purpose to facilitate the merger (paragraph (b)(3)(v) of this section). Because the merger was agreed to at the time of the distribution, the fact described in paragraph (b)(3)(i) of this section is given substantial weight.

(C) None of the facts and circumstances listed in paragraph (b)(4) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(D) The distribution of C and the merger of X into D are part of a plan under paragraph (b) of this section.

(iii) *Public trading of Class B shares.* (A) Assuming that each of the transferors and the transferees of the Class B stock of D in public trading is not one of the prohibited transferors or transferees listed in paragraph (d)(7)(i), Safe Harbor VII will apply to the acquisitions of the Class B stock during the 30-day period following the merger such that the distribution and those acquisitions will not be treated as part of a plan. However, to the extent that those acquisi-

tions result in an indirect acquisition of voting power by a person other than the acquirer of the transferred stock, Safe Harbor VII does not prevent the acquisition of the D stock (with the voting power such stock represents after those acquisitions) by the former X shareholders from being treated as part of a plan.

(B) To the extent that the transfer of the Class B shares causes the voting power of D to shift to the Class A stock acquired by the former X shareholders, such shifted voting power will be treated as attributable to the stock acquired by the former X shareholders as part of a plan that includes the distribution and the X acquisition.

Example 6. Acquisition not involving a public offering that is not similar. (i) D, X, and Y are each corporations the stock of which is publicly traded and widely held. Each of D, X, and Y is engaged in the manufacture and sale of trucks. C is engaged in the manufacture and sale of buses. D and X engage in substantial negotiations concerning X's acquisition of the stock of D from the D shareholders in exchange for stock of X. D and X do not reach an agreement regarding that acquisition. Three months after D and X first began negotiations regarding that acquisition, D distributes the stock of C *pro rata* to its shareholders. Three months after the distribution, Y acquires the stock of D from the D shareholders in exchange for stock of Y. The ultimate owners of Y are substantially different from the ultimate owners of X.

(ii) Although both X and Y engage in the manufacture and sale of trucks, X's truck business and Y's truck business are not the same business operations. Therefore, because Y's acquisition of D does not effect a combination of the same business operations as X's acquisition of D would have effected, and because the ultimate owners of Y are substantially different from the ultimate owners of X, Y's acquisition of D is not similar to X's potential acquisition of D that was the subject of earlier negotiations.

Example 7. Acquisition not involving a public offering that is similar. (i) D is engaged in the business of writing custom software for several industries (industries 1 through 6). The software business of D related to industries 4, 5, and 6 is significant relative to the software business of D related to industries 3, 4, 5, and 6. X, an unrelated corporation, is engaged in the business of writing software and the business of manufacturing and selling hardware devices. X's business of writing software is significant relative to its total businesses. X and D engage in substantial negotiations regarding X's acquisition of D stock from the D shareholders in exchange for stock of X. Because X does not want to acquire the software businesses related to industries 1 and 2, these negotiations relate to an acquisition of D stock where D owns the software businesses related only to industries 3, 4, 5, and 6. Thereafter, D concludes that the intellectual property licenses central to the software business related to industries 1 and 2 are not transferable and that a separation of the software business related to industry 3 from the software business related to industry 2 is not desirable. One month after D begins negotiating with X, D contributes the software businesses related to industries 4, 5, and 6 to C, and distributes the stock of C *pro rata* to its shareholders. In addition, X sells its hardware businesses for cash. After the distribution, C and X negotiate for X's acquisition of the C stock from the C shareholders in exchange for X stock, and X acquires the stock of C.

(ii) Although D and C are different corporations, C does not own the custom software business related to industry 3, and X sold its hardware business prior to the acquisition of C, because X's acquisition of C involves a combination of a significant portion of the same business operations as the combination that would have been effected by the acquisition of D that was the subject of negotiations between D and X, X's acquisition of C is the same as, or similar to, X's potential acquisition of D that was the subject of earlier negotiations.

Example 8. Acquisitions involving public offerings with different purposes. (i) D's managers, directors, and investment banker discuss the possibility of offering D stock to the public for the purpose of funding the acquisition of the assets of X. They decide a public offering of 20 percent of D's stock with D as a stand-alone corporation would allow D to raise the capital needed to effect the acquisition of X's assets. One month later, to facilitate a stock offering by D of 20 percent of its stock, D distributes all the stock of C *pro rata* to D's shareholders. Two months after the distribution, D issues new shares amounting to 20 percent of its stock to the public in a public offering (the first public offering). Four months after the distribution, D acquires the assets of X. Seven months after the distribution, D's managers, directors, and investment banker discuss the possibility of offering D stock to the public solely for the purpose of funding the acquisition of the assets of Y, a corporation unrelated to X. One year after the distribution, D issues new shares amounting to 40 percent of its stock to the public in a public offering (the second public offering). One month after the second public offering, D acquires the assets of Y.

(ii) The first public offering is the same as the potential acquisition that D's managers, directors, and investment banker discussed prior to the distribution. The purpose of the second public offering (funding the acquisition of the assets of Y) is not similar to that of the potential acquisition (funding the acquisition of the assets of X). Therefore, the second public offering is not similar to the potential acquisition.

Example 9. Acquisitions involving public offerings that are close in time. (i) D's managers, directors, and investment banker discuss the possibility of offering D stock to the public for the purpose of raising funds for general corporate purposes. They decide a public offering of 20 percent of D's stock with D as a stand-alone corporation would allow D to raise such funds. One month later, to facilitate a stock offering by D of 20 percent of its stock, D distributes all the stock of C *pro rata* to D's shareholders. Two months after the distribution, D issues new shares amounting to 20 percent of its stock to the public in a public offering (the first public offering). After the first public offering, D's managers, directors, and investment banker discuss the possibility of another offering of D stock to the public for the purpose of raising additional funds for general corporate purposes. Eight months after the distribution, D issues new shares amounting to ten percent of its stock to the public in a public offering (the second public offering).

(ii) The first public offering is the same as the potential acquisition that D's managers, directors, and investment banker discussed prior to the distribution. The purpose of the second public offering (raising funds for general corporate purposes) is the same as

that of the potential acquisition. In addition, the second public offering is close in time to the first public offering. Therefore, the second public offering is similar to the potential acquisition.

Example 10. Acquisitions involving public offerings that are not close in time. The facts are the same as those in *Example 9*, except that the second public offering occurs fourteen months after the distribution. Although the purpose of the second public offering is the same as that of the potential acquisition, the second public offering is not close in time to the first public offering. Therefore, the second public offering is not similar to the potential acquisition.

(k) *Effective dates.* This section applies to distributions occurring after April 19, 2005. For distributions occurring on or before April 19, 2005, and after April 26, 2002, see §1.355-7T as contained in 26 CFR part 1 revised as of April 1, 2003; however, taxpayers may apply these regulations, in whole, but not in part, to such distributions. For distributions occurring on or before April 26, 2002, and after August 3, 2001, see §1.355-7T as contained in 26 CFR part 1 revised as of April 1, 2002; however, taxpayers may apply, in whole, but not in part, either these regulations or §1.355-7T as contained in 26 CFR part 1 revised as of April 1, 2003, to such distributions. For distributions occurring on or before August 3, 2001, and after April 16, 1997, taxpayers may apply, in whole, but not in part, either these regulations or §1.355-7T as contained in 26 CFR part 1 revised as of April 1, 2003, to such distributions.

§1.355-7T [Removed]

Par. 4. Section 1.355-7T is removed.

Cono R. Namorato,
*Acting Deputy Commissioner for
Services and Enforcement.*

Approved April 13, 2005.

Eric Solomon,
*Acting Deputy Assistant Secretary
of the Treasury.*

(Filed by the Office of the Federal Register on April 18, 2005, 8:45 a.m., and published in the issue of the Federal Register for April 19, 2005, 70 F.R. 20279)

Section 411.—Minimum Vesting Standards

26 CFR 1.411(d)-4: Section 411(d)(6) protected benefits.

Whether an amendment pertaining to section 203(a)(3)(B) service is a protected benefit. See Rev. Proc. 2005-23, page 991.

Section 7701.—Definitions

26 CFR 301.7701-2: Business entities; definitions.

T.D. 9197

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Classification of Certain Foreign Entities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary and final regulations relating to certain business entities included on the list of foreign business entities that are always classified as corporations for Federal tax purposes. The text of the temporary regulations also serves as the text of the proposed regulations (REG-148521-04) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on October 7, 2004.

Applicability Date: For the dates of applicability of these regulations, see §301.7701-2T(e).

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

SUPPLEMENTARY INFORMATION:

Background

The IRS and Treasury Department issued final regulations concerning the classification of entities under section 7701 of the Internal Revenue Code (Code) on December 18, 1996 (final regulations). See

generally T.D. 8697, 1997-1 C.B. 215, and §§301.7701-1 through 301.7701-3. Under the final regulations, a business entity that is not specifically classified as a corporation is an eligible entity that can elect its classification for Federal tax purposes under certain circumstances. However, §301.7701-2(b)(8) provides a list of certain foreign business entities that are always classified as corporations for Federal tax purposes (the per se corporation list). These foreign business entities are generally referred to as per se corporations.

On October 8, 2001, the Council of the European Union adopted Council Regulation 2157/2001 2001 O.J. (L 294) (the EU Regulation) to provide for a new business entity, the European public limited liability company (Societas Europaea or SE). The EU Regulation entered into force on October 8, 2004, and has effect in all the Member States of the European Economic Area (which includes all Member States of the European Union plus Norway, Iceland, and Liechtenstein). An SE must have a registered office in one of the Member States.

The SE is a public limited liability company. The EU Regulation provides general rules that govern the formation and operation of an SE and supplements those rules for specified issues and issues it does not address by reference to the laws with respect to public limited liability companies for the country in which the SE has its registered office. Most of the countries in which an SE can have its registered office have a business entity that constitutes a public limited liability company and that currently is on the per se corporation list. However, an SE can have its registered office in the following countries that have a business entity that is a public limited liability company but that is not yet on the per se corporation list: Estonia, Latvia, Lithuania, Slovenia, and Liechtenstein.

Explanation of Provisions

In Notice 2004-68, 2004-43 I.R.B. 706, the IRS and Treasury stated that the SE is properly classified as a per se corporation because it will function as a public limited liability company. The notice also stated that the IRS and Treasury will issue temporary and proposed regulations that will modify §301.7701-2(b)(8) to include the SE on the per se corporation list. The

notice further stated that the temporary and proposed regulations will modify §301.7701-2(b)(8) to include as per se corporations the Estonian Aktsiaselts, Latvian Akciju Sabiedriba, Lithuanian Akcine Bendroves, Slovenian Delniska Druzba, and Liechtenstein Aktiengesellschaft. These entities are the public limited liability companies in their respective countries. The temporary regulations in this document make these modifications to §301.7701-2(b)(8). In addition, in accordance with Notice 2004-68, these regulations will be effective for the Estonian, Latvian, Liechtenstein, Lithuanian, and Slovenian entities formed on or after October 7, 2004, and for the European Economic Area entity formed on or after October 8, 2004. See also section 7805(b)(1)(C).

The status of an SE may be relevant to the application of various Federal income tax provisions, such as the subpart F same-country exception under section 954(c)(3). Treasury and the IRS are considering these issues and invite comments on any additional areas in which guidance on the Federal tax treatment of an SE may be warranted.

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. As a result of the issuance of Notice 2004-68, good cause is found for dispensing with prior notice and comment pursuant to 5 U.S.C. 553(b). For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact.

Drafting Information

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

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301 — PROCEDURE AND ADMINISTRATION

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

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

Par. 2. In §301.7701-2, paragraph (b)(8)(vi) is added to read as follows:

§301.7701-2 Business entities; definitions.

* * * * *

(b) * * *

(8) * * *

(vi) *Certain European entities.* [Reserved]. For further guidance, see §301.7701-2T.

* * * * *

Par. 3. Section 301.7701-2T is amended by adding paragraphs (b)(8)(vi) and (e) to read as follows:

§301.7701-2T Business entities; definitions (temporary).

(a) through (b)(8)(v) [Reserved]. For further guidance, see §301.7701-2(a) through (b)(8)(v).

(b)(8)(vi) *Certain European entities.* The following business entities formed in the following jurisdictions:

- Estonia, Aktsiaselts
- European Economic Area/European Union, Societas Europaea
- Latvia, Akciju Sabiedriba
- Liechtenstein, Aktiengesellschaft
- Lithuania, Akcine Bendroves
- Slovenia, Delniska Druzba.

(c) and (d) [Reserved]. For further guidance, see §301.7701-2(c) and (d).

(e) *Effective dates—*

(1) and (2) [Reserved]. For further guidance, see §301.7701-2(e)(1) and (2).

(3) The reference to the Estonian, Latvian, Liechtenstein, Lithuanian, and Slovenian entities in paragraph (b)(8)(vi) of this section applies to such entities formed on or after October 7, 2004, and to any such entity formed before such date from the date any person or persons,

who were not owners of the entity as of October 7, 2004, own in the aggregate a 50 percent or greater interest in the entity. The reference to the European Economic Area/European Union entity in paragraph (b)(8)(vi) of this section applies to such entities formed on or after October 8, 2004.

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

Approved March 28, 2005.

Eric Solomon,
*Acting Deputy Assistant Secretary
of the Treasury.*

(Filed by the Office of the Federal Register on April 13, 2005, 8:45 a.m., and published in the issue of the Federal Register for April 14, 2005, 70 F.R. 19697)

Section 7805.—Rules and Regulations

26 CFR 301.7805–1: Rules and regulations.

Whether, and to what extent, the holding in *Central Laborers' Pension Fund v. Heinz*, 124 S.Ct. 2230

(2004), will be limited. See Rev. Proc. 2005-23, page 991.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions and Other Related Items

Mutual Agreement on U.K. Pension Arrangements

Announcement 2005–30

Following is a copy of the News Release issued by the Director, International (U.S. Competent Authority), on April 13, 2005 (IR–2005–44).

Agreement Identifies U.K. Pension Arrangements for Tax Treaty Benefits

IR–2005–44, April 13, 2005

WASHINGTON — The Competent Authorities of the United Kingdom and the United States have reached a mutual agreement on the qualification of certain U.K. pension arrangements for treaty benefits under paragraph 3(b) of Article 10 (Dividends) of the Convention Between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation with Respect to Taxes on Income signed at London on July 24, 2001 (“Treaty”).

The agreement constitutes a Mutual Agreement in accordance with paragraph 3 of Treaty Article 26 (Mutual Agreement Procedure).

The text of the agreement is as follows:

COMPETENT AUTHORITY AGREEMENT

The competent authorities of the United States and the United Kingdom hereby enter into the following agreement (“the Agreement”) regarding the qualification of certain U.K. pension or other retirement arrangements for benefits under paragraph 3(b) of Article 10 (Dividends) of the Convention Between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation with Respect to Taxes on Income signed at London on July 24, 2001 (“the Treaty”). The Agreement is entered into under paragraph 3 of Article 26 (Mutual Agreement Procedure).

It is understood that for the purposes of this Agreement the term “Article” refers to an Article of the Treaty.

Qualification for benefits under Article 10(3)

Paragraph 3(b) of Article 10 of the Treaty provides that dividends shall not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends is a pension scheme resident in the other Contracting State, provided that such dividends are not derived from the carrying on of business by the pension scheme.

Pursuant to subparagraphs a) and b) of paragraph 3 of Article 4 (Residence), the term “resident of a Contracting State” includes a pension scheme or a plan, scheme, fund, trust, company or other arrangement established in a Contracting State that is operated exclusively to administer or provide employee benefits and that, by reason of its nature as such, is generally exempt from income taxation in that State.

The term “pension scheme” is defined in Article 3(1)(o) as any plan, scheme, fund, trust or other arrangement established in a Contracting State which is: (i) generally exempt from income taxation in that State; and (ii) operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements.

Subparagraph 2(e) of Article 23 (Limitation on Benefits) provides, in part, that a person described in Article 4(3)(a) or (b) may claim benefits under the Treaty only if more than half of its beneficiaries, members, or participants are individuals who are residents of either Contracting State.

Occupational pension arrangements in the United Kingdom are generally established through separate trust deeds. Many of these pension schemes, particularly the small and medium-sized schemes pool their investments in various ways. Questions have arisen as to the eligibility for benefits under Article 10(3) of such pooling arrangements.

In order to provide certainty for taxpayers, the competent authorities of the United States and the United Kingdom have agreed that the following types of U.K. arrangements are “pension schemes” as that term is defined in Article 3(1)(o), are treated as the beneficial owners of dividends paid to them by U.S. corporations, and therefore are considered to meet the requirements of Article 10(3)(b):

- a. A U.K. resident unit trust, so long as the following conditions are met:
 - i. The trust deed specifically provides that only pension schemes that are not subject to U.K. capital gains tax or corporation tax may participate in the trust; and
 - ii. Any tax paid by the Trustee of such a trust is deemed to be paid by the unit-holder pension schemes such that the tax is refunded to the pension schemes.

- b. A fund, plan or arrangement to which an occupational or individual pension scheme contributes by paying premiums to an insurance company so long as the following conditions are met:
- i. Contributions by the pension scheme are placed by the insurance company in a fund that is generally exempt from tax in the United Kingdom;
 - ii. The insurance company allocates a number of units to the contributing pension scheme, so that the value of the pension scheme's investment is represented by a proportionate share of the total value of the fund;
 - iii. The return on the pension scheme's investment is not fixed;
 - iv. The return to the contributing pension scheme is directly linked to the value of its share of the total return to the fund identified through the unit mechanism under (ii);
 - v. All return on investment inures only to the benefit of the contributing occupational or individual pension scheme and not to the insurance company shareholders; and
 - vi. To the extent that there is withholding on foreign source income received by the fund, the return to the underlying pension scheme is diminished. Any tax so paid is effectively borne by the pension scheme and the insurance company does not benefit from it.

Such arrangements therefore will qualify for the benefits of Article 10(3)(b) if they satisfy the conditions of Article 23(2)(e).

Upon signature by both Competent Authorities, this Agreement is effective as of May 1, 2003, the date the Treaty is effective for taxes withheld at source under Article 29(2).

Agreed to by the undersigned competent authorities:

<u> /s/ </u>	<u> 4-11-05 </u>	<u> /s/ </u>	<u> 3-21-05 </u>
Robert H. Green	Date	Diane Hay	Date
U.S. competent authority		U.K. competent authority	

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.
(Also Part I, §§ 851, 852; 1.851-2.)

Rev. Proc. 2005-20

SECTION 1. PURPOSE

This revenue procedure amplifies and supersedes Rev. Proc. 2003-32, 2003-1 C.B. 803, to take into account that Rev. Proc. 2002-68, 2002-2 C.B. 753, was modified and superseded by Rev. Proc. 2003-84, 2003-2 C.B. 1159, and describes conditions under which a regulated investment company (RIC) that holds a partnership interest is treated, for purposes of qualifying as a RIC under § 851(b)(3) of the Internal Revenue Code of 1986 and for purposes of eligibility to pay exempt-interest dividends under § 852(b)(5), as if it directly invested in the assets held by the partnership.

SECTION 2. BACKGROUND

.01 Certain RICs seek investments with a yield that is treated for federal income tax purposes as interest exempt from tax under § 103 and that reflects current short-term exempt interest rates. Partnerships described in Rev. Proc. 2003-84 offer these advantages to some of their partners. Partnerships described in its predecessor revenue procedure, Rev. Proc. 2002-68, also offered these advantages. The partnership interests are referred to as synthetic tax-exempt variable-rate bonds. Eligible partnerships described in either revenue procedure may make a monthly closing election that permits consenting partners to take into account their distributive shares of partnership income on a monthly basis.

.02 Rev. Proc. 2003-32 provides conditions under which a RIC that holds a partnership interest is treated as if it directly invested in the assets held by the partnership. It applies to consenting partners in eligible partnerships described in Rev. Proc. 2002-68. After the issuance of Rev. Proc. 2003-32, however, Rev. Proc. 2002-68 was modified and superseded by Rev. Proc. 2003-84. This revenue procedure amplifies and supersedes Rev. Proc. 2003-32 to extend this treatment to consenting partners in partnerships described

in Rev. Proc. 2003-84 or in any successor published guidance that provides substantially the same treatment for consenting partners in eligible tax-exempt bond partnerships.

.03 Partners in eligible partnerships described in Rev. Proc. 2003-84 that are RICs must qualify as RICs under § 851(b)(3) and generally also seek to qualify to pay exempt-interest dividends under § 852(b)(5).

.04 Section 851(b)(3)(A) requires that, for a corporation to qualify as a RIC, at the close of each quarter of the taxable year, at least 50 percent of the value of the corporation's total assets must be represented by cash and cash items (including receivables), Government securities, securities of other RICs, and other securities generally limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the corporation and to not more than 10 percent of the outstanding voting securities of such issuer.

.05 Section 851(b)(3)(B) provides that, for a corporation to qualify as a RIC, not more than 25 percent of the corporation's total assets may be invested in the securities (other than Government securities and the securities of other RICs) of any one issuer, or of two or more issuers that the corporation controls and that are determined, under regulations, to be engaged in the same or similar trades or businesses or related trades or businesses.

.06 Section 852(b)(5) provides that, if at least 50 percent of the value (as defined in § 851(c)(4)) of a RIC's total assets at the close of each calendar quarter consists of obligations described in § 103(a), the RIC is eligible to pay exempt-interest dividends, which are treated by the RIC's shareholders as interest excludable from gross income under § 103(a).

SECTION 3. SCOPE

This revenue procedure applies to RICs that are consenting partners in eligible partnerships described in Rev. Proc. 2002-68, in Rev. Proc. 2003-84, or in any successor published guidance that provides substantially the same treatment for consenting partners in eligible tax-exempt-bond partnerships.

SECTION 4. PROCEDURE

For purposes of qualifying as a RIC under § 851(b)(3) and for purposes of eligibility to pay exempt-interest dividends under § 852(b)(5), a RIC meeting the requirements of Section 3 of this procedure is treated as if it directly invested in the assets held by the eligible partnership. For these purposes, its interest in partnership assets is determined in accordance with its capital interest in the partnership.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for asset determinations that are made as of dates that are on or after March 31, 2003.

SECTION 6. TRANSITION RULES

.01 The Service will not challenge a RIC partner's look-through treatment for purposes of an asset determination, provided that—

(1) The asset determination is made as of a date that is in a taxable year beginning before January 1, 2004;

(2) The partnership would be an eligible partnership as defined in Rev. Proc. 2002-68;

(3) The RIC partner's inclusion of income, gain, loss, deduction, and credits is consistent with that permitted under that revenue procedure; and

(4) The RIC partner's tax treatment is consistent with an election under § 761(a) to be excluded from the provisions of subchapter K.

.02 The Service will not challenge a consenting RIC partner's look-through treatment for purposes of an asset determination, provided that the partnership is an electing partnership under the provisions of Rev. Proc. 2002-16 or Rev. Proc. 2002-68 to which the grandfather rule in section 9.02(1) of Rev. Proc. 2003-84 applies.

.03 For purposes of this Section 6, "look-through treatment" means that a RIC makes asset determinations as if it directly invested in the assets held by a partnership in which it invests.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2003–32 is amplified and superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is Lauren J. Blecker of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact her at (202) 622–3920 (not a toll-free call).

26 CFR 601.201: *Rulings and determination letters.* (Also Part I, §§ 411, 7805; §§ 1.411(d)–4, 301.7805–1.)

Rev. Proc. 2005–23

SECTION 1. PURPOSE

.01 *In general.* The purpose of this revenue procedure is to limit the retroactive application of the decision in *Central Laborers' Pension Fund v. Heinz*, 124 S.Ct. 2230 (June 7, 2004) for retirement plans qualified under § 401(a) of the Internal Revenue Code (Code).

.02 *Scope of treatment.* With regard to qualified retirement plans that adopted certain amendments before June 7, 2004, section 3 of this revenue procedure generally provides that the Service will not disqualify a plan solely on account of a plan amendment adding or expanding a suspension of benefit provision, as prohibited under *Central Laborers'*. The treatment under this revenue procedure applies only with respect to amendments described in section 3.01 and not to other plan amendments that may violate § 411(d)(6). The limitation on the retroactive application of *Central Laborers'* under this revenue procedure has no effect on the rights of any party under section 204(g) of the Employee Retirement Income Security Act of 1974 (ERISA) or any other law.

SECTION 2. BACKGROUND

Section 411 requires a qualified plan to meet certain minimum vesting standards. Under § 411(a), an employee's right to the accrued benefit derived from employer contributions must become nonforfeitable

within a specified period of service, and certain other conditions must also be met. Section 411(a)(3) provides circumstances under which an employee's benefit is permitted to be forfeited without violating § 411(a). In particular, § 411(a)(3)(B) provides that a right to an accrued benefit derived from employer contributions is not treated as forfeitable solely because the plan provides that the payment of benefits is suspended for such period as the employee is employed, subsequent to the commencement of payment of such benefits—

(i) in the case of a plan other than a multiemployer plan, by the employer who maintains the plan under which such benefits were being paid; and

(ii) in the case of a multiemployer plan, in the same industry, the same trade or craft, and the same geographic area covered by the plan as when such benefits commenced.

This definition of employment for which benefit payments are permitted to be suspended is further described in 29 CFR § 2530.203–3, which interprets section 203(a)(3)(B) of ERISA, the counterpart to § 411(a)(3)(B) of the Code. Employment that satisfies the conditions described in the statute and regulations is referred to as “section 203(a)(3)(B) service.” See 29 CFR § 2530.203–3(c).

Section 411(d)(6)(A) generally provides that a plan is not treated as satisfying the requirements of § 411 if the accrued benefit of a participant is decreased by a plan amendment. Under § 411(d)(6)(B) and regulations thereunder, a plan amendment that has the effect of eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit, with respect to benefits attributable to service before the amendment, is treated as reducing accrued benefits for any employee who satisfies the pre-amendment conditions for that benefit (either before or after the amendment).

Under § 7805(b)(8), the Commissioner is authorized to prescribe the extent, if any, to which a judicial decision relating to the internal revenue laws is to be applied without retroactive effect.

In *Central Laborers'*, the plaintiffs were two inactive participants in the Central Laborers' Pension Fund, a multiemployer pension plan. The two participants commenced payment of their benefits in

1996 after accruing enough pension credits to qualify for early retirement payments under a plan provision that paid them the same monthly benefit they would have received had they commenced payment at normal retirement age. The plan terms required that payments be suspended if a participant engaged in “disqualifying employment.” At the time the two participants commenced payment, the plan defined disqualifying employment to include only employment covered by the plan. At that time, employment covered by the plan (and thus, disqualifying employment) did not include work as a construction supervisor, the position in which the two participants were employed after they commenced benefits. Accordingly, the participants' benefit payments were not suspended in 1996. However, in 1998, the plan was amended to expand its definition of disqualifying employment to include any employment in the construction industry in the geographic area covered by the plan, and the plan stopped payments to the two participants on account of their disqualifying employment as construction supervisors. The two participants sued to recover the suspended payments, claiming that the amendment expanding the plan's suspension provisions violated section 204(g) of ERISA (the counterpart to § 411(d)(6) of the Code).

The Supreme Court, holding for the two participants, ruled that section 204(g) prohibits a plan amendment expanding the categories of post-retirement employment that results in suspension of the payment of early retirement benefits already accrued. The Court found that while ERISA permits certain conditions that are elements of the benefit itself (such as suspensions under § 411(a)(3)(B) of the Code or section 203(a)(3)(B) of ERISA), such a condition may not be imposed after a benefit has accrued and that the right to receive benefit payments on a certain date may not be limited by a new condition narrowing that right. The Court agreed with the 7th Circuit that “[a] participant's benefits cannot be understood without reference to the conditions imposed on receiving those benefits, and an amendment placing materially greater restrictions on the receipt of the benefit ‘reduces’ the benefit just as surely as a decrease in the size of the monthly benefit payment.” *Central Laborers'*, 124 S.Ct. at 2235–36, quoting

Heinz v. Central Laborers' Pension Fund, 303 F.3d 802, 805 (7th Cir. 2002). However, the Court stated:

Nothing we hold today requires the IRS to revisit the tax-exempt status in past years of plans that were amended in reliance on the agency's representations in its manual by expanding the categories of work that would trigger suspension of benefit payments as to already-accrued benefits. The Internal Revenue Code gives the Commissioner discretion to decline to apply decisions of this Court retroactively. 26 U.S.C. § 7805(b)(8) . . . This would doubtless be an appropriate occasion for exercise of that discretion.

Central Laborers', 124 S.Ct. at 2238, n.4.

SECTION 3. EXERCISE OF AUTHORITY UNDER § 7805(b)(8)

.01 *In general.* Pursuant to the Commissioner's authority under § 7805(b)(8), a plan will not be treated as having failed to satisfy the requirements of § 401(a) merely because an amendment adopted before June 7, 2004, violated § 411(d)(6) by adding or expanding a provision under which a suspension of benefits occurs on account of section 203(a)(3)(B) service. This treatment applies only if a reforming amendment, as described in section 3.02, is adopted and the plan complies operationally with that amendment, as described in sections 3.02, 3.03, and 3.04. For purposes of this revenue procedure, an amendment adopted before June 7, 2004, that violated § 411(d)(6) by adding or expanding a provision under which a suspension of benefits occurs on account of section 203(a)(3)(B) service is referred to as the original amendment, and the amendment required under section 3.02 is referred to as the reforming amendment. This section 3.01 applies to any such original amendment regardless of whether the amendment provided for a suspension of payment of the accrued benefit or for a suspension of the payment of early retirement benefits or retirement-type subsidies such as those at issue in *Central Laborers'*, and regardless of whether the plan as amended by the original amendment provided that subsequent benefit payments under the plan were actuarially adjusted to take into account the fact that benefits were not paid during the suspen-

sion period. For purposes of this revenue procedure, a provision under which a suspension of benefits occurs on account of section 203(a)(3)(B) service includes a provision that results in a plan not providing actuarial increases as a result of such service after normal retirement age. If a plan has more than one original amendment that violated § 411(d)(6) by adding or expanding a provision under which a suspension of benefits occurs on account of section 203(a)(3)(B) service, this revenue procedure applies separately to each amendment.

.02 *Reforming amendment.* (1) *General requirements.* The reforming amendment must provide that, beginning on June 7, 2004, the provisions of the original amendment that suspend benefits do not apply with respect to benefits that had accrued as of the applicable amendment date for the original amendment and must provide certain participants with an option to commence payment of their benefits, as described in section 3.04. For purposes of this revenue procedure, the applicable amendment date for a plan amendment is the later of the effective date of the amendment or the date the amendment is adopted. However, the reforming amendment is permitted to provide that the suspension of benefit provisions of the original amendment will continue to apply with respect to benefits that had accrued after the applicable amendment date for the original amendment. Further, a plan may continue to apply the suspension of benefit provision as in effect immediately prior to the original amendment with respect to all accrued benefits (accruing both before and after the original amendment).

(2) *Broader reforming amendments permitted.* The reforming amendment is permitted to provide greater benefits to participants than the minimum required under section 3.02(1). For example, in addition to satisfying the minimum requirements of this section 3, a reforming amendment might provide that the suspension of benefit provisions of the original amendment cease to apply beginning on a date earlier than June 7, 2004, and might also provide a corresponding opportunity for participants to apply for retroactive benefits commencing on that earlier date. Similarly, the reforming amendment might apply to the entire accrued benefit of those participants with an accrued benefit on the

applicable amendment date of the original amendment, rather than just to benefits that had accrued as of the applicable amendment date, so that the suspension of benefit provisions of the original amendment as reformed only apply to those participants who commence participation after that applicable amendment date.

(3) *Effective date and remedial amendment period.* The reforming amendment must be effective as of a date not later than June 7, 2004. Section 4 provides a remedial amendment period for the reforming amendment.

.03 *Payment of retroactive benefits requirement.* (1) *In general.* In order for a plan to obtain the treatment provided in section 3.01, the reforming amendment described in section 3.02 must provide for the payment of retroactive benefits (beginning as of June 7, 2004, or such earlier date on which the reforming amendment is made effective pursuant to section 3.02(3)) to an affected plan participant (including any appropriate interest or actuarial increase) with respect to benefits that had accrued as of the applicable amendment date for the original amendment. For purposes of this section 3.03, an affected plan participant means (a) a participant who commenced receipt of benefits and whose benefits were suspended on account of the original amendment or (b) a participant who applied to commence benefits, whose application (including the form of payment) was approved, and whose benefits were suspended before payments commenced.

(2) *Effective date for retroactive payment of benefits for affected participants.* The plan must provide for the payment of retroactive benefits described in section 3.03(1) effective not later than January 1, 2006. The plan must be in operational compliance with the reforming amendment by January 1, 2006, with respect to benefits payable through December 31, 2005, and must maintain compliance for all periods on or after that date.

.04 *Option to commence payment.* (1) *In general.* In order for a plan to obtain the treatment provided in section 3.01, a participant described in section 3.04(2) must be given an opportunity to elect retroactively the commencement of payment of benefits as of the first date on which (a) the reforming amendment is made effective and (b) the participant was eligible

to commence receipt of benefits. See § 1.417(e)-1 for rules relating to retroactive annuity starting dates.

(2) *Eligibility for option.* A participant who is eligible for the option described in section 3.04(1) is one who —

(a) at any time after the applicable amendment date of the original amendment, was eligible to commence the receipt of benefits under the plan, determined without regard to the suspension of benefit provisions of the original amendment,

(b) at the same time, engaged in section 203(a)(3)(B) service for which benefits were not permitted to commence, as determined taking into account the original amendment, and

(c) is not an affected participant as defined in section 3.03 (e.g., is a participant who did not apply for benefits).

(3) *Election period.* The election period for the option set forth in section 3.04(1) begins within a reasonable time period after participants described in section 3.04(2) have received notification of the option in accordance with section 3.04(4) and ends no sooner than six months after notification. Reasonable efforts must be taken to notify all such participants. For those participants not located after a mailing to the last known address, reasonable efforts include the use of the Internal Revenue Service Letter Forwarding Program (see Rev. Proc. 94-22, 1994-1 C.B. 608) or the Social Security Administration Employer Reporting Service.

(4) *Notification requirement.* The plan must provide notice of the option set forth in section 3.04(1) to each participant described in section 3.04(2). In addition to satisfying any generally applicable notice requirements, the notice of the option to commence payment of benefits must be designed to be readily understandable by the average plan participant. The notice must explain the option to commence retroactive payment of benefits, as described in section 3.04(1), and the period for making the election, as described in section 3.04(3). The notice must be sent on or before January 1, 2006.

.05 *Terminated plans.* A plan that was terminated with a termination date before June 7, 2004, is not required to adopt a

reforming plan amendment or take the actions required in sections 3.02 through 3.05 in order to receive the treatment provided in section 3.01.

SECTION 4. EFFECT ON DETERMINATION LETTERS AND REMEDIAL AMENDMENT PERIOD

For purposes of any previously issued determination letter and for purposes of applying the rules in § 401(b), the *Central Laborers'* decision constitutes a change in law under § 401(a) that is effective on June 7, 2004 (the date of the *Central Laborers'* decision). Thus, if a favorable determination letter was issued with respect to a plan amendment that is adversely affected by the *Central Laborers'* decision, the plan sponsor cannot rely on the determination letter from and after June 7, 2004.¹ Further, a plan provision that is an original amendment as defined in section 3.01 is designated under § 1.401(b)-1(b)(3)(i) as a disqualifying provision resulting from a change in the qualification requirements under § 401(a). The last day of the remedial amendment period for this disqualifying provision is the same as the last day of the EGTRRA remedial amendment period for the plan.²

SECTION 5. PROPOSED REGULATION

The Treasury Department and the Service intend to propose regulations that reflect the holding in *Central Laborers'*. It is expected that the proposed regulations will provide guidance on when an amendment may add a benefit entitlement condition that is permitted under the vesting rules (e.g., a condition described in § 411(a)(3)) with respect to benefits accrued before the date of the amendment. It is further expected that, with respect to the types of benefits protected under § 411(d)(6), the proposed regulations will provide that such an amendment is not permitted with respect to benefits accrued before the applicable amendment date, but is permitted to the extent that the amendment applies with respect to benefits accrued after the applicable amendment date.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective April 18, 2005.

SECTION 7. 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 1545-1938.

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 3.04(4). This information is required to notify certain participants of the opportunity to elect retroactively the commencement of benefits. The collection of information is required to obtain a benefit. The likely respondents are retirement plan sponsors, administrators, and trustees.

The estimated total annual reporting and/or recordkeeping burden is 142,500 hours.

The estimated annual burden per respondent/recordkeeper varies from 250 hours to 750 hours, depending on individual circumstances, with an estimated average of 500 hours. The estimated number of respondents and/or recordkeepers is 285.

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

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 authors of this revenue procedure are Kathleen J. Herrmann and

¹ See section 21 of Rev. Proc. 2005-6, 2005-1 I.R.B. 200.

² Pursuant to Notice 2001-42, 2001-2 C.B. 70, the EGTRRA remedial amendment period will not end earlier than December 31, 2005. Announcement 2004-71, 2004-40 I.R.B. 569, includes a proposed revenue procedure which, if finalized, would extend this remedial amendment period.

Diane S. Bloom of the Employee Plans, Tax Exempt and Government Entities Division. Ms. Herrmann may be reached at (202) 283-9888 (not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing

Classification of Certain Foreign Entities

REG-148521-04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: This issue of the Bulletin contains temporary and final regulations (T.D. 9197) relating to certain business entities included on the list of foreign business entities that are always classified as corporations for Federal tax purposes. The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides a notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by July 13, 2005. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for July 27, 2005, must be received by July 6, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-148521-04), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday (excluding Federal holidays) between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-148521-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC or sent electronically, via either the IRS internet site at www.irs.gov/reg or the Federal eRulemaking Portal at www.regulations.gov (IRS and REG-148521-04). The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Ronald M. Gootzeit, (202) 622-3860; concerning submissions of comments or the public hearing, Jacqueline B. Turner, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend and revise 26 CFR part 301 relating to section 7701 of the Internal Revenue Code of 1986 (Code). The temporary regulations add certain business entities to the list of foreign business entities that are always classified as corporations for Federal tax purposes. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains both the temporary regulations and these proposed regulations.

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. Also, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact.

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 July 27, 2005, at 10:00 a.m. in the Auditorium of the Internal Revenue building, 1111 Constitution Avenue, NW, Washington, DC. 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 earlier than 30 minutes prior to the start of the hearing. 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 this hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time devoted to each topic (signed original and eight (8) copies) by July 6, 2005. A period of ten minutes will be allotted to each person for making comments. An agenda showing the scheduling of 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.

Proposed Effective Date

Except as otherwise specified, these regulations are proposed to apply as of October 7, 2004.

Drafting Information

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

* * * * *

Proposed Amendments to the Regulations

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

PART 301 — PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.7701-2 is amended by adding paragraphs (b)(8)(vi) and (e)(3) to read as follows:

§301.7701-2 Business entities; definitions.

* * * * *

(b) * * *

(8) * * *

(vi) [The text of the proposed amendment adding §301.7701-2(b)(8)(vi) is the same as the text of §301.7701-2T(b)(8)(vi) published elsewhere in this issue of the Bulletin.]

* * * * *

(e) *Effective dates.* (1) * * *

(2) * * *

(3) [The text of the proposed amendment to §301.7701-2(e)(3) is the same as the text of §301.7701-2T(e)(3) published elsewhere in this issue of the Bulletin.]

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

(Filed by the Office of the Federal Register on April 13, 2005, 8:45 a.m., and published in the issue of the Federal Register for April 14, 2005, 70 F.R. 19722)

Regulations Governing Practice Before the Internal Revenue Service; Correction

Announcement 2005-31

AGENCY: Office of the Secretary, Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to (T.D. 9165, 2005-4 I.R.B. 357), which were published in the **Federal Register** on Monday, December 20, 2004 (69 FR 75839) revising the regulations governing practice before the Internal Revenue Service (Circular 230).

DATES: This correction is effective December 20, 2004.

FOR FURTHER INFORMATION CONTACT: Heather L. Dostaler at (202) 622-4940 or Brinton T. Warren at (202) 622-7800 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The final regulations (T.D. 9165) that are the subject of these corrections are under 31 CFR sections 10.33, 10.35, 10.36, 10.37, 10.38, 10.52 and 10.93.

Need for Correction

As published, T.D. 9165 contains errors that may prove to be misleading and are in need of clarification.

* * * * *

Correction of Publication

Accordingly, 31 CFR Part 10 is corrected by making the following correcting amendments:

PART 10 — PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Paragraph 1. The authority citation for 31 CFR, part 10 continues to read in part as follows:

Authority: Sec. 3, 23 Stat. 258, secs. 2-12, 60 Stat. 237 *et seq.*; 5 U.S.C. 301, 500, 551-559; 31 U.S.C. 330; Reorg. Plan

No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949-1953 Comp., p. 1017.

§10.35 [Corrected]

Par. 2. Section 10.35 is amended by revising paragraphs (b)(2)(ii)(B) introductory text and (b)(4)(i) to read as follows:

§10.35 Requirements for covered opinions.

* * * * *

(b) * * *

(2) * * *(ii) * * *

(A) * * *

(B) Written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion) that—

* * * * *

(4) *Reliance opinion*—(i) Written advice is a *reliance opinion* if the advice concludes at a confidence level of at least more likely than not (a greater than 50 percent likelihood) that one or more significant Federal tax issues would be resolved in the taxpayer's favor.

* * * * *

Richard S. Carro,
*Senior Advisor to the General
Counsel (Regulatory Affairs).*

(Filed by the Office of the Federal Register on April 13, 2005, 8:45 a.m., and published in the issue of the Federal Register for April 14, 2005, 70 F.R. 19892)

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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INTERNAL REVENUE BULLETIN

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