

## **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. 2006-5, page 302.**

**Low-income housing credit; satisfactory bond; “bond factor” amounts for the period January through March 2006.** This ruling provides the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2006.

#### **REG-137243-02, page 317.**

Proposed regulations under section 7216 of the Code update the rules regarding the disclosure and use of tax return information by tax return preparers. The regulations announce new and additional rules for taxpayers to consent electronically to the disclosure or use of their tax return information by tax return preparers. The proposed rules provide guidelines for tax return preparers using or disclosing information obtained in the process of preparing income tax returns. A public hearing is scheduled for April 4, 2006.

#### **Notice 2006-3, page 306.**

Section 1(h) of the Code provides that certain dividends paid to an individual shareholder from either a domestic corporation or a “qualified foreign corporation” are subject to tax at the reduced rates applicable to certain capital gains. This notice provides guidance for persons required to make returns and provide statements under section 6042 regarding distributions with respect to securities issued by a foreign corporation, and for individuals receiving such statements. This notice provides generally that the simplified procedures and other rules contained in Notice 2003-79 and Notice 2004-71 are extended to apply for 2005 information reporting of distributions with respect to securities issued by foreign corporations and for future years.

#### **Notice 2006-4, page 307.**

This notice addresses the application of section 409A of the Code to outstanding stock rights and specifically the determination, for purposes of the exclusion from coverage under section 409A for certain stock rights, of whether a stock right has an exercise price equal to or greater than the fair market value of the underlying stock at the date of grant. For stock rights issued before January 1, 2005, the notice provides that the determination will be made in accordance with the rules governing incentive stock options. For stock rights issued on or after January 1, 2005, but before the effective date of final regulations, the notice reiterates the standard set forth in Notice 2005-1 that the determination of fair market value may be made using any reasonable valuation method.

#### **Rev. Proc. 2006-11, page 309.**

**Simplified service cost and simplified production method change procedures.** This document provides procedures under which a taxpayer may use either the advance consent procedures of Rev. Proc. 97-27 or the automatic consent procedures of Rev. Proc. 2002-9 to request a change in method of accounting to comply with section 1.263A-1T or 1.263A-2T for the taxpayer’s first taxable year ending on or after August 2, 2005. Rev. Procs. 97-27 and 2002-9 modified.

#### **Rev. Proc. 2006-12, page 310.**

This document provides procedures under which certain taxpayers may obtain automatic consent for a taxable year ending on or after December 31, 2005, and for certain earlier taxable years, to change to a method of accounting provided in regulations sections 1.263(a)-4, 1.263(a)-5, or 1.167(a)-3(b). Rev. Procs. 97-27 and 2002-9 modified and amplified. Rev. Procs. 2004-23 and 2005-9 superseded for certain taxable years.

**(Continued on the next page)**

Finding Lists begin on page ii.



## EMPLOYEE PLANS

### **Rev. Proc. 2006–13, page 315.**

**Reporting requirements; fair market value of conversion; Roth IRAs.** This procedure provides safe harbor methods for determining the fair market value of an annuity contract that has not yet been annuitized for purposes of determining the amount includible in gross income as a result of a conversion of a traditional IRA to a Roth IRA, as described in Q&A–14 of section 1.408A–4T.

### **Rev. Proc. 2006–11, page 309.**

**Simplified service cost and simplified production method change procedures.** This document provides procedures under which a taxpayer may use either the advance consent procedures of Rev. Proc. 97–27 or the automatic consent procedures of Rev. Proc. 2002–9 to request a change in method of accounting to comply with section 1.263A–1T or 1.263A–2T for the taxpayer's first taxable year ending on or after August 2, 2005. Rev. Procs. 97–27 and 2002–9 modified.

## EXEMPT ORGANIZATIONS

### **Announcement 2006–3, page 327.**

American Institute of Marine Studies, Inc., of Lauderdale by the Sea, FL, and Hampton Roads Community Foundation of Mechanicsville, VA, no longer qualify as organizations to which contributions are deductible under section 170 of the Code.

## EMPLOYMENT TAX

### **T.D. 9233, page 303.**

Final regulations under section 3121 of the Code provide guidance for payments made on account of sickness or accident disability under a workers' compensation law for purposes of the Federal Insurance Contributions Act (FICA).

## EXCISE TAX

### **Announcement 2006–4, page 328.**

This document contains a notice of public hearing on proposed regulations (REG–138647–04) under section 4980G of the Code that provide guidance on employer comparable contributions to Health Savings Accounts (HSAs). The hearing is scheduled for February 23, 2006.

## ADMINISTRATIVE

### **REG–137243–02, page 317.**

Proposed regulations under section 7216 of the Code update the rules regarding the disclosure and use of tax return information by tax return preparers. The regulations announce new and additional rules for taxpayers to consent electronically to the disclosure or use of their tax return information by tax return preparers. The proposed rules provide guidelines for tax return preparers using or disclosing information obtained in the process of preparing income tax returns. A public hearing is scheduled for April 4, 2006.

# The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by

applying the tax law with integrity and fairness to all.

## Introduction

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

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

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

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

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

### **Part II.—Treaties and Tax Legislation.**

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

### **Part III.—Administrative, Procedural, and Miscellaneous.**

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

### **Part IV.—Items of General Interest.**

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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

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

## Section 1.—Tax Imposed

A notice provides guidance for persons required to make returns and provide statements under section 6042 regarding distributions with respect to securities issued by a foreign corporation, and for individuals receiving such statements. See Notice 2006-3, page 306.

## Section 42.—Low-Income Housing Credit

**Low-income housing credit; satisfactory bond; “bond factor” amounts for the period January through March 2006.** This ruling provides the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2006.

## Rev. Rul. 2006-5

In Rev. Rul. 90-60, 1990-2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of bond factor amounts for dispositions occurring during each calendar month.

Rev. Proc. 99-11, 1999-1 C.B. 275, established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of the low-income housing tax credits under

§ 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99-11 for dispositions of qualified low-income buildings or interests therein during the period January through March 2006.

Table 1 Rev. Rul. 2006-5 Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits											
	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Jan '06	16.49	30.74	43.01	53.65	62.94	64.28	65.95	67.76	69.76	72.19	74.98
Feb '06	16.49	30.74	43.01	53.65	62.94	64.14	65.81	67.62	69.61	72.03	74.80
Mar '06	16.49	30.74	43.01	53.65	62.94	64.00	65.67	67.47	69.46	71.89	74.63

Table 1 (cont'd) Rev. Rul. 2006-5 Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits											
	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	2003	2004	2005	2006							
Jan '06	78.01	81.02	83.60	83.98							
Feb '06	77.81	80.77	83.28	83.98							
Mar '06	77.61	80.53	83.00	83.98							

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see: Rev. Rul. 98-3, 1998-1 C.B. 248; Rev. Rul. 2001-2, 2001-1 C.B. 255; Rev. Rul. 2001-53, 2001-2 C.B. 488; Rev. Rul. 2002-72, 2002-2 C.B. 759; Rev. Rul. 2003-117, 2003-2 C.B. 1051; Rev. Rul. 2004-100, 2004-2 C.B. 718; and Rev. Rul. 2005-67, 2005-43 I.R.B. 771.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is David McDonnell of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. McDonnell at (202) 622-3040 (not a toll-free call).

## Section 162.—Trade or Business Expenses

The Service provides the procedures under which certain taxpayers may obtain automatic consent for a taxable year ending on or after December 31, 2005, and for certain earlier taxable years, to change to a method of accounting provided in sections 1.263(a)-4, 1.263(a)-5, or 1.167(a)-3(b) of the regulations. See Rev. Proc. 2006-12, page 310.

## Section 263.—Capital Expenditures

*26 CFR 1.263(a)-4: Amounts paid to acquire or create intangibles.*

*26 CFR 1.263(a)-5: Amounts paid or incurred to facilitate an acquisition of a trade or business, a change in the capital structure of a business entity, and certain other transactions.*

The Service provides the procedures under which certain taxpayers may obtain automatic consent for a taxable year ending on or after December 31, 2005, and for certain earlier taxable years, to change to a method of accounting provided in sections 1.263(a)-4, 1.263(a)-5, or 1.167(a)-3(b) of the regulations. See Rev. Proc. 2006-12, page 310.

## Section 408.—Individual Retirement Accounts

Safe harbors for reporting the fair market value of the conversion of an annuity held in an Individual Retirement Account or an Individual Retirement Annuity to a Roth IRA are set forth. See Rev. Proc. 2006-13, page 315.

## Section 408A.—Roth IRAs

*26 CFR 1.408A-4T: Converting amounts to Roth IRAs.*

Safe harbors for reporting the fair market value of the conversion of an annuity held in an Individual Retirement Account or an Individual Retirement Annuity to a Roth IRA are set forth. See Rev. Proc. 2006-13, page 315.

## Section 446.—General Rule for Methods of Accounting

*26 CFR 1.446-1: General rule for methods of accounting.*

Can a taxpayer utilize the advance consent procedures of Rev. Proc. 97-27 to request the consent of the Commissioner to change its method of accounting to comply with section 1.263A-1T or 1.263A-2T of the regulations? See Rev. Proc. 2006-11, page 309.

*26 CFR 1.446-1: General rule for methods of accounting.*

The Service provides the procedures under which certain taxpayers may obtain automatic consent for a taxable year ending on or after December 31, 2005, and for certain earlier taxable years, to change to a method of accounting provided in sections 1.263(a)-4, 1.263(a)-5, or 1.167(a)-3(b) of the regulations. See Rev. Proc. 2006-12, page 310.

## Section 461.—General Rule for Taxable Year of Deduction

The Service provides the procedures under which certain taxpayers may obtain automatic consent for a taxable year ending on or after December 31, 2005, and for certain earlier taxable years, to change to a method of accounting provided in sections 1.263(a)-4, 1.263(a)-5, or 1.167(a)-3(b) of the regulations. See Rev. Proc. 2006-12, page 310.

## Section 481.—Adjustments Required by Changes in Method of Accounting

*26 CFR 1.481-1: Adjustments in general.*

The Service provides the procedures under which certain taxpayers may obtain automatic consent for a taxable year ending on or after December 31, 2005, and for certain earlier taxable years, to change to a method of accounting provided in sections 1.263(a)-4, 1.263(a)-5, or 1.167(a)-3(b) of the regulations. See Rev. Proc. 2006-12, page 310.

## Section 3121.—Definitions

*26 CFR 31.3121(a)(2)-1: Payments on account of sickness or accident disability, medical or hospitalization expenses, or death.*

### T.D. 9233

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 31 and 32

### Sickness or Accident Disability Payments

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance regarding the treatment of payments made on account of sickness or accident disability under a workers' compensation law for purposes of the Federal Insurance Contributions Act (FICA).

DATES: *Effective Date:* These regulations are effective December 15, 2005.

*Applicability Date:* These regulations apply to payments on account of sickness or accident disability payments made on or after December 15, 2005.

FOR FURTHER INFORMATION CONTACT: David Ford (202) 622-6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Background

This document contains amendments to 26 CFR parts 31 and 32 under section 3121(a)(2) of the Internal Revenue Code (Code). This section excepts from wages for FICA purposes payments made on account of sickness or accident disability that are received under a "workmen's compensation law," hereinafter referred to as a workers' compensation law.

Proposed regulations (REG-160315-03, 2005-14 I.R.B. 833) under section 3121(a)(2) were published in the **Federal Register** (70 FR 12164) on March 11, 2005. No written comments responding to the notice of proposed rulemaking

were received and a public hearing was not requested or held. Accordingly, the proposed regulations are adopted as final regulations. In addition, this document contains amendments to §32.1 of the Temporary Employment Tax Regulations to provide guidance that the definition of workers' compensation law in the final regulations under §31.3121(a)(2)-1 applies for payments on account of sickness or accident disability made on or after December 15, 2005.

### Explanation of Provisions

Section 3121(a)(2)(A) of the Code excepts from "wages" for FICA tax purposes payments to an employee or any of his dependents on account of sickness or accident disability only if the payments are received under a workers' compensation law.

Section 3121(a)(4) provides that wages does not include any payment on account of sickness or accident disability made by an employer to or on behalf of an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for the employer. Thus, unless made under a workers' compensation law, payments received on account of sickness or accident disability are wages subject to FICA during the first 6 months the employee is out of work.

These final regulations amend §31.3121(a)(2)-1 to provide that payments made under a statute in the nature of a workers' compensation act will be treated as having been made under a workers' compensation law and, therefore excluded from wages for FICA purposes. For income tax purposes, section 104(a)(1) excludes from gross income certain amounts received under "workmen's compensation acts." Section 1.104-1(b) of the Income Tax Regulations, provides that amounts received under section 104(a)(1) include amounts received by an employee under a statute in the nature of a workers' compensation act. Thus, the final regulations align the interpretation of what constitutes payments received under a workers' compensation law for FICA purposes with §1.104-1(b) of the Income tax regulations.

The preamble to the proposed regulations specified that §32.1 of the Temporary Employment Tax Regulations

would be amended, if needed. It is necessary to remove the reference to §31.3121(a)(2)-1(a)(2) in the first phrase of §32.1(a) and insert a reference to §31.3121(a)(2)-1(d)(3) in §32.1(a)(1) to specify that the definition of workers' compensation law applicable to payments on account of sickness or accident disability made on or after December 15, 2005, is now in final regulation §31.3121(a)(2)-1(d)(3). No other amendments are made to §32.1.

The preamble to the proposed regulations also specified guidance would be provided related to Federal Unemployment Tax Act (FUTA) to the extent necessary. The IRS has concluded that no additional guidance is necessary for FUTA since these payments are made to employees of states and local governments and FUTA does not apply to services performed by state or local government employees.

### Special Analyses

It has been determined that these regulations are 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. In addition, because no collection of information is imposed on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small business.

### Drafting Information

The principal author of these regulations is David Ford of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt/Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 31 and 32 are amended as follows:

#### PART 31 — EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

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

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

Par. 2. Section 31.3121(a)(2)-1 is amended by:

1. Revising the section heading.
2. Removing paragraph (a)(1).
3. Redesignating paragraphs (a)(2) through (a)(4) as (a)(1) through (a)(3), respectively.
4. Revising newly redesignated paragraph (a)(1).
5. Redesignating paragraph (d) as (f).
6. Adding new paragraphs (d) and (e)

The revisions and additions are as follows:

*§31.3121(a)(2)-1 Payments on account of sickness or accident disability, medical or hospitalization expenses, or death.*

(a) \* \* \*

(1) Sickness or accident disability of an employee or any of his dependents, only if payment is received under a workers' compensation law;

\* \* \* \* \*

(d) *Workers' compensation law.* (1) For purposes of paragraph (a)(1) of this section, a payment made under a workers' compensation law includes a payment made pursuant to a statute in the nature of a workers' compensation act.

(2) For purposes of paragraph (a)(1) of this section, a payment made under a workers' compensation law does not include a payment made pursuant to a State temporary disability insurance law.

(3) If an employee receives a payment on account of sickness or accident disability that is not made under a workers' compensation law or a statute in the nature of a workers' compensation act, the payment is not excluded from wages as defined by section 3121(a)(2)(A) even if the payment must be repaid if the employee receives a workers' compensation award or an award under a statute in the nature of a workers'

compensation act with respect to the same period of absence from work.

(4) If an employee receives a payment on account of non-occupational injury sickness or accident disability such payment is not excluded from wages, as defined by section 3121(a)(2)(A).

(e) *Examples.* The following examples illustrate the principles of paragraph (d) of this section:

*Example 1.* A local government employee is injured while performing work-related activities. The employee is not covered by the State workers' compensation law, but is covered by a local government ordinance that requires the local government to pay the employee's full salary when the employee is out of work as a result of an injury incurred while performing services for the local government. The ordinance does not limit or otherwise affect the local government's liability to the employee for the work-related injury. The local ordinance is not a workers' compensation law, but it is in the nature of a workers' compensation act. Therefore, the salary the employee receives while out of work as a result of the work-related injury is excluded from wages under section 3121(a)(2)(A).

*Example 2.* The facts are the same as in *Example 1* except that the local ordinance requires the employer to continue to pay the employee's full salary while the employee is unable to work due to an injury whether or not the injury is work-related. Thus, the local ordinance does not limit benefits to instances of work-related disability. A benefit paid under an ordinance that does not limit benefits to instances of work-related injuries is not a statute in the nature of a workers' compensation act. Therefore, the salary the injured employee receives from the employer while out of work is wages subject to FICA even though the employee's injury is work-related.

*Example 3.* The facts are the same as in *Example 1* except that the local ordinance includes a rebuttable presumption that certain injuries, including any heart attack incurred by a firefighter or other law enforcement personnel is work-related. The presumption in the ordinance does not eliminate the requirement that the injury be work-related in order to entitle the injured worker to full salary. Therefore, the ordinance is a statute in the nature of a workers' compensation act, and the salary the injured employee receives pursuant to the ordinance is excluded from wages under section 3121(a)(2)(A).

\* \* \* \* \*

PART 32 — TEMPORARY  
EMPLOYMENT TAX REGULATIONS  
UNDER THE ACT OF DECEMBER 29,  
1981 (PUB. L. 97-123)

Par. 3. The authority section for part 32 continues to read, in part, as follows:

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

Par. 4. Section 32.1 is amended by:

1. Revising paragraph (a) introductory text.

2. Revising paragraph (a)(1).

The revisions and additions are as follows:

\* \* \* \* \*

(a) *General rule.* The amount of any payment on or after January 1, 1982, made to, or on behalf of, an employee or any of his dependents on account of sickness or accident disability is not excluded from the term wages as defined in section 3121(a)(2)(A) unless such payment is—

(1) Received under a workmen's compensation law (as defined in §31.3121(a)(2)-1(d)(3) of this chapter for payments made on or after December 15, 2005), or

\* \* \* \* \*

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

Approved December 1, 2005.

Eric Solomon,  
*Acting Deputy Assistant Secretary  
of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on December 14, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 15, 2005, 70 F.R. 74198)

## Section 6042.—Returns Regarding Payments of Dividends and Corporate Earnings and Profits

A notice provides guidance for persons required to make returns and provide statements under section 6042 regarding distributions with respect to securities issued by a foreign corporation, and for individuals receiving such statements. See Notice 2006-3, page 306.

## Section 6721.—Failure to File Correct Information Returns

A notice provides guidance for persons required to make returns and provide statements under section 6042 regarding distributions with respect to securities issued by a foreign corporation, and for individuals receiving such statements. See Notice 2006-3, page 306.

## Section 6722.—Failure to Furnish Correct Payee Statements

A notice provides guidance for persons required to make returns and provide statements under section 6042 regarding distributions with respect to securities issued by a foreign corporation, and for individuals receiving such statements. See Notice 2006-3, page 306.

## Section 6724.—Waiver; Definitions and Special Rules

A notice provides guidance for persons required to make returns and provide statements under section 6042 regarding distributions with respect to securities issued by a foreign corporation, and for individuals receiving such statements. See Notice 2006-3, page 306.

# Part III. Administrative, Procedural, and Miscellaneous

## Information Reporting and Other Guidance Regarding Distributions With Respect to Securities Issued by Foreign Corporations

### Notice 2006-3

#### SECTION 1. OVERVIEW

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27, 117 Stat. 752) (the “2003 Act”) was enacted on May 28, 2003. Subject to certain limitations, the 2003 Act generally provides that a dividend paid to an individual shareholder from either a domestic corporation or a “qualified foreign corporation” is subject to tax at the reduced rates applicable to certain capital gains. A qualified foreign corporation includes certain foreign corporations that are eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of this provision and which includes an exchange of information program. In addition, a foreign corporation not otherwise treated as a qualified foreign corporation is so treated with respect to any dividend it pays if the stock with respect to which it pays such dividend is readily tradable on an established securities market in the United States. The 2003 Act excluded from the definition of qualified foreign corporation any foreign corporation which for the taxable year of the corporation in which the dividend was paid, or the preceding taxable year, was a foreign personal holding company (as defined in section 552), a foreign investment company (as defined in section 1246(b)), or a passive foreign investment company (as defined in section 1297). Effective for taxable years of foreign corporations beginning after December 31, 2004, the American Jobs Creation Act (P.L. 108-357) (the “AJCA”) repealed the rules applicable to foreign personal holding companies and foreign investment companies from the Code. The AJCA made conforming amendments to section 1(h)(11)(C)(iii).

This notice provides guidance for persons required to make returns and provide statements under section 6042 of the In-

ternal Revenue Code with respect to securities issued by a foreign corporation, and for individuals receiving such statements. This notice provides generally that the simplified procedures regarding information reporting of distributions with respect to securities issued by foreign corporations and other rules contained in Notice 2003-79 and Notice 2004-71 for tax years 2003 and 2004, respectively, are extended to apply for 2005 and future years.

#### SECTION 2. NOTICE 2003-79 and NOTICE 2004-71

In November of 2003, the Treasury Department and the IRS issued Notice 2003-79, 2003-2 C.B. 1206, which provided guidance for persons required to make returns and provide statements under section 6042 of the Internal Revenue Code (*e.g.*, Form 1099-DIV) regarding distributions made in 2003 with respect to securities issued by a foreign corporation, and for individuals receiving such statements. Notice 2003-79 identified a series of separate determinations that must be made in order to determine whether a distribution with respect to a security issued by a foreign corporation is eligible for the reduced rates of tax under the 2003 Act. Notice 2003-79 provided simplified procedures to be used for 2003 information reporting of a distribution with respect to such a security. Notice 2003-79 also provided guidance regarding the determination as to whether a security (or an American depositary receipt in respect of such security) issued by a foreign corporation other than ordinary or common stock (such as preferred stock) is considered readily tradable on an established securities market in the United States for purposes of the 2003 Act.

In November of 2004, Treasury and the IRS issued Notice 2004-71, 2004-2 C.B. 793, which provided guidance for persons required to make returns and provide statements under section 6042 of the Internal Revenue Code regarding distributions made in 2004 with respect to securities issued by a foreign corporation, and for individuals receiving such statements. Notice 2004-71 generally provided that the simplified procedures and other rules contained in Notice 2003-79 were extended

to apply for 2004 information reporting of distributions with respect to securities issued by foreign corporations.

#### SECTION 3. GUIDANCE FOR 2005 AND FUTURE YEARS

##### .01 Generally.

While the Treasury Department and the IRS continue to acknowledge that more detailed information reporting guidance may be necessary, and such procedures continue to be under study, Treasury and the IRS have concluded that it is appropriate to extend the simplified procedures that were provided in Notice 2003-79 and Notice 2004-71 with respect to tax years 2003 and 2004, to 2005 and future years with appropriate modifications to take into account the changes enacted by the AJCA.

Section 3.02 of this notice summarizes guidance for 2005 and future years information reporting of a distribution with respect to a security issued by a foreign corporation. Section 3.03 provides guidance for 2005 and future years for recipients of Form 1099-DIV.

##### .02 Persons Required to File Form 1099-DIV.

The rules for 2003 information reporting of a distribution with respect to a security issued by a foreign corporation that are described in detail in sections 3.01 through 3.07 of Notice 2003-79 will continue to apply for 2005. Those rules are outlined in the following summary. However, in order to account for the amendments enacted by the AJCA, for 2006 and future years the foreign investment company exclusion test shall be applied without regard to whether the foreign corporation is or was a foreign personal holding company or a foreign investment company.

A person required to make a return under section 6042 shall report a distribution with respect to such a security in Box 1b of Form 1099-DIV as a qualified dividend if:

1. either the security with respect to which the distribution is made is a common or an ordinary share, or a public SEC filing contains a statement that the security will be, should be, or more likely than not will be



treated as equity rather than debt for U.S. federal income tax purposes; and

2. either:

- a. the security is considered “readily tradable on an established securities market in the United States”;<sup>1</sup>
- b. the foreign corporation is organized in a possession of the United States; or
- c. the foreign corporation is organized in a country whose income tax treaty with the United States is comprehensive, is satisfactory to the Secretary for purposes of section 1(h)(11), and includes an exchange of information program,<sup>2</sup> and if the relevant treaty contains a limitation on benefits provision, the corporation’s common or ordinary stock is listed on an exchange covered by that limitation on benefits provision’s public trading test, unless the person required to file an information return knows or has reason to know that the corporation is not eligible for benefits under that treaty; and

3. the person required to file Form 1099-DIV does not know or have reason to know that the foreign corporation is or expects to be, in the taxable year of the corporation in which the dividend was paid, or was, in the preceding taxable year, a foreign personal holding company (as defined in section 552), a foreign investment company (as defined in section 1246(b)), or a passive foreign investment company (as defined in section 1297);<sup>3</sup> and

4. the person required to make a return under section 6042 determines that the owner of the distribution has satisfied the holding period requirement of section 1(h)(11) or it is impractical for such person to make such determination.

The IRS will exercise its authority under section 6724(a) of the Code to waive penalties under sections 6721 and 6722 with respect to reporting of payments if persons required to file Form 1099-DIV make a good faith effort to report payments consistent with the rules summarized above and described in detail in sections 3.01 through 3.06 of Notice 2003–79. A person required to make a return under section 6042 may report a distribution in Box 1b as a qualified dividend even if the distribution does not satisfy these simplified information reporting procedures, subject to the applicable penalty provisions, as described in detail in section 3.07 of Notice 2003–79.

.03 Recipients of Form 1099-DIV.

For taxable years beginning in 2005 and future tax years, a recipient of Form 1099-DIV may treat amounts reported in Box 1b as qualified dividends, unless and to the extent the recipient knows or has reason to know that such amounts are not qualified dividends, as described in detail in section 3.08 of Notice 2003–79.

#### SECTION 4. EFFECTIVE DATE

This notice is effective for taxable years beginning on or after January 1, 2005.

#### SECTION 5. COMMENTS

Treasury and the IRS continue to invite interested persons to comment on the information reporting procedures contained in this notice and the certification procedures outlined in Section 5 of Notice 2003–79. Written comments may be submitted to CC:PA:LPD:PR (Notice 2006–3), room 5207, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 am and 5 pm to: CC:PA:LPD:PR (Notice 2006–3), Courier’s desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically via the following e-mail address:

*Notice.Comments@irs.counsel.treas.gov*. Please include “Notice 2006–3” in the subject line of any electronic communications.

#### SECTION 6. PAPERWORK REDUCTION ACT

The information collection referenced in this notice has been previously reviewed and approved by the Office of Management and Budget as part of the promulgation of Form 1099-DIV. See OMB Control Number 1545–0110. This notice merely provides additional guidance regarding the proper filing of such returns and furnishing of such statements.

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.

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.

#### SECTION 7. CONTACT INFORMATION

The principal author of this notice is Karen A. Rennie of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact David Lundy at (202) 622–3880 (not a toll-free call).

## Interim Guidance With Respect to the Application of Section 409A to Outstanding Stock Rights

### Notice 2006–4

#### I. Background

Section 409A was added to the Internal Revenue Code as part of the American Jobs Creation Act of 2004, Pub. Law

<sup>1</sup> Notice 2003–71, 2003–2 C.B. 922, and section 3.02 of Notice 2004–71, 2004–2 C.B. 793, provide guidance regarding when a security is considered readily tradable on an established securities market in the United States for purposes of section 1(h)(11).

<sup>2</sup> Notice 2003–69, 2003–2 C.B. 851, contains a list of qualifying treaties for this purpose.

<sup>3</sup> Notice 2004–70, 2004–2 C.B. 724, provides guidance regarding the extent to which distributions, inclusions, and other amounts received by, or included in the income of, individual shareholders as ordinary income from foreign corporations subject to certain anti-deferral regimes may be treated as qualified dividend income for purposes of section 1(h)(11).

No. 108-357, 118 Stat. 1418. Section 409A generally provides that all amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are met. The IRS issued Notice 2005-1, 2005-2 I.R.B. 274, on December 20, 2004 (published as modified on January 6, 2005) and issued proposed regulations (REG-158080-04, 2005-43 I.R.B. 786) under section 409A on September 29, 2005 (70 Fed. Reg. 57930 (Oct. 4, 2005)). The proposed regulations are proposed to be effective on January 1, 2007, and do not limit the application of the guidance provided in Notice 2005-1.

## II. Stock Options and Stock Appreciation Rights Granted before January 1, 2005

### A. Application of the Reasonable Valuation Standard

Commentators expressed concern with respect to the application of section 409A to stock options and stock appreciation rights (collectively, stock rights) issued before January 1, 2005. Specifically, commentators expressed concern that although the issuer of a stock right intended to establish an exercise price not less than the fair market value of the stock at the time of grant, the issuer of the stock right may not be able to demonstrate that the exercise price of the stock right was determined using a reasonable valuation method in accordance with the requirements set forth in Notice 2005-1, Q&A-4(d) or § 1.409A-1(b)(5)(i)(B) of the proposed regulations. Commentators noted further that at the time such stock rights were granted, section 409A had not been enacted and thus no guidance with respect to the application of section 409A to stock rights was available.

### B. Application of the Good Faith Standards of § 1.422-2(e)(2)

Section 1.422-2(e)(1) generally provides that except as provided by § 1.422-2(e)(2), the option price of an incentive stock option must not be less than the fair market value of the stock subject to the option at the time the option

is granted. Section 1.422-2(e)(2) generally provides that if a share of stock is transferred to an individual pursuant to the exercise of an option which fails to qualify as an incentive stock option merely because there was a failure of an attempt, made in good faith, to meet the option price requirements of § 1.422-2(e)(1), those option price requirements are considered to have been met. Whether there was a good-faith attempt to set the option price at not less than the fair market value of the stock subject to the option at the time the option was granted depends on the relevant facts and circumstances.

Until further guidance is issued, with respect to a stock right issued before January 1, 2005, for purposes of determining whether the stock option results in a deferral of compensation pursuant to Notice 2005-1, Q&A-4(d)(ii), or the stock appreciation right results in a deferral of compensation pursuant to § 1.409A-1(b)(5)(i)(B) of the proposed regulations, principles similar to those set forth in § 1.422-2(e)(2) will be applied. Accordingly, where there was a good-faith attempt to set the exercise price of a stock right granted before January 1, 2005, at a price not less than the fair market value of the stock subject to the stock right at the time the stock right was granted, then such exercise price will be treated as being not less than the fair market value of the stock at the time of grant for purposes of determining whether the stock right is excluded from the requirements applicable to deferred compensation under section 409A.

## III. Stock Rights Issued on or after January 1, 2005 and Continued Application of Notice 2005-1, Q&A-4(d)(ii)

With respect to stock options granted on or after January 1, 2005 and before the effective date of final regulations, Notice 2005-1, Q&A-4(d)(ii) remains applicable guidance. Taxpayers may also rely on § 1.409A-1(b)(5)(i)(B) of the proposed regulations during this period. With respect to stock appreciation rights issued on or after January 1, 2005 and before the effective date of final regulations, taxpayers may rely on § 1.409A-1(b)(5)(i)(B) of the proposed regulations. In applying the provisions of the proposed regulations relating to stock appreciation rights, and

specifically § 1.409A-1(b)(5)(i)(B)(I) and (2), taxpayers may apply the rule set forth in Notice 2005-1, Q&A-4(d)(ii) that, for purposes of determining the fair market value of the stock at the date of grant, any reasonable valuation method may be used. Accordingly, where a taxpayer can demonstrate that the exercise price of a stock right, granted on or after January 1, 2005, and before the effective date of final regulations, is intended to be not less than the fair market value of the stock at the date of grant and that the value of such stock was determined using a reasonable valuation method, then that valuation will meet the requirements of Notice 2005-1, Q&A-4(d)(ii) regardless of whether that determination satisfies the valuation requirements in § 1.409A-1(b)(5)(i)(B) of the proposed regulations.

## IV. Request for Additional Comments regarding Application of Final Regulations to Outstanding Stock Rights

Final regulations may establish more detailed standards for valuation in the context of stock rights than those provided in this notice and Notice 2005-1. The Treasury Department and the IRS continue to request comments with respect to the proposed regulations, and specifically how the standards proposed with respect to the determination of the fair market value of stock subject to stock rights may be improved both to meet commentators' requests for more certainty with respect to the valuation requirement, and the legislative intent that only stock rights with exercise prices that may not be lower than the fair market value of the underlying stock on the date of grant be excluded from coverage under section 409A. See H.R. Conf. Rep. No. 108-755, at 735 (2004).

In addition, commentators have expressed concerns relating to the definition of service recipient stock for purposes of the exclusions from coverage under section 409A for certain stock rights, and the treatment of modifications, extensions and renewals of otherwise excluded stock rights. The Treasury Department and the IRS are considering comments on these issues, and invite further comments with respect to the rules proposed under the proposed regulations, as well as any additional transitional relief that may be

appropriate in conjunction with the implementation of the final regulations. For information regarding the submission of comments, see the “Comments and Public Hearing” section of the preamble to the proposed regulations.

## V. Drafting Information

The principal author of this guidance is Stephen Tackney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, contact Stephen Tackney at (202) 927-9639 (not a toll-free call).

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*26 CFR 1.263A-1T: Uniform capitalization of costs (temporary).*  
(Also Part I, §§ 446(e); 1.263A-2T, 1.446-1.)

## Rev. Proc. 2006-11

### SECTION 1. PURPOSE

This revenue procedure provides procedures by which a taxpayer changing its method of accounting to comply with § 1.263A-1T or 1.263A-2T of the Income Tax Regulations as set forth in T.D. 9217, 2005-37 I.R.B. 498 (70 FR 44467) for its first taxable year ending on or after August 2, 2005, may request the consent of the Commissioner utilizing either the advance consent procedures of Rev. Proc. 97-27, 1997-1 C.B. 680 (as modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432) or the automatic consent procedures of Rev. Proc. 2002-9, 2002-1 C.B. 327 (as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432).

### SECTION 2. BACKGROUND

.01 Under §§ 446(e) and 1.446-1(e), a taxpayer generally must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. To obtain the Commissioner’s consent to a change in method,

§ 1.446-1(e)(3)(i) generally requires a taxpayer to file Form 3115, *Application for Change in Accounting Method*, during the taxable year in which the taxpayer desires to make the proposed change. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures that provide the terms and conditions necessary for a taxpayer to obtain consent to change a method of accounting. The terms and conditions the Commissioner may prescribe include whether the change is to be made with a § 481(a) adjustment, and if so, the § 481(a) adjustment period, or on a cut-off basis.

.02 Section 481(c) and §§ 1.446-1(e)(3)(ii) and 1.481-4 provide that the adjustment required by § 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

.03 This revenue procedure applies only for a taxpayer’s first taxable year ending on or after August 2, 2005, for a change in method of accounting to comply with § 1.263A-1T or 1.263A-2T. A change in method of accounting under this revenue procedure requires a § 481(a) adjustment, and the § 481(a) adjustment period is two taxable years for a net positive adjustment. It is expected that this two-year adjustment period for a net positive § 481(a) adjustment will apply to changes in methods of accounting made in future years to comply with the rules in §§ 1.263A-1T and 1.263A-2T, and the successor final regulations.

.04 Rev. Proc. 97-27 provides the general procedures under §§ 446(e) and 1.446-1(e) for obtaining the consent of the Commissioner to change a method of accounting for federal income tax purposes. Except as specifically provided in section 4.02 of Rev. Proc. 97-27 or other published guidance, Rev. Proc. 97-27 applies to all taxpayers requesting the Commissioner’s consent to change a method of accounting for federal income tax purposes. See Rev. Proc. 97-27, sections 1.01 and 4.01.

.05 Section 4.02(1) of Rev. Proc. 97-27 provides that Rev. Proc. 97-27 does not apply if the change in method of accounting is required to be made pursuant to a published automatic change procedure.

.06 Rev. Proc. 2002-9 provides procedures under §§ 446(e) and 1.446-1(e)

for obtaining the automatic consent of the Commissioner to change certain methods of accounting for federal income tax purposes. Specifically, Rev. Proc. 2002-9 applies to a taxpayer requesting the Commissioner’s consent to change to a method of accounting described in the APPENDIX of such revenue procedure. Rev. Proc. 2002-9 is the exclusive procedure for a taxpayer within its scope to obtain the Commissioner’s consent. See Rev. Proc. 2002-9, sections 1 and 4.01.

.07 T.D. 9217 contains final and temporary regulations relating to the capitalization of costs under the simplified service cost method provided by § 1.263A-1(h) and the simplified production method provided by § 1.263A-2(b). Specifically, the regulations under § 1.263A-1T and § 1.263A-2T clarify what property qualifies as self-constructed assets produced on a routine and repetitive basis for purposes of the simplified service cost method or the simplified production method, respectively.

.08 Section 1.263A-1T(k)(1) provides that a change in a taxpayer’s treatment of mixed service costs to comply with § 1.263A-1T is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. Section 1.263A-1T(k)(1) further provides that for a taxpayer’s first taxable year ending on or after August 2, 2005, the taxpayer is granted the consent of the Commissioner to change its method of accounting to comply with § 1.263A-1T, provided the taxpayer follows the administrative procedures issued under § 1.446-1(e)(3)(ii), as modified by § 1.263A-1T(k)(2) through (4), for obtaining the Commissioner’s automatic consent to a change in accounting method.

.09 Section 1.263A-2T(e)(1) provides that a change in a taxpayer’s treatment of additional § 263A costs to comply with § 1.263A-2T is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. Section 1.263A-2T(e)(1) further provides that for a taxpayer’s first taxable year ending on or after August 2, 2005, the taxpayer is granted the consent of the Commissioner to change its method of accounting to comply with § 1.263A-2T, provided the taxpayer follows the administrative procedures issued under § 1.446-1(e)(3)(ii), as modified

by § 1.263A-2T(e)(2) through (4), for obtaining the Commissioner's automatic consent to a change in accounting method.

.10 Pursuant to the foregoing provisions, a taxpayer changing its method of accounting to comply with § 1.263A-1T or 1.263A-2T as set forth in T.D. 9217 for its first taxable year ending on or after August 2, 2005, is required to use the automatic consent procedures of Rev. Proc. 2002-9 (as modified by § 1.263A-1T(k) or 1.263A-2T(e), whichever is applicable) to obtain the consent of the Commissioner to change its method of accounting. Some taxpayers contemplating such accounting method changes are uncertain whether their proposed methods of accounting will comply with the regulations under § 263A, and have requested that the Internal Revenue Service allow for advance review of their requested accounting methods.

.11 The Service has determined that it is in the best interest of sound tax administration to allow taxpayers changing their methods of accounting to comply with § 1.263A-1T or 1.263A-2T for their first taxable years ending on or after August 2, 2005, to utilize either the advance consent procedures of Rev. Proc. 97-27 or the automatic consent procedures of Rev. Proc. 2002-9. Therefore, when §§ 1.263A-1T and 1.263A-2T are issued as final regulations, the final regulations will allow taxpayers to use the advance consent procedures for their first taxable year ending on or after August 2, 2005. This revenue procedure is being issued in advance of the final regulations and the rules provided herein are consistent with the rules that will be provided in the final regulations.

### SECTION 3. SCOPE

This revenue procedure applies to any taxpayer seeking to change its method of accounting for mixed service costs to comply with § 1.263A-1T for its first taxable year ending on or after August 2, 2005, and to any taxpayer seeking to change its method of accounting for additional § 263A costs to comply with § 1.263A-2T for its first taxable year ending on or after August 2, 2005.

### SECTION 4. APPLICATION

.01 The provisions of section 4.02(1) of Rev. Proc. 97-27 and section 4.01 of Rev. Proc. 2002-9 that preclude a taxpayer from requesting the Commissioner's advance consent to change a method of accounting that is required to be made pursuant to a published automatic change procedure shall not apply to changes in method of accounting to comply with § 1.263A-1T or 1.263A-2T for a taxpayer's first taxable year ending on or after August 2, 2005. Accordingly, a taxpayer within the scope of this revenue procedure may utilize either the advance consent procedures of Rev. Proc. 97-27 or the automatic consent procedures of Rev. Proc. 2002-9 to obtain the consent of the Commissioner to make such changes.

.02 The following provisions shall apply to a taxpayer within the scope of this revenue procedure that requests the consent of the Commissioner under Rev. Proc. 97-27 to change its method of accounting to comply with § 1.263A-1T or 1.263A-2T for its first taxable year ending on or after August 2, 2005:

(1) Notwithstanding the provisions of § 1.446-1(e)(3)(i) and section 5.01(1)(a) of Rev. Proc. 97-27, a taxpayer may submit a Form 3115 on or before January 31, 2006, or the date that is 30 days after the end of the taxpayer's taxable year for which the change is requested, whichever is later;

(2) The provisions of section 4.02 of Rev. Proc. 97-27 that otherwise would prevent certain taxpayers under examination, before appeals or before a federal court from requesting the Commissioner's advance consent to change a method of accounting shall not apply;

(3) A taxpayer that changes its method of accounting for mixed service costs to comply with § 1.263A-1T will not receive audit protection under section 9 of Rev. Proc. 97-27 if its method of accounting for mixed service costs is an issue under consideration (as defined in section 3.08 of Rev. Proc. 97-27) at the time the Form 3115 is filed with the National Office;

(4) A taxpayer that changes its method of accounting for additional § 263A costs to comply with § 1.263A-2T will not receive audit protection under section 9 of Rev. Proc. 97-27 if its method of accounting for additional § 263A costs is an issue

under consideration (as defined in section 3.08 of Rev. Proc. 97-27) at the time the Form 3115 is filed with the National Office; and

(5) The change in method of accounting requires a § 481(a) adjustment. The § 481(a) adjustment period is two taxable years for a net positive adjustment.

### SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97-27 and Rev. Proc. 2002-9 are modified.

### SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Grant D. Anderson of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Scott Rabinowitz at (202) 622-4970 (not a toll-free call).

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*26 CFR 601.204: Changes in accounting periods and in methods of accounting.*

*(Also Part 1, §§ 162, 263, 446, 461, 481; 1.167(a)-3(b), 1.263(a)-4, 1.263(a)-5, 1.446-1, 1.481-1.)*

## Rev. Proc. 2006-12

### SECTION 1. PURPOSE

This revenue procedure provides the exclusive administrative procedures under which a taxpayer described in section 3 of this revenue procedure may obtain automatic consent for a taxable year ending on or after December 31, 2005, and for any earlier taxable year that is after the taxpayer's second taxable year ending on or after December 31, 2003, to change to a method of accounting provided in §§ 1.263(a)-4, 1.263(a)-5, or 1.167(a)-3(b) of the Income Tax Regulations (the "final regulations").

### SECTION 2. BACKGROUND

.01 On January 5, 2004, the Internal Revenue Service and Treasury Department published final regulations in the **Federal Register** (T.D. 9107, 2004-1 C.B. 447 [69 FR 436]). Section 1.263(a)-4 prescribes the extent to which taxpayers must

capitalize amounts paid or incurred to acquire or create (or to facilitate the acquisition or creation of) intangibles. Section 1.263(a)-5 prescribes the extent to which taxpayers must capitalize amounts paid or incurred to facilitate an acquisition of a trade or business, a change in the capital structure of a business entity, and certain other transactions. Section 1.167(a)-3(b) provides a safe harbor useful life for certain intangible assets. The final regulations under §§ 1.263(a)-4 and 1.263(a)-5 are effective for amounts paid or incurred on or after December 31, 2003. The final regulations under § 1.167(a)-3(b) are effective for intangible assets created on or after December 31, 2003.

.02 Sections 1.263(a)-4(p) and 1.263(a)-5(n) provide that a taxpayer seeking to change to a method of accounting provided in the final regulations must secure the consent of the Commissioner in accordance with the requirements of § 1.446-1(e). In addition, §§ 1.263(a)-4(p) and 1.263(a)-5(n) provide that, for the taxpayer's first taxable year ending on or after December 31, 2003, the taxpayer is granted the consent of the Commissioner to change to a method of accounting provided in the final regulations, provided the taxpayer follows the administrative procedures issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002-9, 2002-1 C.B. 327, as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432). The final regulations further provide that any applicable § 481(a) adjustment for a change to a method of accounting provided in the final regulations for a taxpayer's first taxable year ending on or after December 31, 2003, is determined by taking into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. The preamble to the final regulations states that the Service may issue additional guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the regulations.

.03 Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe adminis-

trative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting.

.04 Rev. Proc. 2002-9 provides procedures by which a taxpayer may obtain automatic consent to change to a method of accounting described in the Appendix of Rev. Proc. 2002-9.

.05 Rev. Rul. 90-38, 1990-1 C.B. 57, provides that, if a taxpayer uses an erroneous method of accounting for two or more consecutive taxable years, the taxpayer has adopted a method of accounting. The ruling further provides that a taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing an amended return.

.06 Rev. Proc. 2004-23, 2004-1 C.B. 785, and Rev. Proc. 2005-9, 2005-2 I.R.B. 303, as modified by Rev. Proc. 2005-17, 2005-13 I.R.B. 797, provide the exclusive administrative procedures under which a taxpayer may obtain automatic consent for the taxpayer's first and second taxable years, respectively, ending on or after December 31, 2003, to change to a method of accounting provided in the final regulations and, if desired, to change to a method of utilizing the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or the recurring item exception authorized by § 1.461-5 in conjunction with a change to a method of accounting provided in the final regulations. Rev. Proc. 2004-23 and Rev. Proc. 2005-9 provide, as a term and condition of obtaining the Commissioner's consent, that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002.

.07 This revenue procedure constitutes the exclusive guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the final regulations for taxable years subsequent to those covered by Rev. Proc. 2004-23 and Rev. Proc. 2005-9 — specifically, a taxable year ending on or after December 31, 2005, and any earlier taxable year that is after the taxpayer's second taxable year ending on or after December 31, 2003. As in Rev. Proc. 2004-23 and Rev. Proc. 2005-9, a term and condition of obtaining the Commissioner's consent is that any applicable § 481(a) adjustment take into account only amounts paid or incurred in

taxable years ending on or after January 24, 2002. For any change in method of accounting to which this revenue procedure applies, a taxpayer may not file an application for a change in method of accounting under Rev. Proc. 97-27, 1997-1 C.B. 680, as modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432. See section 4.02(1) of Rev. Proc. 97-27.

### SECTION 3. SCOPE

This revenue procedure applies to a taxpayer that seeks, for a taxable year ending on or after December 31, 2005, and for any earlier taxable year that is after the taxpayer's second taxable year ending on or after December 31, 2003, to change to a method of accounting provided in the final regulations.

### SECTION 4. APPLICATION

.01 *In general.* A taxpayer within the scope of this revenue procedure and Rev. Proc. 2002-9, as modified by this revenue procedure, is, in accordance with section 6.01 of Rev. Proc. 2002-9, granted the consent of the Commissioner to change to a method of accounting provided in the final regulations provided the taxpayer follows the automatic change in method of accounting provisions in Rev. Proc. 2002-9, with the following modifications:

(1) The taxpayer must prepare and file Form 3115, *Application for Change in Accounting Method*, in accordance with section 4.02 of this revenue procedure;

(2) The taxpayer must compute any applicable § 481(a) adjustment and take such adjustment into account in accordance with section 5 of this revenue procedure; and

(3) A taxpayer described in section 4.03(2) of this revenue procedure must file one or more amended federal income tax returns (amended returns) in accordance with section 4.03(3), (4), or (5), as applicable, and section 4.03(6), if applicable, of this revenue procedure.

.02 *Form 3115.* In preparing the Form 3115 referred to in section 4.01 of this revenue procedure, a taxpayer must comply with the following procedures:

(1) The taxpayer may use one Form 3115 for all changes in method of accounting made pursuant to the final regulations;

(2) The taxpayer is required to complete only the following information on Form 3115:

(a) The identification section of Page 1 (above Part I);

(b) The signature section at the bottom of Page 1;

(c) Part I, Line 1(a). The designated automatic accounting method change number for changes in method of accounting made pursuant to this revenue procedure is No. "78";

(d) Part II, all lines except lines 11, 13, 14, 15, and 17 (for purposes of completing line 12, see section 5.02(2) of this revenue procedure if the taxpayer is making more than one change in method of accounting);

(e) Part IV, in accordance with section 5 of this revenue procedure; and

(f) Schedule E, if applicable;

(3) In addition to the other information required on line 12 of Form 3115, the taxpayer must include the citation to the paragraph of the final regulations that provides for the proposed method of accounting for each item (*e.g.*, § 1.263(a)-4(d)(6) or § 1.263(a)-4(f));

(4) In addition to the other information required on Schedule E of Form 3115 (if applicable), the taxpayer must include a statement as to whether the useful life is the safe harbor useful life prescribed by § 1.167(a)-3(b)(1) or § 1.167(a)-3(b)(1)(iv) and, if the useful life is the safe harbor useful life prescribed by § 1.167(a)-3(b)(1), a statement explaining why the intangible asset does not have a useful life the length of which can be estimated with reasonable accuracy; and

(5) A taxpayer that must file one or more amended returns as provided in section 4.03 of this revenue procedure to be eligible to use the automatic consent procedures of this revenue procedure must attach to the Form 3115 a written statement signed under penalties of perjury confirming that the taxpayer has filed the amended returns pursuant to section 4.03 of this revenue procedure.

.03 *Unauthorized change in a preceding year.*

(1) A taxpayer may change a method of accounting only with the consent of the Commissioner. § 1.446-1(e)(2). A tax-

payer that changes a method of accounting without the consent of the Commissioner has made an unauthorized change in method of accounting. If a taxpayer makes an unauthorized change in method of accounting, the Service may adjust the taxpayer's taxable income during the examination of the taxpayer's income tax return for the taxable year the unauthorized change was made and for all affected subsequent taxable years. In the notice of proposed rulemaking that preceded the publication of the final regulations (REG-125638-01, 2003-1 C.B. 373 [67 FR 77701]), the Service and Treasury Department advised taxpayers not to seek to change a method of accounting in reliance on rules contained in the notice of proposed rulemaking until the rules were published as final regulations. The Service and Treasury Department are aware that some taxpayers have made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations. The Service and Treasury Department have determined that it is not appropriate for taxpayers that have made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations to obtain automatic consent under this revenue procedure without correcting such unauthorized change. Therefore, a taxpayer that made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations is eligible to use the automatic consent procedures provided in this revenue procedure only if the taxpayer amends prior federal income tax returns to correct the unauthorized change in method of accounting. However, as a matter of administrative grace, the Service and Treasury Department have limited the application of this section 4.03 to certain taxpayers described in section 4.03(2) of this revenue procedure.

(2) This section 4.03 applies to a taxpayer that —

(a) in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is after January 24, 2002 —

(i) made any unauthorized change in method of accounting for an item the treat-

ment of which is provided for in the final regulations; or

(ii) impermissibly changed the treatment of an item that is provided for in the final regulations for the taxable year preceding the taxable year for which the taxpayer is requesting to change to a method of accounting provided in the final regulations under this revenue procedure and used such treatment on only one federal income tax return; or

(b) made an unauthorized change in method of accounting to a method of accounting that is provided in the final regulations in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is on or before January 24, 2002, if the taxpayer wishes to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting to which the taxpayer previously made the unauthorized change.

(3) A taxpayer described in section 4.03(2)(a)(i) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer changes back to its prior method of accounting (*i.e.*, the method of accounting used for an item prior to making the unauthorized change for the item) for each item referred to in section 4.03(2)(a)(i) of this revenue procedure by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method (or methods) was used. See section 4.03(6) of this revenue procedure if the period of limitations has expired for the taxable year in which the taxpayer made the unauthorized change in method of accounting or for any subsequent taxable year.

(4) A taxpayer described in section 4.03(2)(a)(ii) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer amends its federal income tax return for the preceding taxable year in which the unauthorized treatment was used to change the treatment of each item referred to in section 4.03(2)(a)(ii) of this revenue procedure to a treatment consis-

tent with the taxpayer's historic method of accounting (*i.e.*, the method of accounting used for an item prior to changing the treatment of the item).

(5) A taxpayer described in section 4.03(2)(b) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting provided in the final regulations to which the taxpayer previously made the unauthorized change only if the taxpayer changes back to its prior method of accounting for the item (*i.e.*, the method of accounting used for the item prior to making the unauthorized change for the item) by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method was used. See section 4.03(6) of this revenue procedure if the period of limitations has expired for the taxable year in which the taxpayer made the unauthorized change in method of accounting or for any subsequent taxable year.

(6) For purposes of section 4.03(3) or (5) of this revenue procedure, if the period of limitations has expired for the taxable year in which a taxpayer made the unauthorized change in method of accounting or for any subsequent taxable year, the taxpayer is eligible to use the automatic consent procedures to change to a method of accounting provided in the final regulations only if the taxpayer changes back to the prior method of accounting for the earliest taxable year for which the statute of limitation has not expired and that does not precede a taxable year for which the statute of limitations has expired (retroactive year of change) by amending its federal income tax returns for the retroactive year of change and all subsequent taxable years in which the unauthorized method (or methods) was used. The taxpayer must take the entire amount of the § 481(a) adjustment attributable to the change back to the prior method of accounting into account in the retroactive year of change. The taxpayer must identify that § 481(a) adjustment on its federal income tax return for the retroactive year of change as resulting from a retroactive change in method of accounting under section 4.03(6) of Rev. Proc. 2006-12.

*Example.* X, a calendar year taxpayer, made an unauthorized change to a method of accounting provided in the final regulations in 2001. X continued to

use its new method in all subsequent taxable years. In February 2009, X decides to properly change to that method under this revenue procedure for 2008. At that time, the statute of limitations has expired for X's 2001, 2002, and 2004 federal income tax returns. However, the statute of limitations on X's 2003 tax federal income tax return has not expired. Because 2005 is the earliest taxable year that does not precede a taxable year for which the statute of limitations has expired, pursuant to section 4.03(6) of this revenue procedure, 2005 is the retroactive year of change. X must file amended federal income tax returns for taxable years 2005, 2006 and 2007 to change back to the method of accounting X used before its unauthorized change in method of accounting in 2001. Further, X must take the entire amount of the section 481(a) adjustment attributable to the change in method of accounting back to X's prior method into account in 2005.

(7) A taxpayer filing one or more amended returns pursuant to section 4.03 of this revenue procedure must file the amended returns on or before the date the taxpayer files a Form 3115 under this revenue procedure (including the copy of Form 3115 filed with the national office). For this purpose, a taxpayer under examination will be considered to have filed an amended return by providing the amended return to the examining agent.

(8) In accordance with § 1.446-1(e)(3)(ii) and Rev. Rul. 90-38, consent is hereby granted for a taxpayer changing to a method of accounting provided in the final regulations under this revenue procedure that is described in section 4.03(2)(a)(i) or (b) of this revenue procedure to file the amended returns referred to in section 4.03(3) or (5), and section 4.03(6) of this revenue procedure, as applicable, to retroactively change its method of accounting. This consent is granted for the taxable year for which the taxpayer made the unauthorized change or, if applicable, the retroactive year of change pursuant to section 4.03(6) of this revenue procedure, and for all subsequent taxable years affected by the unauthorized change.

.04 *Prior change.* For purposes of this revenue procedure, the 5-year prior change scope limitation contained in section 4.02(6) of Rev. Proc. 2002-9 is modified. In applying the 5-year prior change scope limitation contained in section 4.02(6) of Rev. Proc. 2002-9, the taxpayer does not take into account a change in method of accounting provided in the final regulations requested or made for a taxable year ending on or before December 31, 2005. For example, a taxpayer

that applied for a change in method of accounting provided in the final regulations for its taxable year ended December 31, 2002, and withdrew its request or had its request denied is not prohibited under section 4.02(6) of Rev. Proc. 2002-9 from obtaining automatic consent to change to a method of accounting provided in the final regulations under this revenue procedure for its taxable year ended December 31, 2005.

## SECTION 5. COMPUTATION OF SECTION 481(a) ADJUSTMENT

.01 *In general.* A taxpayer changing to a method of accounting provided in the final regulations under this revenue procedure is required to take into account any applicable § 481(a) adjustment as provided in §§ 1.263(a)-4(p)(3) and 1.263(a)-5(n)(3). The § 481(a) adjustment is computed as of the first day of the taxpayer's taxable year of change and, as provided in the final regulations, takes into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. Thus, the § 481(a) adjustment is computed by taking into account only amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the last taxable year prior to the year of change. The amount of the § 481(a) adjustment must include (i) as a reduction of taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the taxable year prior to the taxable year of change, that were capitalized under the taxpayer's present method of accounting and are currently deductible under the taxpayer's proposed method of accounting, reduced by the amount of such capitalized costs recovered through amortization or depreciation under the taxpayer's present method of accounting, (ii) as an increase to taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the taxable year prior to the taxable year of change, that were currently deducted under the taxpayer's present method of accounting and are capitalized under the taxpayer's

proposed method of accounting, reduced by the amount of capitalized costs that would have been recovered through amortization or depreciation if the taxpayer's proposed method of accounting had been applied in taxable years ending on or after January 24, 2002, and (iii) as an increase or a reduction to taxable income, as appropriate, any other adjustments required as a result of the change in method of accounting. If under its present method of accounting a taxpayer capitalized costs incurred prior to the first taxable year that includes January 24, 2002, the taxpayer must continue to treat amortization or depreciation deductions attributable to those costs in accordance with the taxpayer's present method of accounting. Thus, for example, a taxpayer that files its federal income tax return on a calendar year basis continues to amortize or depreciate in 2005 an intangible created in 2001, even though the taxpayer has changed to a method of accounting provided in the final regulations under which the entire cost of the intangible would be currently deductible if incurred in 2005. For taxpayers who correct an unauthorized change in a preceding year under section 4.03 of this revenue procedure, the taxpayer's present method of accounting is the method used by the taxpayer prior to making the unauthorized change.

*.02 Reporting the section 481(a) adjustment on Form 3115.*

(1) *Netting.* For purposes of determining the adjustment period under section 2.05(2) of Rev. Proc. 2002-9, the § 481(a) adjustment is determined separately for each change in method of accounting being made under this revenue procedure. Thus, a positive adjustment attributable to a change in one method may not be netted against a negative adjustment attributable to a change in another method. However, in determining the adjustment attributable to a change in method, a taxpayer must net positive § 481(a) adjustments and negative § 481(a) adjustments resulting from that change in method (*e.g.*, if a taxpayer changes to a method of applying the 12-month rule to prepaid amounts, the taxpayer must net the resulting negative § 481(a) adjustment with the positive § 481(a) adjustment that results from including those amounts in inventory pursuant to the taxpayer's existing § 263A method of accounting for inventory).

(2) *Itemized listing on Form 3115.* The taxpayer must include on Form 3115, Part IV, line 25, the total § 481(a) adjustment for all changes in methods of accounting being made. If the taxpayer is making more than one change in method of accounting under the final regulations, the taxpayer must include on an attachment to Form 3115 —

(a) the information required by Part IV, line 25 for each change in method of accounting (including the amount of the § 481(a) adjustment for each change in method of accounting);

(b) the information required by Part II, line 12 of Form 3115 that is associated with each change; and

(c) the citation to the paragraph of the final regulations that provides for each proposed method of accounting (*e.g.*, § 1.263(a)-4(d)(6) or § 1.263(a)-4(f)).

*.03*

*Example:* Y, a calendar year taxpayer that uses an accrual method of accounting, is a service provider not required to maintain inventories. Y wishes to change to a method of accounting provided in the final regulations for taxable year 2005. Y incurred and capitalized \$100x in taxable year 2001, \$200x in taxable year 2002, \$250x in taxable year 2003, and \$300x in taxable year 2004. In addition, Y incurred \$330x in taxable year 2005. The \$100x, \$200x, \$250x, and \$300x capitalized and depreciated by Y in 2001, 2002, 2003, and 2004 all relate to the same method of accounting and would be currently deductible under the final regulations if the amounts had been incurred on or after December 31, 2003. Y claimed a depreciation deduction of \$10x in each of the taxable years 2001, 2002, 2003, and 2004 with respect to the \$100x incurred and capitalized in 2001, a depreciation deduction of \$20x in each of the taxable years 2002, 2003, and 2004 with respect to the \$200x incurred and capitalized in 2002, a depreciation deduction of \$25x in each of the taxable years 2003 and 2004 with respect to the \$250x incurred and capitalized in 2003, and a depreciation deduction of \$30x in taxable year 2004 with respect to the \$300x incurred and capitalized in 2004. For taxable year 2005, Y may apply for an automatic change in method of accounting with respect to the method under which the amounts had been capitalized. Y's section 481(a) adjustment is a decrease in income of \$610x (\$140x relating to amounts capitalized in 2002 (\$200x - \$60 (\$20 for each of 2002, 2003, and 2004)) + \$200x relating to amounts capitalized in 2003 (\$250x - \$50x (\$25 for each of 2003 and 2004)) + 270x relating to amounts capitalized in 2004 (\$300x - \$30x)). Y must continue to use its present method of accounting for the amount capitalized in 2001. Y uses its new method of accounting for the amount incurred in 2005.

**SECTION 6. HOW THIS REVENUE PROCEDURE DIFFERS FROM REV. PROC. 2005-9**

.01 Rev. Proc. 2005-9 applies to a taxpayer's second taxable year ending on or after December 31, 2003. This revenue procedure applies to a taxable year ending on or after December 31, 2005, and any earlier taxable year that is after the taxpayer's second taxable year ending on or after December 31, 2003.

.02 Rev. Proc. 2005-9 grants taxpayers the Commissioner's consent to change to a method of accounting utilizing the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or to utilize the recurring item exception authorized by § 1.461-5 for the item for which the taxpayer is simultaneously changing to a method of accounting provided in the final regulations. This revenue procedure provides consent only for a change to a method of accounting provided in the final regulations. This revenue procedure does not provide consent for a change in method utilizing the 3½ month rule or the recurring item exception in conjunction with a change to a method provided by the final regulations. Thus, for a change in method of accounting utilizing the 3½ month rule or the recurring item exception in conjunction with a change to a method provided by the final regulations, a taxpayer must file two separate applications for a change in method of accounting — an application for a change in method of accounting under this revenue procedure to change to the method of accounting provided in the final regulations, and a separate application for a change in method of accounting under Rev. Proc. 97-27 for a change in method of accounting utilizing the 3½ month rule or the recurring item exception.

.03 Rev. Proc. 2005-9, as modified by Rev. Proc. 2005-17, waives the 5-year prior change scope limitation contained in section 4.02(6) of Rev. Proc. 2002-9. This revenue procedure modifies the waiver of the 5-year prior change scope limitation to restrict such waiver to prior requests for, or changes in, methods of accounting provided in the final regulations for a taxable year ending on or before December 31, 2005. See section 4.04 of this revenue procedure.

.04 Unlike Rev. Proc. 2005-9, this revenue procedure provides procedures to



change back to the taxpayer's method of accounting used for an item prior to making an unauthorized change when the period of limitations has expired for one or more affected taxable years. See section 4.03(6) of this revenue procedure.

.05. This revenue procedure eliminates the requirement to submit the copy of Form 3115 to a special address. Taxpayers must submit the copy of Form 3115 to the address for taxpayers filing under automatic change request procedures. See the current Instructions for Form 3115 for the address.

## SECTION 7. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 2002-9 is modified and amplified to include these automatic changes in method of accounting to methods provided in the final regulations in section 3 of the APPENDIX.

.02 Rev. Proc. 2004-23 and Rev. Proc. 2005-9 are superseded for taxable years ending on or after December 31, 2005, and for any earlier taxable year that is after the taxpayer's second taxable year ending on or after December 31, 2003.

.03 Rev. Proc. 97-27 is modified and amplified to state that, for changes to methods of accounting provided in the final regulations, any applicable § 481(a) adjustment takes into account only amounts paid or incurred in taxable years ending on or after January 24, 2002.

## SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for a taxable year ending on or after December 31, 2005, and for any earlier taxable year that is after the taxpayer's second taxable year ending on or after December 31, 2003.

## SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Grace Matuszeski of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, call Ms. Matuszeski at (202) 622-7900 (not a toll-free call).

*26 CFR 601.201: Rulings and determination letters. (Also Part I, §§ 408 and 408A; § 1.408A-4T.)*

## Rev. Proc. 2006-13

### SECTION 1. PURPOSE

This revenue procedure provides safe harbor methods that are permitted to be used in determining the fair market value of an annuity contract for purposes of determining the amount includible in gross income as a result of the conversion of a traditional IRA to a Roth IRA, as described in Q&A-14 of § 1.408A-4T of the temporary regulations. The safe harbor method provided in Section 3 of this revenue procedure is available to determine the fair market value of an annuity contract that has not yet been annuitized with respect to any Roth IRA conversion described in A-14 of § 1.408A-4T until further guidance is issued. The simplified safe harbor method provided in Section 4 of this revenue procedure is available where such a conversion occurs before January 1, 2006.

### SECTION 2. BACKGROUND

Under § 408(d) of the Code and A-7 of § 1.408A-4 of the regulations, any amount that is converted from a traditional IRA to a Roth IRA is includible in gross income as a distribution for the taxable year in which the amount is distributed or transferred from the traditional IRA. In the case of a conversion involving property, the conversion amount generally is the fair market value of the property on the date of distribution or the date the property is treated as distributed from the traditional IRA. Under A-1 of § 1.408A-7, any amount converted from a traditional IRA to a Roth IRA is treated as a distribution for which a Form 1099-R must be filed by the trustee maintaining the traditional IRA.

Temporary regulations under § 408A regarding the valuation of annuity contracts upon conversion of a traditional IRA were published in the Federal Register on August 22, 2005 (T.D. 9220, 2005-39 I.R.B. 596 [70 FR 48868]). Section 1.408A-4T, A-14 of the temporary regulations states that, when a traditional individual retirement annuity is converted to a Roth IRA, the amount that is treated as distributed is the fair market value of the

annuity contract on the date the annuity contract is converted. Similarly, when a traditional individual retirement account holds an annuity contract as an account asset and the account is converted to a Roth IRA, the amount that is treated as distributed with respect to the annuity contract is the fair market value of the annuity contract on the date the annuity contract is distributed or treated as distributed from the traditional IRA.

A-14 of § 1.408A-4T does not apply to a conversion of a traditional IRA where the conversion is accomplished by the complete surrender of an annuity contract for its cash value and the reinvestment of the cash proceeds in a Roth IRA, but only if the surrender extinguishes all benefits and other characteristics of the contract. A-14 of § 1.408A-4T does not apply in that circumstance because the contract is not being converted. Instead, the cash from the surrendered contract is reinvested in the Roth IRA.

A-14 of § 1.408A-4T also provides rules for determining the fair market value of an annuity contract in the case of a conversion. These rules vary depending on certain factors, including whether the conversion occurs soon after the contract was sold, whether there has been a material change in market conditions, and whether future premiums are to be paid. A-14 of § 1.408A-4T applies to any conversion where an annuity contract is distributed or treated as distributed from a traditional IRA on or after August 19, 2005. As indicated in the preamble to the temporary regulations, no implication is intended concerning whether or not a rule adopted in the regulations is applicable law for earlier conversions.

The temporary regulations also provide authority for the Commissioner to issue additional guidance regarding the fair market value of an annuity contract, including formulas to be used in determining fair market value. The Service and Treasury requested and received comments regarding this anticipated guidance. Commentators indicated that a more specific methodology for valuing the annuity contracts is needed and noted that they are currently implementing the method under A-12 of § 1.401(a)(9)-6 of the regulations for valuing annuity contracts that have not yet been annuitized.

Under A-12 of § 1.401(a)(9)-6, an employee's entire interest under an annuity contract that has not yet been annuitized (which is used to determine the employee's required minimum distribution) is the sum of the following: (1) the dollar amount credited to the employee or beneficiary under the contract (which may not be reduced to reflect any surrender charges under the contract) and (2) the actuarial present value of any additional benefits (such as survivor benefits in excess of the account balance, any guaranteed minimum benefits, and any charges that are expected to be refunded, rebated or otherwise reversed at a later date) that will be provided under the contract.

For this purpose, the actuarial present value of any additional benefits is to be determined using reasonable actuarial assumptions, including reasonable assumptions as to future distributions, and without regard to an individual's health. However, paragraph (c)(1) of A-12 of § 1.401(a)(9)-6 provides that the actuarial present value of the additional benefits may be disregarded if: (1) the sum of the dollar amount credited to the employee or beneficiary under the contract and the actuarial present value of the additional benefits is no more than 120 percent of the dollar amount credited to the employee or beneficiary under the contract and (2) the additional benefits satisfy certain other requirements. Also, paragraph (c)(2) of A-12 of § 1.401(a)(9)-6 provides that the actuarial value of the right to receive a final payment upon death that does not exceed the excess of the premiums paid less the amount of prior distributions may also be disregarded if it is the only additional benefit under the contract. Because some benefits may be disregarded, the method-

ology of A-12 of § 1.401(a)(9)-6 does not always reflect the full value of all of the benefits under the contract.

### **SECTION 3. SAFE HARBOR METHOD FOR ROTH IRA CONVERSIONS**

The Service and Treasury recognize that it may be difficult to determine the fair market value of an annuity contract under the temporary regulations. Moreover, the Service and Treasury believe it is appropriate to permit the use of a modified version of the methodology applied under A-12 of § 1.401(a)(9)-6 as a safe harbor method to be used in determining the fair market value of such an annuity contract. Accordingly, this revenue procedure provides that, until further guidance is issued, for purposes of determining the amount includible in gross income as a result of the conversion of a traditional IRA to a Roth IRA as described in A-14 of § 1.408A-4T, the fair market value of an annuity contract that has not yet been annuitized is permitted to be determined using the methodology provided in A-12 of § 1.401(a)(9)-6 with the following modifications:

(1) All front-end loads and other non-recurring charges assessed in the twelve months immediately preceding the conversion must be added to the account value.

(2) Future distributions are not to be assumed in the determination of the actuarial present value of additional benefits.

(3) The exclusions provided under paragraphs (c)(1) and (c)(2) of A-12 of § 1.401(a)(9)-6 are not to be taken into account.

### **SECTION 4. SIMPLIFIED SAFE HARBOR METHOD FOR PRE-2006 ROTH IRA CONVERSIONS**

The Service and Treasury recognize that Forms 1099-R must soon be issued for Roth IRA conversions occurring in 2005. Accordingly, this section 4 provides that, in the case of a Roth IRA conversion where an annuity contract that has not yet been annuitized is distributed or treated as distributed before January 1, 2006, for purposes of determining the amount includible in gross income as a result of the conversion of a traditional IRA to a Roth IRA as described in A-14 of § 1.408A-4T, the fair market value of the contract is permitted to be determined using the methodology provided in A-12 of § 1.401(a)(9)-6 except that all front-end loads and other non-recurring charges assessed in the twelve months immediately preceding the conversion must be added to the account value.

### **DRAFTING INFORMATION**

The principal authors of this revenue procedure are Larry Isaacs and Robert Walsh of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the Service's taxpayer assistance telephone service between the hours of 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday, by calling 800-829-1040 (a toll-free number). Mr. Isaacs and Mr. Walsh may be reached at (202) 283-9888 (not a toll-free number).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking

### Guidance Necessary to Facilitate Electronic Tax Administration-Updating of Section 7216 Regulations

#### REG-137243-02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations to update the rules regarding the disclosure and use of tax return information by tax return preparers. The proposed regulations announce new and additional rules for taxpayers to consent electronically to the disclosure or use of their tax return information by tax return preparers. The proposed rules provide guidelines for tax return preparers using or disclosing information obtained in the process of preparing income tax returns.

DATES: Written or electronically generated comments must be received by March 8, 2006.

Outlines of topics to be discussed at the public hearing scheduled for April 4, 2006, in the Auditorium of the Internal Revenue Building at 1111 Constitution Avenue, NW, Washington, DC 20224, must be received by March 14, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-137243-02), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-137243-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at <http://www.irs.gov/reg> or via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS and REG-137243-02). The public hearing will be held in the IRS Auditorium, Inter-

nal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Dillon Taylor, at (202) 622-4940; concerning submissions of comments, LaNita Van Dyke of the Publications and Regulations Branch at (202) 622-7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document contains proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 7216 of the Internal Revenue Code (Code). Section 7216 imposes criminal penalties on tax return preparers who make unauthorized disclosures or uses of information furnished to them in connection with the preparation of an income tax return. In addition, tax return preparers are subject to civil penalties under section 6713 for disclosure or use of this information unless an exception under the rules of section 7216(b) applies to the disclosure or use.

Section 7216 was enacted by section 316 of the Revenue Act of 1971, Public Law 92-178 (85 Stat. 529, 1971). In 1988, Congress modified the section by limiting the criminal sanction to knowing or reckless unauthorized disclosures. Public Law 100-647, (102 Stat. 3749, 1988). At the same time, Congress enacted the civil penalty that is now found in section 6713. Public Law 100-647, §6242(a) (102 Stat. 3759, 1988). In 1989, Congress further modified section 7216, directing the Treasury Department to issue regulations permitting disclosures of tax return information for quality or peer reviews. Public Law 101-239, 7739(a) (102 Stat. 3759, 1989).

The Treasury Department and the IRS proposed regulations under section 7216 on December 20, 1972 (37 FR 28070). Final regulations were issued on March 29, 1974 (T.D. 7310, 1974-1 C.B. 348 [39 FR 11537]). These regulations are divided into three parts: section 301.7216-1 for general provisions and definitions; section

301.7216-2 for disclosures and uses that do not require formal taxpayer consent; and section 301.7216-3 for disclosures and uses that require formal taxpayer consent. Since the regulations were adopted in 1974, the Treasury Department and the IRS have amended §301.7216-2 on occasion, but §§301.7216-1 and 301.7216-3 have remained unchanged.

The current regulations were written in a paper filing era. They do not address current common industry practices, such as electronic preparation or filing of tax returns. The regulations are silent on taxpayers' consent to the disclosure or use of tax return information in an electronic environment. The proposed regulations address these issues.

The proposed regulations also contain other modifications to reflect the principle that taxpayers may provide knowing, informed, and voluntary consent to a tax return preparer's use of tax return information for purposes other than tax return preparation. While the ability of a tax return preparer to solicit consent from a taxpayer remains limited under certain circumstances, such as when the taxpayer has already rejected a substantially similar request for consent, these regulations allow a tax return preparer to solicit a taxpayer's consent to use tax return information under certain circumstances that the existing regulations currently prohibit. For example, these proposed regulations allow tax return preparers to obtain consents to use tax return information for solicitation of services or facilities furnished by any person rather than limiting solicitations to the services or facilities offered by the tax return preparer or member of the tax return preparer's "affiliated group."

Concurrently, with publication of these proposed regulations, the IRS is publishing a notice (Notice 2005-93, 2005-52 I.R.B. 1204) containing a proposed revenue procedure that would provide guidance to tax return preparers on the format and content of consents to disclose and consents to use tax return information under §301.7216-3. The proposed revenue procedure would also provide specific guidance for electronic signatures when a taxpayer executes an electronic consent to

the disclosure or use of the taxpayer's tax return information.

## Explanation of Provisions

### 1. §301.7216-1 Penalty for Disclosure or Use of Tax Return Information.

The regulations revise and clarify several definitions and clarify the scope of the rules. For example, section 7216, rather than section 7701(a)(36) (defining income tax return preparer) or the privacy provisions of Title V of the Gramm-Leach-Bliley Act, Public Law 106-102 (113 Stat. 1338, GLBA), governs the disclosure and use of tax return information by tax return preparers. The GLBA governs the use and disclosure of customer information by financial institutions. Any requirements of the GLBA that may be applicable to tax return preparers do not supersede, alter, or affect the requirements of section 7216 and §§301.7216-1 through 301.7216-3. Similarly, the requirements of section 7216 and §§301.7216-1 through 301.7216-3 do not nullify any requirements or restrictions of the GLBA, which are in addition to the requirements or restrictions of section 7216 and §§301.7216-1 through 301.7216-3.

#### A. Tax return preparer

The definition of *tax return preparer* is revised to distinguish it from the definition of income tax return preparer in section 7701(a)(36); tax return preparers subject to section 7216 include a broader group of persons than income tax return preparers defined in section 7701(a)(36). Some persons who are excluded from the definition of an income tax return preparer under section 7701(a)(36), for example, persons providing secretarial services, are tax return preparers under section 7216, as defined by §301.7216-1(b)(2). Some of the examples and exclusions have been revised to address common scenarios.

#### B. Tax return information

The revised definition of *tax return information* clarifies that the term encompasses a broader range of information than what taxpayers literally furnish to a tax return preparer. The taxpayer's entitlement to a refund and the amount of the refund are both tax return information. Similarly, information the IRS furnishes a tax return

preparer with respect to the processing of a return, including the acknowledgment of acceptance of an electronically-filed return, is tax return information, even though the taxpayer does not communicate that information to the tax return preparer.

#### C. Use and disclosure

The proposed regulations add a definition of the term "use" to clarify application of that term in the context of electronic preparation and filing. The proposed regulations add a definition of "disclosure" to clarify that the term should be broadly construed. The proposed regulations provide that to the extent that a taxpayer's use of a hyperlink results in the transmission of tax return information, that transmission of tax return information is a disclosure.

### 2. §301.7216-2 Permissible Disclosures or Uses Without Consent of the Taxpayer.

Proposed §301.7216-2 provides exceptions to the general rule of section 7216(a) that imposes criminal penalties on tax return preparers who make unauthorized disclosures or uses of tax return information. A tax return preparer may disclose or use tax return information as §301.7216-2 permits without obtaining consent from a taxpayer. A number of subsections dealing with disclosures or uses without consent are proposed in substantially their current form. Some subsections are renumbered to achieve a more logical ordering, and some subsections have been proposed with minor changes to the current language to refine the rules or promote clarity. Some subsections addressing disclosures between tax return preparers have been changed to reflect new rules.

#### A. Proposed changes to specifically account for technological, legal, and other developments

(1) Proposed §301.7216-2(b) provides that disclosures to the IRS that will facilitate electronic tax administration are authorized without the taxpayer's prior written consent. Disclosures that will facilitate electronic tax administration include IRS requests for tax return information to investigate compliance with electronic filing rules or to evaluate the effectiveness of electronic filing programs.

(2) Proposed §301.7216-2(d) expands current §301.7216-2(h), which authorizes disclosures to tax return preparers who process tax return information. The proposed regulations provide that disclosures between tax return preparers are authorized when the disclosures (i) assist in the preparation of a return; (ii) as long as the services provided by the recipient of the disclosure are not substantive determinations or advice affecting a taxpayer's reported tax liability; and (iii) as long as the disclosure is to a tax return preparer located in the United States. The proposed regulations clarify that disclosures to other tax return preparers for substantive determinations or advice require the taxpayer's prior written consent. The proposed regulations also provide that tax return preparers' disclosures to other tax return preparers located outside of the United States require the taxpayer's prior written consent. The written consent for disclosure of tax return information outside of the United States is needed because it is difficult for the Secretary to pursue a criminal action under section 7216 against a tax return preparer located outside of the United States or to collect a civil penalty assessed under section 6713 from a tax return preparer located outside the United States. Proposed §301.7216-2(d) also provides that a tax return preparer may disclose tax return information to contractors performing certain auxiliary services in connection with tax return preparation. For the disclosure to fall within this exception, the tax return preparer must present the individuals receiving the disclosure with a written notice informing them that section 7216 applies to them and describes the requirements and penalties of section 7216. Contractors to whom disclosures are made pursuant to this provision are tax return preparers pursuant to §301.7216-1(b)(2)(i)(D).

(3) Proposed §301.7216-2(f) amends current §301.7216-2(c), regarding disclosures pursuant to an order of a court or an administrative order, demand, summons or subpoena issued by a Federal or State agency, by also authorizing disclosures made pursuant to a subpoena issued by the United States Congress. In addition, the IRS is aware that most state accountancy boards work in conjunction with the American Institute of Certified Public Accountants' (AICPA) Professional Ethics

Executive Committee, and state and local bar associations to investigate potential ethical violations by certified public accountants who are members of the AICPA. The proposed amendment authorizes disclosures to the AICPA made pursuant to an ethics violation investigation of the tax return preparer. The proposed amendment authorizes disclosures made pursuant to a formal demand from the Public Company Accounting Oversight Board.

(4) Proposed §301.7216-2(g), governing disclosures for use in Treasury investigations or court proceedings, amends current §301.7216-2(d), which limits disclosures to IRS investigations and court proceedings. This change is necessary because a function within the Treasury Department, but outside of the IRS, may handle some investigations that will require a disclosure of tax return information. Disclosures are also authorized to officers of a court in court proceedings in which a taxpayer-client of a return preparer is a party. The proposed regulations clarify that the tax return preparer need not be a party to a court proceeding for a disclosure to be authorized under this section.

(5) Proposed §301.7216-2(k) expands the current provision in §301.7216-2(k) governing the preparation or audit of State or local tax returns to allow the use of tax return information to assist in the preparation of any tax return of the taxpayer under the law of a country other than the United States. Disclosures are also expanded to allow for the preparation of tax returns under the law of another country to the same extent that disclosures are allowed for the preparation and filing of a Federal tax return.

(6) Proposed §301.7216-2(o) addresses the use of tax return information to prepare statistical compilations and the use of the statistical compilations themselves. Rev. Rul. 79-114, 1979-1 C.B. 441, holds that the current regulations prohibit a tax return preparer's use of tax return information to prepare anonymous statistical compilations unless the affected taxpayers individually consent. Section 301.7216-2(o) will obsolete Rev. Rul. 79-114. Section 301.7216-2(o) will permit the use of tax return information to prepare anonymous statistical compilations for limited purposes related to management or support of the tax return preparer's business. The tax return information will remain pro-

TECTED FROM ANY OTHER USE AND DISCLOSURE OUTSIDE THE LIMITED PURPOSES OF THIS PROPOSED SECTION.

#### B. *Other changes to existing provisions*

(1) Proposed §301.7216-2(h) amends current §301.7216-2(e), which authorizes attorneys and accountants to disclose tax return information to third parties in the normal course of rendering legal or accounting services if the taxpayer expressly or impliedly consents to the disclosure. The proposed regulations remove the requirement that the taxpayer's express or implied consent is necessary before these types of disclosures can be made because implied consent would exist in virtually every situation when an attorney or accountant is required to disclose tax return information to a third party in the normal course of providing legal or accounting services to a taxpayer. The proposed regulations provide that these disclosures are authorized unless the taxpayer directs otherwise.

(2) Proposed §301.7216-2(i) amends current §301.7216-2(f), which provides that corporate fiduciaries are authorized to disclose tax return information to a taxpayer's attorney, accountant, or investment advisor only with the taxpayer's express or implied consent. As with disclosures made by attorneys and accountants, a taxpayer will generally give implied consent to disclosures by corporate fiduciaries to a taxpayer's attorney, accountant, or investment advisor. The proposed regulations remove the express or implied consent requirement, and provide instead that disclosures are authorized unless the taxpayer directs otherwise.

(3) Proposed §301.7216-2(c) amends current §301.7216-2(i), regarding disclosures by an officer, employee, or member of a tax return preparer to another officer, employee, or member of the same tax return preparer to perform services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, the tax return of a taxpayer. The proposed regulations provide that these disclosures or uses are authorized without the taxpayer's written consent only if the officer, employee, or member to whom the information is disclosed is located within the United States. The written consent for disclosure of tax return

information outside of the United States is needed because it is difficult for the Secretary to pursue a criminal action under section 7216 against a tax return preparer located outside of the United States or to collect a civil penalty assessed under section 6713 from a tax return preparer located outside the United States. Therefore, a taxpayer's written consent is required before a tax return preparer can disclose a taxpayer's tax return information to another tax return preparer located outside of the United States.

(4) Proposed §301.7216-2(q) amends current §301.7216-2(n), regarding disclosures to report the commission of a crime, by clarifying that penalties for disclosure shall not apply to disclosures necessary to report a crime, nor to any disclosures necessary for the investigation and prosecution of the crime.

#### 3. *Proposed §301.7216-3: Disclosures and Uses Authorized by Taxpayer Consent.*

Significant revisions are proposed under §301.7216-3 to address a number of issues concerning the application of these rules in the context of electronic return preparation and filing. The Treasury Department and the IRS propose these amendments to protect taxpayers' tax return information, and to ensure that taxpayers are fully informed when providing consent to disclose or use tax return information.

##### A. *Restrictions regarding the offering of certain services*

The current regulations restrict use of tax return information for the solicitation of services or facilities in matters not related to the IRS to those "currently offered" by the tax return preparer or members of the tax return preparer's "affiliated group," within the meaning of section 1504. Because taxpayers must consent to any use or disclosure connected with the solicitation, taxpayer privacy interests are adequately protected regardless of whether a service is currently offered or whether a business offering a service to the taxpayer is a member of a tax return preparer's affiliated group. The currently-offered and affiliated-group rules restrict the ability of taxpayers to control and direct the use of their own tax return information

as they see fit. The proposed regulations adopt an approach that ensures taxpayers are provided with a meaningful opportunity to consent to the use and disclosure of their tax return information. Accordingly, the proposed rules revoke the affiliated-group and currently-offered restrictions.

The current regulations do not place limits on tax return preparers' ability to obtain consents to use tax return information to solicit business in matters related to the IRS. The proposed regulations remove the distinction between matters related to the IRS and matters not related to the IRS, and thereby make uniform the requirements regarding consents to use tax return information to solicit business.

#### B. *Form of consent*

The proposed regulations provide that the IRS may provide guidance, by revenue procedure, on the form and content of a taxpayer's consent. The proposed regulations also allow a taxpayer to use a single document to consent to multiple uses of their tax return information, or use a single document to consent to multiple disclosures of their tax return information, provided certain requirements are met. Although the proposed regulations permit a single document to authorize multiple uses or multiple disclosures, the taxpayer must affirm separately each use or disclosure within the single document. In addition, because the Treasury Department and the IRS believe taxpayers should be alerted to the significant difference between consenting to disclosures to third parties and consenting to uses of tax return information by their tax return preparers, the proposed regulations provide that a single document cannot authorize both uses and disclosures; rather, one document must authorize uses and another separate document must authorize disclosures.

#### **Proposed Effective Date**

These regulations are proposed to apply on the date that is 30 days after the final regulations are published in the **Federal Register**.

#### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a signifi-

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

#### **Comments and Public Hearing**

Before these regulations are adopted as final regulations, consideration will be given to any written comments and electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS specifically request comments on the following: whether it is necessary to have an exception to section 7216 for disclosures made to contractors as provided in proposed §301.7216-2(d)(2), and, if so, how should the regulations protect the information from being used or disclosed by the contractors; and what should constitute an electronic signature on electronic consents. In addition, the IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

The public hearing is scheduled for April 4, 2006, at 10 a.m., and will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. All visitors must present photo identification to enter the building. Visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must

submit written or electronic comments by March 8, 2006, and submit an outline of the topics to be discussed and the time to be devoted to each topic by March 14, 2006. A period of 10 minutes will be allocated to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### **Drafting Information**

The principal authors of the regulations are Brinton T. Warren, Bridget E. Tombul, and Dillon Taylor of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

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#### **Proposed Amendment 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 301.7216-0 is added to read as follows:

#### *§301.7216-0 Table of contents.*

This section lists captions contained in §§301.7216-1 through 301.7216-3.

*§301.7216-1 Penalty for disclosure or use of tax return information.*

- (a) In general.
- (b) Definitions.
- (c) Gramm-Leach-Bliley Act.
- (d) Effective date.

*§301.7216-2 Permissible disclosures or uses without consent of the taxpayer.*

- (a) Disclosure pursuant to other provisions of Internal Revenue Code.
- (b) Disclosure to facilitate electronic tax administration.
- (c) Disclosures or uses for preparation of a taxpayer's return.

(d) Disclosures to other tax return preparers.

(e) Disclosure or use of information in the case of related taxpayers.

(f) Disclosure pursuant to an order of a court, or an administrative order, a demand, summons or subpoena which is issued in the performance of its duties by a Federal or State agency, the United States Congress, a professional ethics board, or the Public Company Accounting Oversight Board.

(g) Disclosure for use in Treasury investigations or court proceedings.

(h) Certain disclosures by attorneys and accountants.

(i) Corporate fiduciaries.

(j) Disclosure to taxpayer's fiduciary.

(k) Disclosure or use of information in preparation or audit of State or local tax returns or assisting a taxpayer with foreign country tax obligations.

(l) Payment of tax preparation services.

(m) Retention of records.

(n) Lists for solicitation of tax return business.

(o) Producing statistical information in connection with tax return preparation business.

(p) Disclosure or use of information for quality or peer reviews.

(q) Disclosure to report the commission of a crime.

(r) Disclosure of tax return information due to a tax return preparer's incapacity or death.

(s) Effective date.

*§301.7216-3 Disclosure or use permitted only with the taxpayer's consent.*

(a) In general.

(b) Timing requirements and limitations.

(c) Special rules.

(d) Permissible disclosures to third parties at the request of the taxpayer.

(e) Effective date.

Par. 3. Section 301.7216-1 is revised to read as follows:

*§301.7216-1 Penalty for disclosure or use of tax return information.*

(a) *In general.* Section 7216(a) prescribes a criminal penalty for tax return preparers who knowingly or recklessly disclose or use tax return information for a purpose other than preparing a tax return.

A violation of section 7216 is a misdemeanor, with a maximum penalty of up to one year imprisonment or a fine of not more than \$1,000, or both, together with the costs of prosecution. Section 7216(b) establishes exceptions to the general rule in section 7216(a) prohibiting disclosure and use. Section 7216(b) also authorizes the Secretary to promulgate regulations prescribing additional permitted disclosures and uses. Section 6713(a) prescribes a related civil penalty for disclosures and uses that constitute a violation of section 7216. The penalty for violating section 6713 is \$250 for each disclosure and use, not to exceed a total of \$10,000 for a calendar year. Section 6713(b) provides that the exceptions in section 7216(b) also apply to section 6713. Under section 7216(b), the provisions of section 7216(a) will not apply to any disclosure or use permitted under regulations prescribed by the Secretary.

(b) *Definitions.* For purposes of section 7216 and §§301.7216-1 through 301.7216-3:

(1) *Tax return.* The term *tax return* means any return (or amended return) of income tax imposed by chapter 1 of the Internal Revenue Code.

(2) *Tax return preparer*—(i) *In general.* The term *tax return preparer* means:

(A) Any person who is engaged in the business of preparing or assisting in preparing tax returns;

(B) Any person who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns, including a person who develops software that is used to prepare or file a tax return and any Authorized IRS *e-file* Provider;

(C) Any person who is otherwise compensated for preparing, or assisting in preparing, a tax return for any other person; or

(D) Any individual who, as part of their duties of employment with any person described in paragraph (b)(2)(i)(A), (B), or (C) of this section performs services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, a tax return.

(ii) *Business of preparing returns.* A person is engaged in the business of preparing tax returns as described in paragraph (b)(2)(i)(A) of this section if, in the course of the person's business, the person

holds himself out to tax return preparers or taxpayers as a person who prepares tax returns or assists in preparing tax returns, whether or not tax return preparation is the person's sole business activity and whether or not the person charges a fee for tax return preparation services.

(iii) *Providing auxiliary services.* A person is engaged in the business of providing auxiliary services in connection with the preparation of tax returns as described in paragraph (b)(2)(i)(B) of this section if, in the course of the person's business, the person holds himself out to tax return preparers or to taxpayers as a person who performs auxiliary services, whether or not providing the auxiliary services is the person's sole business activity and whether or not the person charges a fee for the auxiliary services. Likewise, a person is engaged in the business of providing auxiliary services if, in the course of the person's business, the person receives a taxpayer's tax return information from another tax return preparer pursuant to the provisions of §301.7216-2(d)(2).

(iv) *Otherwise compensated.* A tax return preparer described in paragraph (b)(2)(i)(C) of this section includes any person who—

(A) Is compensated for preparing a tax return for another person, but not in the course of a business; or

(B) Is compensated for helping, on a casual basis, a relative, friend, or other acquaintance to prepare their tax return.

(v) *Exclusions.* A person is not a tax return preparer merely because he leases office space to a tax return preparer, furnishes credit to a taxpayer whose tax return is prepared by a tax return preparer, furnishes information to a tax return preparer at the taxpayer's request, furnishes access (free or otherwise) to a separate person's tax return preparation website through a hyperlink on his own website, or otherwise performs some service that only incidentally relates to the preparation of tax returns.

(vi) *Application of section 7701(a)(36).* If a person is an income tax return preparer for purposes of section 7701(a)(36), the person is subject to the provisions of section 7216 and is a tax return preparer for purposes of §§301.7216-1 through 301.7216-3. The fact that a person is not an income tax return preparer for purposes of section 7701(a)(36), however, is not

determinative of whether the person is a tax return preparer for purposes of section 7216(a) and §§301.7216-1 through 301.7216-3.

(vii) *Examples.* The application of §301.7216-1(b)(2) may be illustrated by the following examples:

*Example 1.* Bank B is a tax return preparer within the meaning of paragraph (b)(2)(i)(A) of this section, and an Authorized IRS e-file Provider. B employs one individual, Q, to solicit the necessary tax return information for the preparation of a tax return; another individual, R, to prepare the return on the basis of the information that is furnished; a secretary, S, who types the information on the returns into a computer; and an administrative assistant, T, who uses a computer to file electronic versions of the tax returns. Under these circumstances, only R is an income tax return preparer for purposes of section 7701(a)(36), but all four employees are tax return preparers for purposes of section 7216, as provided in paragraph (b) of this section.

*Example 2.* Tax return preparer P contracts with department store D to rent space in D's store. D advertises that taxpayers who use P's services may charge the cost of having their tax return prepared to their charge account with D. Under these circumstances, D is not a tax return preparer because it provides space, credit, and services only incidentally related to the preparation of tax returns.

(3) *Tax return information—(i) In general.* The term *tax return information* means any information, including, but not limited to, a taxpayer's name, address, or identifying number, which is furnished in any form or manner for, or in connection with, the preparation of a tax return of the taxpayer. This information includes information that the taxpayer furnishes to a tax return preparer and information furnished the tax return preparer by a third party. Tax return information also includes information the tax return preparer derives or generates from tax return information in connection with the preparation of a taxpayer's return.

(A) Tax return information can be provided directly by the taxpayer or by another person. Likewise, tax return information includes information received by the tax return preparer from the IRS in connection with the processing of such return, including an acknowledgment of acceptance or notice of rejection of an electronically filed return.

(B) Tax return information includes statistical compilations of tax return information, even in a form that cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. See §301.7216-2(o) for limited use of tax re-

turn information to make statistical compilations without taxpayer consent and to use the statistical compilations for limited purposes.

(C) Tax return information does not include information identical to any tax return information that has been furnished to a tax return preparer if the identical information was obtained otherwise than in connection with the preparation of a tax return. Information maintained in a form that is associated with the tax return preparation, however, becomes tax return information, regardless of how the information was initially obtained.

(D) Information is considered "in connection with tax return preparation," and therefore tax return information, if the taxpayer would not have furnished the information to the tax return preparer but for his intention to engage, or his engagement of, the tax return preparer to prepare his tax return.

(ii) *Examples.* The application of this paragraph (b)(3) may be illustrated by the following examples:

*Example 1.* Taxpayer A purchases computer software designed to assist with the preparation and filing of her income tax return. When A loads the software onto her computer, it prompts her to register her purchase of the software. As part of the registration process, the software provider states that it will provide registrants with any updates to the software. In this situation, the software provider is a tax return preparer under paragraph (b)(2)(i)(B) of this section and the information that A provides to register her purchase is tax return information because she is providing it in connection with the preparation of a tax return.

*Example 2.* Corporation A is a brokerage firm that maintains a website through which its clients may access their accounts, trade stocks, and generally conduct a variety of financial activities. Through its website, A offers its clients free access to its own tax preparation software. Taxpayer B is a client of A and has furnished A his name, address, and other information when registering for use of A's website to use A's brokerage services. In addition, A has a record of B's brokerage account activity, including sales of stock, dividends paid, and IRA contributions made. B uses A's tax preparation software to prepare his tax return. The software populates some fields on B's return on the basis of information A already maintains in its databases. A is a tax return preparer within the meaning of paragraph (b)(2)(i)(B) of this section because it has prepared and provided software for use in preparing tax returns. The information in A's databases that the software accesses to populate B's return, *i.e.*, the registration information and brokerage account activity, is not tax return information because A did not receive that information in connection with the preparation of a tax return. Once A uses the information to populate the return, however, the information associated with the return becomes tax return informa-

tion. If A retains the information in a form in which A can identify that the information was used in connection with the preparation of a return, the information in that form is tax return information. If, however, A retains the information in a database in which A cannot identify whether the information was used in connection with the preparation of a return, then that information is not tax return information.

(4) *Use—(i) In general.* Use of tax return information includes any circumstance in which a tax return preparer refers to, or relies upon, tax return information as the basis to take or permit an action.

(ii) *Example.* The application of this paragraph (b)(4) may be illustrated by the following example:

*Example.* Preparer G is a tax return preparer as defined by paragraph (b)(2)(i)(A) of this section. If G determines, upon preparing a return, that a refund is due to the taxpayer, G will ask whether the taxpayer desires a refund anticipation loan, *i.e.*, a loan that the taxpayer repays from the taxpayer's refund proceeds. G does not ask about refund anticipation loans in cases in which the taxpayer is not due a refund. G is using tax return information when it asks whether a taxpayer is interested in obtaining a refund anticipation loan because G is basing the inquiry on the taxpayer's being entitled to a refund.

(5) *Disclosure.* The term *disclosure* means the act of making tax return information known to any person in any manner whatever. To the extent that a taxpayer's use of a hyperlink results in the transmission of tax return information, such transmission of tax return information is a disclosure by the tax return preparer subject to penalty under section 7216 if not authorized by regulation.

(6) *Hyperlink.* For purposes of section 7216, a hyperlink is the device used to transfer an individual using tax preparation software from a tax return preparer's webpage to a webpage operated by another person without the individual having to separately enter the web address of the destination page.

(7) *Request for consent.* A request for consent includes any effort by a tax return preparer to obtain the taxpayer's consent to use or disclose the taxpayer's tax return information. The act of supplying a taxpayer with a paper or electronic form that meets the requirements of a revenue procedure published pursuant to §301.7216-3(a) is a request for a consent. When a tax return preparer requests a taxpayer's consent, any associated efforts of the tax return preparer, including, but not limited to, verbal or written explanations of the form, are part of the request for consent.



(c) *Gramm-Leach-Bliley Act.* Any applicable requirements of the Gramm-Leach-Bliley Act, Public Law 106-102 (113 Stat. 1338), do not supersede, alter, or affect the requirements of section 7216 and §§301.7216-1 through 301.7216-3. Similarly, the requirements of section 7216 and §§301.7216-1 through 301.7216-3 do not nullify any requirements or restrictions of the Gramm-Leach-Bliley Act, which are in addition to the requirements or restrictions of section 7216 and §§301.7216-1 through 301.7216-3.

(d) *Effective date.* This section applies on the date that is 30 days after the final regulations are published in the **Federal Register**.

Par. 4. Section 301.7216-2 is revised to read as follows:

*§301.7216-2 Permissible disclosures or uses without consent of the taxpayer.*

(a) *Disclosure pursuant to other provisions of Internal Revenue Code.* The provisions of section 7216(a) and §301.7216-1 shall not apply to any disclosure of tax return information if the disclosure is made pursuant to any other provision of the Internal Revenue Code or the regulations thereunder. Thus, for example, these provisions will not apply to—

(1) A disclosure under section 7269 to an officer or employee of the IRS of information concerning the estate of a decedent; or

(2) A disclosure under section 7602 (through formal or informal procedures) to an officer or employee of the IRS of books, papers, records, or other tax return information that may be relevant to any person's income tax liability.

(b) *Disclosures to facilitate electronic tax administration.* Tax return preparers may disclose to the IRS any tax return information the IRS requests to assist in the administration of electronic filing programs. The information can include tax return information requested in the course of investigating Authorized IRS *e-file* Providers for compliance with electronic filing rules or tax return information that the IRS determines would assist in evaluating the effectiveness of electronic filing programs.

(c) *Disclosures or uses for preparation of a taxpayer's return—*(1) *Tax return pre-*

*parers located within the same firm in the United States.* If a taxpayer furnishes tax return information to a tax return preparer located within the United States, including any territory or possession of the United States, an officer, employee, or member of a tax return preparer may use the tax return information, or disclose the tax return information to another officer, employee, or member of the same tax return preparer, for the purpose of performing services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, the taxpayer's tax return. If an officer, employee, or member to whom the tax return information is to be disclosed is located outside of the United States or any territory or possession of the United States, the taxpayer's consent under §301.7216-3 prior to any disclosure is required.

(2) *Furnishing tax return information to tax return preparers located outside the United States.* If a taxpayer initially furnishes tax return information to a tax return preparer located outside of the United States or any territory or possession of the United States, an officer, employee, or member of a tax return preparer may use tax return information, or disclose any tax return information to another officer, employee, or member of the same tax return preparer, for the purpose of performing services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, the tax return of a taxpayer by or for whom the information was furnished without the taxpayer's consent under §301.7216-3.

(3) *Examples.* The following examples illustrate this paragraph (c):

*Example 1.* T is a client of Firm, which is a tax return preparer. E, an employee at Firm's State A office, receives tax return information from T for use in preparing T's income tax return. E discloses the tax return information to P, an employee in Firm's State B office; P uses the tax return information to process T's income tax return. Firm is not required to receive T's consent under §301.7216-3 prior to E's disclosure of T's tax return information to P, because the tax return information is disclosed to an employee employed by the same tax return preparer located within the United States.

*Example 2.* Same facts as *Example 1* except T's tax return information is disclosed to FE who is located in Firm's Country F office. FE uses the tax return information to process T's income tax return. After processing, FE returns the processed tax return information to E in Firm's State A office. Because FE is outside of the United States, Firm is required

to obtain T's consent under §301.7216-3 prior to E's disclosure of T's tax return information to FE.

*Example 3.* T, Firm's client, is temporarily located in Country F. She initially furnishes her tax return information to employee FE in Firm's Country F office for the purpose of having Firm prepare her U.S. income tax return. FE makes the substantive determinations concerning T's tax liability and forwards T's tax return information to FP, an employee in Firm's Country P office, for the purpose of processing T's tax return information. FP processes the return information and forwards it to Partner at Firm's State A office in the United States for review and delivery to T. Because T initially furnished the tax return information to a tax return preparer outside of the United States, T's prior consent for use or disclosure under §301.7216-3 was not required. An officer, employee, or member of Firm in the United States may use T's tax return information or disclose the tax return information to another officer, employee, or member of Firm without T's prior consent under §301.7216-3 as long as any use or disclosure of T's tax return information is within the United States. Firm is required to receive T's consent under §301.7216-3 prior to any subsequent disclosure of T's tax return information to a tax return preparer located outside of the United States.

(d) *Disclosures to other tax return preparers—*(1) *Preparer-to-preparer disclosures.* Except as limited in paragraph (d)(2) of this section, an officer, employee, or member of a tax return preparer may disclose tax return information of a taxpayer to another tax return preparer located in the United States (including any territory or possession of the United States) for the purpose of preparing, or assisting in preparing a tax return, or obtaining or providing auxiliary services in connection with the preparation of any tax return so long as the services provided are not substantive determinations or advice affecting a taxpayer's reported tax liability. The authorized disclosures permitted under this subparagraph include one tax return preparer disclosing tax return information to another tax return preparer for the purpose of having the second tax return preparer transfer that information to, and compute the tax liability on, a tax return of the taxpayer by means of electronic, mechanical, or other form of tax return processing service. The authorized disclosures permitted under this subparagraph also include disclosures by a tax return preparer to an Authorized IRS *e-file* Provider for the purpose of electronically filing the return with the IRS. Authorized disclosures also include disclosures by a tax return preparer to a second tax return preparer for the purpose of making information concerning the return avail-

able to the taxpayer. This would include, for example, whether the return has been accepted or rejected by the IRS, or the status of the taxpayer's refund. Except as provided in paragraph (c) of this section, a tax return preparer may not disclose tax return information to another tax return preparer for the purpose of the second tax return preparer providing substantive determinations without first receiving the taxpayer's consent in accordance with the rules under §301.7216-3.

(2) *Disclosures to contractors.* A tax return preparer may disclose tax return information to a person under contract with the tax return preparer in connection with the programming, maintenance, repair, testing, or procurement of equipment or software used for purposes of tax return preparation only to the extent necessary for the person to provide the contracted services, and only if the tax return preparer ensures that all individuals who are to receive disclosures of tax return information receive a written notice that informs them of the applicability of sections 6713 and 7216 to them and describes the requirements and penalties of sections 6713 and 7216. Contractors receiving tax return information pursuant to this subsection are tax return preparers under section 7216 because they are performing auxiliary services in connection with tax return preparation. See §301.7216-1(b)(2)(i)(B) and (D).

(3) *Examples.* The following examples illustrate this paragraph (d):

*Example 1.* E, an employee at Firm's State A office, receives tax return information from T for Firm's use in preparing T's income tax return. E makes substantive determinations and forwards the tax return information to P, an employee at Processor; Processor is located in State B. P places the tax return information on the income tax return and furnishes the finished product to E. E is not required to receive T's prior consent under §301.7216-3 before disclosing T's tax return information to P, because Processor's services are not substantive determinations and the tax return information remained in the United States at Processor's State B office during the entire course of the tax return preparation process.

*Example 2.* Firm, a tax return preparer, offers income tax return preparation services. Firm's contract with its software provider, Contractor, requires Firm to periodically randomly select certain taxpayers' tax return information solely for the purpose of testing the reliability of the software sold to Firm. Under its agreement with Contractor, Firm discloses tax return information to Contractor's employee, C, who services Firm's contract without providing Contractor or C with a written notice that describes the requirements of and penalties under sections 7216 and 6713. C uses the tax return information solely for

quality assurance purposes. Firm's disclosure of tax return information to C was an impermissible disclosure, because Firm failed to ensure that C received a written notice that describes the requirements and penalties of sections 7216 and 6713.

*Example 3.* E, an employee of Firm in State A in the United States, receives tax return information from T for use in preparing T's income tax return. After E enters T's tax return information into Firm's computer, that information is stored on a computer server that is physically located in State A. Firm contracts with Contractor, located in Country F, to prepare its clients' tax returns. FE, an employee of Contractor, uses a computer in Country F and inputs a password to view T's income tax information stored on the computer server in State A to prepare T's tax return. A computer program permits FE to view T's tax return information, but prohibits FE from downloading or printing out T's tax return information from the computer server. Because Firm is disclosing T's tax return information outside of the United States, Firm is required to obtain T's consent under §301.7216-3 prior to the disclosure to FE.

(e) *Disclosure or use of information in the case of related taxpayers.* (1) In preparing a tax return of a second taxpayer, a tax return preparer may use, and may disclose to the second taxpayer, in the form in which it appears on the return, any tax return information that the tax return preparer obtained from a first taxpayer if—

(i) The second taxpayer is related to the first taxpayer within the meaning of paragraph (e)(2) of this section;

(ii) The first taxpayer's tax interest in the information is not adverse to the second taxpayer's tax interest in the information; and

(iii) The first taxpayer has not expressly prohibited the disclosure or use.

(2) For purposes of paragraph (e)(1)(i) of this section, a taxpayer is related to another taxpayer if they have any one of the following relationships: husband and wife, child and parent, grandchild and grandparent, partner and partnership, trust or estate and beneficiary, trust or estate and fiduciary, corporation and shareholder, or members of a controlled group of corporations as defined in section 1563.

(3) See §301.7216-3 for disclosure or use of tax return information of the taxpayer in preparing the tax return of a second taxpayer when the requirements of this paragraph are not satisfied.

(f) *Disclosure pursuant to an order of a court, or an administrative order, demand, summons or subpoena which is issued in the performance of its duties by a Federal or State agency, the United States Congress, a professional ethics board, or*

*the Public Company Accounting Oversight Board.* The provisions of section 7216(a) and §301.7216-1 will not apply to any disclosure of tax return information if the disclosure is made pursuant to any one of the following documents:

(1) The order of any court of record, Federal, State, or local.

(2) A subpoena issued by a grand jury, Federal or State.

(3) A subpoena issued by the United States Congress.

(4) An administrative order, demand, summons or subpoena that is issued in the performance of its duties by—

(i) Any Federal agency as defined in 5 U.S.C. 551(1) and 5 U.S.C. 552(f), or

(ii) A State agency, body, or commission charged under the laws of the State or a political subdivision of the State with the licensing, registration, or regulation of tax return preparers.

(5) A written request from a professional ethics board investigating the ethical conduct of the tax return preparer.

(6) A formal demand from the Public Company Accounting Oversight Board to registered public accounting firms in connection with an inspection under section 104 of the Sarbanes-Oxley Act of 2002 (Act), 15 U.S.C. 7214, or an investigation under section 105 of the Act.

(g) *Disclosure for use in Treasury investigations or court proceedings.* A tax return preparer may disclose tax return information—

(1) To his attorney, or to an employee of the Treasury Department, for use in connection with any investigation of the tax return preparer (including investigations relating to the tax return preparer in its capacity as a practitioner) conducted by the IRS or the Treasury Department; or

(2) To his attorney, or to any officer of a court, for use in connection with proceedings involving the tax return preparer (including proceedings involving the tax return preparer in its capacity as a practitioner), or the return preparer's client, before the court or before any grand jury that may be convened by the court.

(h) *Certain disclosures by attorneys and accountants.* The provisions of section 7216(a) and §301.7216-1 shall not apply to any disclosure of tax return information permitted by this paragraph (h).

(1) (i) A tax return preparer who is lawfully engaged in the practice of law or ac-

countancy and prepares a tax return for a taxpayer may use the taxpayer's tax return information, or disclose the information to another officer, employee or member of the tax return preparer's law or accounting firm, consistent with applicable legal and ethical responsibilities, who may use the tax return information for the purpose of providing other legal or accounting services to the taxpayer. As an example, a lawyer who prepares a tax return for a taxpayer may use the tax return information of the taxpayer for, or in connection with, rendering legal services, including estate planning or administration, or preparation of trial briefs or trust instruments, for the taxpayer or the estate of the taxpayer. In addition, the lawyer who prepared the tax return may disclose the tax return information to another officer, employee or member of the same firm for the purpose of providing other legal services to the taxpayer. As another example, an accountant who prepares a tax return for a taxpayer may use the tax return information, or disclose it to another officer, employee or member of the firm, for use in connection with the preparation of books and records, working papers, or accounting statements or reports for the taxpayer. In the normal course of rendering the legal or accounting services to the taxpayer, the attorney or accountant may make the tax return information available to third parties, including stockholders, management, suppliers, or lenders, consistent with the applicable legal and ethical responsibilities, unless the taxpayer directs otherwise. For rules regarding disclosing outside of the United States, see §301.7216-2(c) and (d).

(ii) A tax return preparer's law or accounting firm does not include any related or affiliated firms. For example, if law firm A is affiliated with law firm B, officers, employees and members of law firm A must receive a taxpayer's consent under §301.7216-3 before disclosing the taxpayer's tax return information to an officer, employee or member of law firm B.

(2) A tax return preparer who is lawfully engaged in the practice of law or accountancy and prepares a tax return for a taxpayer may, consistent with the applicable legal and ethical responsibilities, take the tax return information into account, and may act upon it, in the course of performing legal or accounting services for

a client other than the taxpayer, or disclose the information to another officer, employee or member of the tax return preparer's law or accounting firm to enable that other officer, employee or member to take the information into account, and act upon it, in the course of performing legal or accounting services for a client other than the taxpayer. This is permissible when the information is, or may be, relevant to the subject matter of the legal or accounting services for the other client, and consideration of the information by those performing the services is necessary for the proper performance of the services. In no event, however, may the tax return information be disclosed to a person who is not an officer, employee or member of the law or accounting firm, unless the disclosure is exempt from the application of section 7216(a) and §301.7216-1 by reason of another provision of §§301.7216-2 or 301.7216-3.

(3) The application of this paragraph may be illustrated by the following examples:

*Example 1.* A, a member of an accounting firm, renders an opinion on a financial statement of M Corporation that is part of a registration statement filed with the Securities and Exchange Commission. After the registration statement is filed, but before its effective date, B, a member of the same accounting firm, prepares an income tax return for N Corporation. In the course of preparing N's income tax return, B discovers that N does business with M and concludes that the information given by N should be considered by A to determine whether the financial statement opined on by A contains an untrue statement of material fact or omits a material fact required to keep the statement from being misleading. B discloses to A the tax return information of N for this purpose. A determines that there is an omission of material fact and that an amended statement should be filed. A so advises M and the Securities and Exchange Commission. A explains that the omission was revealed as a result of confidential information that came to A's attention after the statement was filed, but A does not disclose the identity of the taxpayer or the tax return information itself. Section 7216(a) and §301.7216-1 do not apply to B's disclosure of N's tax return information to A and A's use of the information in advising M and the Securities and Exchange Commission of the necessity for filing an amended statement. Section 7216(a) and §301.7216-1 would apply to a disclosure of N's tax return information to M or to the Securities and Exchange Commission unless the disclosure is exempt from the application of section 7216(a) and §301.7216-1 by reason of another provision of either this section or §301.7216-3.

*Example 2.* A, a member of an accounting firm, is conducting an audit of M Corporation, and B, a member of the same accounting firm, prepares an income tax return for D, an officer of M. In the course of preparing the return, B obtains information from

D indicating that D, pursuant to an arrangement with a supplier doing business with M, has been receiving from the supplier a percentage of the amounts that the supplier invoices to M. B discloses this information to A who, acting upon it, searches in the course of the audit for indications of a kickback scheme. As a result, A discovers information from audit sources that independently indicate the existence of a kickback scheme. Without revealing the tax return information A has received from B, A brings to the attention of officers of M the audit information indicating the existence of the kickback scheme. Section 7216(a) and §301.7216-1 do not apply to B's disclosure of D's tax return information to A, A's use of D's information in the course of the audit, and A's disclosure to M of the audit information indicating the existence of the kickback scheme. Section 7216(a) and §301.7216-1 would apply to a disclosure to M, or to any other person not an employee or member of the accounting firm, of D's tax return information furnished to B.

(i) *Corporate fiduciaries.* A trust company, trust department of a bank, or other corporate fiduciary that prepares a tax return for a taxpayer for whom it renders fiduciary, investment, or other custodial or management services may, unless the taxpayer directs otherwise—

(1) Disclose or use the taxpayer's tax return information in the ordinary course of rendering such services to or for the taxpayer; or

(2) Make the information available to the taxpayer's attorney, accountant, or investment advisor.

(j) *Disclosure to taxpayer's fiduciary.* If, after furnishing tax return information to a tax return preparer, the taxpayer dies or becomes incompetent, insolvent, or bankrupt, or the taxpayer's assets are placed in conservatorship or receivership, the tax return preparer may disclose the information to the duly appointed fiduciary of the taxpayer or his estate, or to the duly authorized agent of the fiduciary.

(k) *Disclosure or use of information in preparation or audit of State or local tax returns or assisting a taxpayer with foreign country tax obligations.* The provisions of paragraphs (c) and (d) of this section shall apply to the disclosure by any tax return preparer of any tax return information in the preparation of, or in connection with the preparation of, any tax return of the taxpayer under the law of any State or political subdivision thereof, of the District of Columbia, of any territory or possession of the United States, or of a country other than the United States. The provisions of section 7216(a) and §301.7216-1 shall not apply to the use by any tax return preparer

of any tax return information in the preparation of, or in connection with the preparation of, any tax return of the taxpayer under the law of any State or political subdivision thereof, of the District of Columbia, of any territory or possession of the United States, or of a country other than the United States. The provisions of section 7216(a) and §301.7216-1 shall not apply to the disclosure or use by any tax return preparer of any tax return information in the audit of, or in connection with the audit of, any tax return of the taxpayer under the law of any State or political subdivision thereof, of the District of Columbia, of any territory or possession of the United States.

(l) *Payment for tax preparation services.* A tax return preparer may use and disclose, without the taxpayer's written consent, tax return information that the taxpayer provides to the tax return preparer to pay for tax preparation services to the extent necessary to process the payment. For example, if the taxpayer gives the tax return preparer a credit card to pay for tax preparation services, the tax return preparer may disclose the taxpayer's name, credit card number, credit card expiration date, and amount due for tax preparation services to the credit card company, as necessary, to process the payment. Any tax return information that is not relevant to the payment may not be used or disclosed by the tax return preparer without the taxpayer's prior written consent, unless otherwise permitted under another provision of this section.

(m) *Retention of records.* A tax return preparer may retain tax return information of a taxpayer, including copies of tax returns, in paper or electronic format, prepared on the basis of the tax return information, and may use the information in connection with the preparation of other tax returns of the taxpayer or in connection with an examination by the Internal Revenue Service of any tax return or subsequent tax litigation relating to the tax return. The provisions of paragraph (n) of this section regarding the transfer of a taxpayer list also apply to the transfer of any records and related papers to which this paragraph applies.

(n) *Lists for solicitation of tax return business.* A tax return preparer may compile and maintain a separate list containing solely the names, addresses, e-mail addresses, and phone numbers of taxpayers

whose tax returns the tax return preparer has prepared or processed. This list may be used by the compiler solely to contact the taxpayers on the list for the purpose of offering tax information or additional tax return preparation services to such taxpayers. The compiler of the list may not transfer the taxpayer list, or any part thereof, to any other person unless the transfer takes place in conjunction with the sale or other disposition of the compiler's tax return preparation business. A person who acquires a taxpayer list, or a part thereof, in conjunction with a sale or other disposition of a tax return preparation business is subject to the provisions of this paragraph with respect to the list. The term *list*, as used in this paragraph, includes any record or system whereby the names and addresses of taxpayers are retained. The provisions of this paragraph also apply to the transfer of any records and related papers to which this paragraph (n) applies.

(o) *Producing statistical information in connection with tax return preparation business.* A tax return preparer may use, for the limited purpose specified in this paragraph, tax return information to produce a statistical compilation of data described in §301.7216-1(b)(3)(i)(B). The purpose and use of the statistical compilation must relate directly to the internal management or support of the tax return preparer's tax return preparation business. The tax return preparer may not disclose or use the tax return information in connection with, or support of, businesses other than tax return preparation. The compiler of the statistical compilation may not transfer the compilation, or any part thereof, to any other person unless the transfer takes place upon the sale or other disposition of the tax return preparation business of the compiler. A person who acquires a compilation, or a part thereof, in conjunction with a sale or other disposition of a tax return preparation business is subject to the provisions of this paragraph with respect to the compilation as if the acquiring person had compiled it.

(p) *Disclosure or use of information for quality or peer reviews.* The provisions of section 7216(a) and §301.7216-1 shall not apply to any disclosure for the purpose of a quality or peer review to the extent necessary to accomplish the review. A quality or peer review is a review that is undertaken to evaluate, monitor, and improve

the quality and accuracy of a tax return preparer's tax preparation, accounting, or auditing services. A quality or peer review may be conducted only by attorneys, certified public accountants, enrolled agents, and enrolled actuaries who are eligible to practice before the Internal Revenue Service. See Department of the Treasury Circular 230, 31 CFR part 10. Disclosure of tax return information is also authorized to persons who provide administrative or support services to an individual who is conducting a quality or peer review under this paragraph (p), but only to the extent necessary for the reviewer to conduct the review. Tax return information gathered in conducting a review may be used only for purposes of a review. No tax return information identifying a taxpayer may be disclosed in any evaluative reports or recommendations that may be accessible to any person other than the reviewer or the tax return preparer being reviewed. The tax return preparer being reviewed will maintain a record of the review including the information reviewed and the identity of the persons conducting the review. After completion of the review, no documents containing information that may identify any taxpayer by name or identification number may be retained by a reviewer or by the reviewer's administrative or support personnel. Any person (including administrative and support personnel) receiving tax return information in connection with a quality or peer review is a tax return preparer for purposes of sections 7216(a) and 6713(a).

(q) *Disclosure to report the commission of a crime.* The provisions of section 7216(a) and §301.7216-1 shall not apply to the disclosure of any tax return information to the proper Federal, State, or local official in order, and to the extent necessary, to inform the official of activities that may constitute, or may have constituted, a violation of any criminal law or to assist the official in investigating or prosecuting a violation of criminal law. A disclosure made in the *bona fide* but mistaken belief that the activities constituted a violation of criminal law is not subject to section 7216(a) and §301.7216-1.

(r) *Disclosure of tax return information due to a tax return preparer's incapacity or death.* In the event of incapacity or death of a tax return preparer, disclosure of tax return information may be made for the purpose of assisting the tax return preparer

or his legal representative (or the representative of a deceased tax return preparer's estate) in operating the business. Any person receiving tax return information under the provisions of this paragraph (r) is a tax return preparer for purposes of sections 7216(a) and 6713(a).

(s) *Effective date.* This section applies on the date that is 30 days after the final regulations are published in the **Federal Register**.

Par. 5. Section 301.7216-3 is revised to read as follows:

*§301.7216-3 Disclosure or use permitted only with the taxpayer's consent.*

(a) *In general*—(1) *Taxpayer consent.* Unless section 7216 or §301.7216-2 specifically authorizes the disclosure or use of tax return information, a tax return preparer may not disclose or use a taxpayer's tax return information prior to obtaining a consent from the taxpayer, as described in this section. The consent must be knowing and voluntary. As an example, a tax return preparer may not condition its provision of preparation services upon the taxpayer's consenting to a use of the taxpayer's tax return information. Except as provided in paragraph (a)(2) of this section, conditioning the provision of services on the taxpayer's furnishing consent will make the consent involuntary, and the consent will not satisfy the requirements of this section.

(2) *Taxpayer consent to a tax return preparer furnishing tax return information to another tax return preparer.* A tax return preparer may condition its provision of preparation services upon a taxpayer's consenting to disclosure of the taxpayer's tax return information to another tax return preparer for the purpose of performing services that assist in the preparation of, or provide auxiliary services in connection with the preparation of, the tax return of the taxpayer.

(3) *Guidance describing the form and contents of taxpayer consents.* The Commissioner may issue guidance, by revenue procedure, describing the form and content of taxpayer consents authorized under this section.

(b) *Timing requirements and limitations*—(1) *No retroactive consent.* A taxpayer must provide written consent be-

fore a tax return preparer discloses or uses the taxpayer's tax return information.

(2) *Time limitations on requesting consent.* A tax return preparer may not request a taxpayer's consent to use or disclose tax return information after the tax return preparer provides a completed tax return to the taxpayer for signature.

(3) *No requests for consent after an unsuccessful request.* With regard to tax return information for each income tax return that a tax return preparer prepares, if a taxpayer declines a request for consent to the use or disclosure of tax return information, the tax return preparer may not make another request to obtain consent for a purpose substantially similar to that of the rejected request.

(4) *Duration of consent.* No consent to the use or disclosure of tax return information may be effective for a period longer than one year from the date the taxpayer signed the consent.

(c) *Special rules*—(1) *Multiple disclosures within a single consent form or multiple uses within a single consent form.* A taxpayer may consent to multiple uses within the same written document, or multiple disclosures within the same written document. A single written document, however, cannot authorize both uses and disclosures; rather one written document must authorize the uses and another separate written document must authorize the disclosures. Furthermore, a consent that authorizes multiple uses or multiple disclosures must specifically and separately identify each use or disclosure.

(2) *Disclosure of entire return.* A consent may authorize the disclosure of all information contained within a return. A consent authorizing the disclosure of an entire return must set forth an explanation of the reasons why a consent authorizing a more limited disclosure of tax return information is unsatisfactory for the purpose of the consent.

(3) *Copy of consent must be provided to taxpayer.* The tax return preparer must provide a copy of the executed consent to the taxpayer at the time of execution. The requirements of this paragraph may also be satisfied by giving the taxpayer the opportunity, at the time of executing the consent, to print the completed consent or save it in electronic form.

(d) *Permissible disclosures to third parties at the request of the taxpayer.* A

tax return preparer may disclose tax return information to third parties as the taxpayer directs so long as the taxpayer provides a consent to disclose tax return information that satisfies the requirements of this paragraph and as prescribed by the Commissioner by revenue procedure. (See §601.601(d)(2) of this chapter.)

(e) *Effective date.* This section applies on the date that is 30 days after the final regulations are published in the **Federal Register**.

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

(Filed by the Office of the Federal Register on December 7, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 8, 2005, 70 F.R. 72954)

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

### Announcement 2006-3

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

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

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on January 17, 2006,

and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is \$1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

American Institute of Marine Studies, Inc.  
Lauderdale by the Sea, FL

Hampton Roads Community Foundation  
Mechanicsville, VA

## **Employer Comparable Contributions to Health Savings Accounts Under Section 4980G; Hearing**

### **Announcement 2006-4**

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Notice of public hearing on proposed rulemaking.

SUMMARY: This document contains a notice of public hearing on proposed regulations (REG-138647-04, 2005-41 I.R.B. 697) providing guidance on employer comparable contributions to Health Savings Accounts (HSAs) under section 4980G.

DATES: The public hearing is being held on February 23, 2006, at 10 a.m. The IRS must receive outlines of the topics to be discussed at the hearing by February 2, 2006.

ADDRESSES: The public hearing is being held in the IRS Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC. Send submissions to: CC:PA:LPD:PR (REG-138647-04), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-138647-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic outlines of oral comments directly to the IRS Internet site <http://www.irs.gov/regs>.

FOR FURTHER INFORMATION: Concerning submission of comments, the hearing, and/or to be placed on the building access to attend the hearing, Kelly Banks at (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION: The subject of the public hearing is the notice of proposed rulemaking (REG-138647-04) that was published in the **Federal Register** on August 26, 2005 (70 FR 50233).

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

A period of 10 minutes is allotted to each person for presenting oral comments. The IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available, free of charge, at the hearing.

Because of access restrictions, the IRS will not admit visitors beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this document.

Guy R. Traynor,  
*Acting Chief, Publications and  
Regulations Branch,  
Associate Chief Counsel  
(Procedure and Administration).*

(Filed by the Office of the Federal Register on December 21, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 22, 2005, 70 F.R. 75998)

# 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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