Internal Revenue
bulletin

Bulletin No. 2006-6
February 6, 2006

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. 2006–7, page 399.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for February 2006.

T.D. 9238, page 408.
REG–143244–05, page 419.

Temporary and proposed regulations under section 7874 of the Code provide for determination of whether a foreign corporation is a surrogate foreign corporation when the foreign corporation is part of an expanded affiliated group. A public hearing on the proposed regulations is scheduled for April 27, 2006.

Notice 2006–9, page 413.

This notice provides procedures for a vehicle manufacturer to certify that a passenger automobile or light truck meets certain requirements for the new advanced lean burn technology motor vehicle credit or the new qualified hybrid motor vehicle credit, and to certify the amount of the credit available with respect to the vehicle. The notice also provides guidance to taxpayers who purchase passenger automobiles and light trucks regarding the conditions under which they may rely on the vehicle manufacturer's certification.

EMPLOYEE PLANS

T.D. 9237, page 394.

Final regulations under section 401 of the Code provide guidance concerning the requirements for designated Roth contributions under qualified cash or deferred arrangements.

EMPLOYMENT TAX

T.D. 9239, page 401.
REG–148568–04, page 417.

Final, temporary, and proposed regulations under section 6011 of the Code relate to the time for employers to file returns and make deposits under the Federal Insurance Contributions Act (FICA) and returns of income tax withheld. The regulations require employers who receive notification of qualification for the Employers' Annual Federal Tax Program (Form 944) to file Form 944, *Employer's Annual Federal Tax Return*, annually instead of Form 941, *Employer's Quarterly Federal Tax Return*, quarterly beginning in the 2006 taxable year. The regulations also permit most employers who file Form 944 to remit accumulated employment taxes annually with their return and modify the look-back period and *de minimis* deposit rule for these employers. The proposed regulations also provide an additional method for quarterly return filers to determine whether the amount of accumulated employment taxes is considered *de minimis*. A public hearing on the proposed regulations is scheduled for April 26, 2006.

ADMINISTRATIVE

Announcement 2006–11, page 420.

This announcement contains a correction to a notice of proposed rulemaking (REG–158080–04, 2005–43 I.R.B. 786) regarding the application of section 409A to nonqualified deferred compensation plans.

Announcement 2006–12, page 421.

This announcement contains a correction to T.D. 9203, 2005–25 I.R.B. 1285, which is adding back regulations section 301.7701–3T after it was removed in error.

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

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

The adjusted applicable federal long-term rate is set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(k)–1: Certain cash or deferred arrangements.

T.D. 9237

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

Designated Roth Contributions to Cash or Deferred Arrangements Under Section 401(k)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains amendments to the regulations under sections 401(k) and (m) of the Internal Revenue Code. These regulations provide guidance concerning the requirements for designated Roth contributions under qualified cash or deferred arrangements described in section 401(k). These regulations affect section 401(k) plans that provide for designated Roth contributions and participants eligible to make elective contributions under these plans.

DATES: *Effective Date:* These regulations are effective January 1, 2006.

Applicability Date: These regulations apply to plan years beginning on or after January 1, 2006.

FOR FURTHER INFORMATION CONTACT: Cathy A. Vohs, 202–622–6090 or R. Lisa Mojiri-Azad, 202–622–6060 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1930.

The collection of information in these regulations is in 26 CFR §1.401(k)–1(f)(1)&(2). This information is required to comply with the separate accounting and recordkeeping requirements of section 402A.

The estimated annual burden per respondent under control number 1545–1930 is 1 hour.

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

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

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

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under section 401(k) and (m) of the Internal Revenue Code of 1986 (Code). The amendments provide guidance on designated Roth contributions under section 402A of the Code, added by section 617(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107–16, 115 Stat. 38) (EGTRRA).

Section 401(k) provides that a profit-sharing, stock bonus, pre-ERISA money purchase or rural cooperative plan will not fail to qualify under section 401(a) merely because it contains a qualified cash or deferred arrangement. Contributions made at the election of an employee under a qualified cash or deferred arrangement are known as elective contributions. Generally, such elective contributions are not includible in gross income at the time contributed and are sometimes referred to as pre-tax elective contributions.

Under section 402A, effective for tax years beginning on or after January 1, 2006, a plan may permit an employee who makes elective contributions under a qualified cash or deferred arrangement to designate some or all of those contributions as designated Roth contributions. Designated Roth contributions are elective contributions under a qualified cash or deferred arrangement that, unlike pre-tax elective contributions, are currently includible in gross income. However, a qualified distribution of designated Roth contributions is excludable from gross income.

Although designated Roth contributions under a qualified cash or deferred arrangement bear some similarity to contributions to a Roth IRA described in section 408A (*e.g.*, contributions to either type of account are after-tax contributions

and qualified distributions from either type of account are excludable from gross income), there are many differences between these types of arrangements. For example, under section 408A(c)(3), an individual is ineligible to make Roth IRA contributions if his or her modified adjusted gross income exceeds certain limits, but section 402A does not impose any comparable income limits on an individual's eligibility to make designated Roth contributions under a qualified cash or deferred arrangement. In addition, under section 408A(d)(3), a traditional IRA may be converted to a Roth IRA, but section 402A does not provide for a conversion of a pre-tax elective contribution account under a qualified cash or deferred arrangement to a designated Roth account. Also, under section 408A(d)(4), specific ordering rules apply to distributions from Roth IRAs. Section 402A, however, does not provide a specific ordering rule for distributions from designated Roth accounts, so section 72 applies to determine the character of distributions from such accounts.

On December 29, 2004, final regulations (T.D. 9169, 2005–5 I.R.B. 381) under section 401(k) were issued (69 FR 78144). Those regulations generally apply to plan years beginning on or after January 1, 2006, although they also may be applied to plan years ending after December 29, 2004. Under those final regulations, §1.401(k)–1(f) was reserved for special rules for designated Roth contributions. On March 2, 2005, proposed regulations (REG–152354–04, 2005–13 I.R.B. 805) to fill in that reserved paragraph and provide additional rules applicable to designated Roth contributions were issued (70 FR 10062). Written public comments were received on the proposed regulations and public reaction to the proposed regulations generally was favorable. After consideration of the comments, these final regulations adopt the provisions of the proposed regulations with certain modifications, the most significant of which are highlighted below.

Explanation of Provisions

Rules Relating to Designated Roth Contributions

These final regulations retain the special rules which were included in the proposed regulations relating to designated Roth contributions under a section 401(k) plan. Thus, these final regulations amend §1.401(k)–1(f) to provide a definition of designated Roth contributions and special rules with respect to such contributions. Under these final regulations, designated Roth contributions are defined as elective contributions under a qualified cash or deferred arrangement that are: (1) designated irrevocably by the employee at the time of the cash or deferred election as designated Roth contributions that are being made in lieu of all or a portion of the pre-tax elective contributions the employee is otherwise eligible to make under the plan; (2) treated by the employer as includible in the employee's gross income at the time the employee would have received the contribution amounts in cash if the employee had not made the cash or deferred election (*e.g.*, by treating the contributions as wages subject to applicable withholding requirements); and (3) maintained by the plan in a separate account. The regulations also provide that elective contributions may only be treated as designated Roth contributions to the extent permitted under the plan.

Some commentators requested that an employer sponsoring a qualified cash or deferred arrangement be permitted to offer only designated Roth contributions. However, under section 402A(b)(1), designated Roth contributions are made in lieu of all or a portion of elective contributions that the employee is otherwise eligible to make under the cash or deferred arrangement. If a cash or deferred arrangement offered only designated Roth contributions, an employee participating in the arrangement would not be electing to make such contributions in lieu of elective contributions he or she was otherwise eligible to make under the plan. Thus, these final regulations clarify that, in order to provide for designated Roth contributions, a qualified cash or deferred arrangement must also offer pre-tax elective contributions.

Separate Accounting Requirement

These final regulations also retain the rule that, under the separate accounting requirement, contributions and withdrawals of designated Roth contributions must be credited and debited to a designated Roth account maintained for the employee and the plan must maintain a record of the employee's investment in the contract (*i.e.*, designated Roth contributions that have not been distributed) with respect to the employee's designated Roth account. In addition, gains, losses, and other credits or charges must be separately allocated on a reasonable and consistent basis to the designated Roth account and other accounts under the plan. The proposed regulations provided that forfeitures may not be allocated to the designated Roth account. The final regulations retain this rule and, in response to comments, clarify that no contributions other than designated Roth contributions and rollover contributions described in section 402A(c)(3)(B) are permitted to be allocated to a designated Roth account. For example, matching contributions are not permitted to be allocated to a designated Roth account. The final regulations also retain the rule that the separate accounting requirement applies at the time the designated Roth contribution is contributed to the plan and must continue to apply until the designated Roth account is completely distributed.

Other Rules

These final regulations retain the requirement that a designated Roth contribution must satisfy the requirements applicable to any other elective contributions made under a qualified cash or deferred arrangement. Thus, designated Roth contributions are subject to the nonforfeitability and distribution restrictions applicable to elective contributions and are taken into account under the actual deferral percentage test (ADP test) of section 401(k)(3) in the same manner as pre-tax elective contributions. Similarly, designated Roth contributions may be treated as catch-up contributions and serve as the basis for a participant loan.

A number of commentators discussed the application of section 401(a)(9) to plans to which designated Roth contributions are made. These commentators pointed out that under section 408A, Roth IRAs are not subject to the rules of section 401(a)(9)(A) (*i.e.*, Roth IRAs are not subject to the rules of section 401(a)(9) while the Roth IRA owner is alive). Although Roth IRAs are not subject to section 401(a)(9) while the IRA owner is alive, section 402A does not provide comparable

rules regarding the application of section 401(a)(9) to designated Roth accounts under a cash or deferred arrangement. Thus, such designated Roth accounts are subject to the rules of section 401(a)(9)(A) and (B) in the same manner as pre-tax elective contributions.

In response to comments asking for clarification, the final regulations provide rules regarding elections to make designated Roth contributions. These rules specifically provide that the rules in §1.401(k)–1(e)(2)(ii) regarding frequency of elections to make pre-tax elective contributions also apply to elections to make designated Roth contributions. The rules also specifically address automatic enrollment and permit a plan to utilize automatic enrollment in conjunction with designated Roth contributions. Under the final regulations, a plan that provides for a cash or deferred election under which contributions are made in the absence of an affirmative election and that has both pre-tax elective contributions and designated Roth contributions must set forth the extent to which those default contributions are pre-tax elective contributions or designated Roth contributions. If the default contributions are designated Roth contributions, then an employee who has not made an affirmative election is deemed to have irrevocably designated the contributions (in accordance with section 402A(c)(1)(B)) as designated Roth contributions.

A number of commentators addressed direct rollovers of amounts from a designated Roth account. In response to these comments, the regulations clarify that a direct rollover from a designated Roth account under a qualified cash or deferred arrangement may only be made to another designated Roth account under an applicable retirement plan described in section 402A(e)(1) or to a Roth IRA described in section 408A, and only to the extent the direct rollover is permitted under the rules of section 402(c). In addition, a plan is permitted to treat the balance of the participant's designated Roth account and the participant's other accounts under the plan as accounts held under two separate plans (within the meaning of section 414(l)) for purposes of applying the special rule in A–11 of §1.401(a)(31)–1 (under which a plan will satisfy section 401(a)(31) even though the plan administrator does not permit any distributee to elect a direct rollover with respect to eligible rollover distributions during a year that are reasonably expected to total less than $200). Thus, if a participant's balance in the designated Roth account is less than $200, then the plan is not required to offer a direct rollover election with respect to that account or to apply the automatic rollover provisions of section 401(a)(31)(B) with respect to that account.

Section 1.401(k)–2 contains correction methods that may be used when a plan fails to satisfy the ADP test for a year. These final regulations retain the rule in the proposed regulations relating to these correction methods that permits a highly compensated employee (HCE), as defined in section 414(q), with elective contributions for a year that include both pre-tax elective contributions and designated Roth contributions to elect whether excess contributions are to be attributed to pre-tax elective contributions or designated Roth contributions. There is no requirement that the plan provide this option, and a plan may provide for one of the correction methods described in the final regulations without permitting an HCE to make such an election.

These final regulations also retain the rule that a distribution of excess contributions is not includible in gross income to the extent it represents a distribution of designated Roth contributions. However, the income allocable to a corrective distribution of excess contributions that are designated Roth contributions is includible in gross income in the same manner as income allocable to a corrective distribution of excess contributions that are pre-tax elective contributions. The regulations also provide a similar rule under the correction methods that may be used when a plan fails to satisfy the actual contribution percentage (ACP) test in §1.401(m)–2.

Additional Plan Terms

In addition to the rules relating to sections 401(k) and (m) discussed above, there are other aspects of designated Roth contributions that would be reflected in plan terms and are not addressed in these regulations. For example, while a plan is permitted to allow an employee to elect the character of a distribution (*i.e.*, whether the distribution will be made from the designated Roth account or other accounts), the extent to which a plan so permits must be set forth in the terms of the plan.

Certain Issues Addressed in Proposed Regulations

These final regulations do not provide guidance with respect to the taxation of distributions of designated Roth contributions. For example, the regulations do not provide guidance with respect to the recovery of an employee's investment in the contract associated with his or her designated Roth contributions. Proposed regulations under section 402A, to be issued in the near future, address these taxation issues.

Effective Date

Section 402A is effective for an employee's taxable years beginning after December 31, 2005. These regulations have the same effective date as the regulations under section 401(k) that they are amending. Thus, these final regulations are generally applicable to plan years beginning on or after January 1, 2006. If a plan is applying the section 401(k) regulations as of an earlier effective date (as provided under those regulations), to the extent that section 402A is effective, that same early effective date applies to these regulations. For a plan that has an effective date for the section 401(k) regulations that is after the effective date of section 402A (either an employer that does not have a calendar year plan or a plan established pursuant to a collective bargaining agreement that has a delayed effective date for the section 401(k) regulations), the employer may rely on these regulations prior to the effective date of the final section 401(k) regulations for the plan, even if the plan does not otherwise implement the section 401(k) regulations earlier than required.

These regulations do not provide rules for the application of the EGTRRA sunset provision (section 901 of EGTRRA), under which the provisions of EGTRRA do not apply to taxable, plan, or limitation years beginning after December 31, 2010. Unless the EGTRRA sunset provision is repealed before it becomes effective, additional guidance will be needed to clarify its application.

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 5 U.S.C. 553(b) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that most small entities that maintain a section 401(k) plan use a third party provider to administer the plan. Therefore, an analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are R. Lisa Mojiri-Azad and Cathy A. Vohs of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in the development of these regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1 — INCOME TAXES

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

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

Par. 2. Section 1.401(k)–0 is amended as follows:

1. The entry for §1.401(k)–1(f) is revised and entries for §1.401(k)–1(f)(1), (2), (3), (4) and (5) are added.

2. An entry for §1.401(k)–2(b)(2)(vi)(C) is added.

The additions read as follows:

§1.401(k)–0 Table of contents.

* * * * *

§1.401(k)–1 Certain cash or deferred arrangements.

* * * * *

(f) Special rules for designated Roth contributions.

(1) In general.

(2) Separate accounting required.

(3) Designated Roth contributions must satisfy rules applicable to elective contributions.

(i) In general.

(ii) Special rules for direct rollovers.

(4) Rules regarding designated Roth contribution elections.

(i) Frequency of elections.

(ii) Default elections.

(5) Effective date.

(i) In general.

(ii) Sunset provisions.

* * * * *

§1.401(k)–2 ADP test.

* * * * *

(b) * * *

(2) * * *

(vi) * * *

(C) Corrective distributions attributable to designated Roth contributions.

* * * * *

Par. 3. Section 1.401(k)–1(f) is revised as follows:

§1.401(k)–1 Certain cash or deferred arrangements.

* * * * *

(f) *Special rules for designated Roth contributions*—(1) *In general*. The term *designated Roth contribution* means an elective contribution under a qualified cash or deferred arrangement that, to the extent permitted under the plan, is—

(i) Designated irrevocably by the employee at the time of the cash or deferred election as a designated Roth contribution that is being made in lieu of all or a portion of the pre-tax elective contributions the employee is otherwise eligible to make under the plan;

(ii) Treated by the employer as includible in the employee's gross income at the time the employee would have received the amount in cash if the employee had not made the cash or deferred election (*e.g.*, by treating the contributions as wages subject to applicable withholding requirements); and

(iii) Maintained by the plan in a separate account (in accordance with paragraph (f)(2) of this section).

(2) *Separate accounting required*. Under the separate accounting requirement of this paragraph (f)(2), contributions and withdrawals of designated Roth contributions must be credited and debited to a designated Roth account maintained for the employee and the plan must maintain a record of the employee's investment in the contract (*i.e.*, designated Roth contributions that have not been distributed) with respect to the employee's designated Roth account. In addition, gains, losses, and other credits or charges must be separately allocated on a reasonable and consistent basis to the designated Roth account and other accounts under the plan. However, forfeitures may not be allocated to the designated Roth account and no contributions other than designated Roth contributions and rollover contributions described in section 402A(c)(3)(B) may be allocated to such account. The separate accounting requirement applies at the time the designated Roth contribution is contributed to the plan and must continue to apply until the designated Roth account is completely distributed.

(3) *Designated Roth contributions must satisfy rules applicable to elective contributions*—(i) *In general*. A designated Roth contribution must satisfy the requirements applicable to elective contributions made under a qualified cash or deferred arrangement. Thus, for example, a designated Roth contribution must satisfy the requirements of paragraphs (c) and (d) of this section and is treated as an employer contribution for purposes of sections 401(a), 401(k), 402, 404, 409, 411, 412, 415, 416 and 417. In addition, the designated Roth contributions are treated as elective contributions for purposes of the ADP test. Similarly, the designated Roth account under the plan is subject to the rules of section 401(a)(9)(A) and (B) in the same manner as an account that contains pre-tax elective contributions.

(ii) *Special rules for direct rollovers*. A direct rollover from a designated Roth account under a qualified cash or deferred arrangement may only be made to another designated Roth account under an applicable retirement plan described in section

402A(e)(1) or to a Roth IRA described in section 408A, and only to the extent the rollover is permitted under the rules of section 402(c). Moreover, a plan is permitted to treat the balance of the participant's designated Roth account and the participant's other accounts under the plan as accounts held under two separate plans (within the meaning of section 414(l)) for purposes of applying the special rule in A–11 of §1.401(a)(31)–1 (under which a plan will satisfy section 401(a)(31) even though the plan administrator does not permit any distributee to elect a direct rollover with respect to eligible rollover distributions during a year that are reasonably expected to total less than $200).

(4) *Rules regarding designated Roth contribution elections*—(i) *Frequency of elections*. The rules under paragraph (e)(2)(ii) of this section regarding frequency of elections apply in the same manner to both pre-tax elective contributions and designated Roth contributions. Thus, an employee must have an effective opportunity to make (or change) an election to make designated Roth contributions at least once during each plan year.

(ii) *Default elections*—(A) In the case of a plan that provides for both pre-tax elective contributions and designated Roth contributions and in which, under paragraph (a)(3)(ii) of this section, the default in the absence of an affirmative election is to make a contribution under the cash or deferred arrangement, the plan terms must provide the extent to which the default contributions are pre-tax elective contributions and the extent to which the default contributions are designated Roth contributions.

(B) If the default contributions under the plan are designated Roth contributions, then an employee who has not made an affirmative election is deemed to have irrevocably designated the contributions (in accordance with section 402A(c)(1)(B)) as designated Roth contributions.

(5) *Effective date*—(i) *In general*. Section 402A is effective for taxable years beginning after December 31, 2005.

(ii) *Sunset provisions*. The rules set forth in this paragraph (f) do not address the application of section 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107–16; 115 Stat. 38) (under which the amendments made by that Act do not apply to taxable, plan, or limitation years beginning after December 31, 2010).

* * * * *

Par. 4. Section 1.401(k)–2 is amended as follows:

1. A new sentence is added after the second sentence in paragraph (b)(1)(ii).

2. The last sentence in paragraph (b)(2)(vi)(B) is amended by adding the phrase ", except to the extent provided in paragraph (b)(2)(vi)(C) of this section."

3. Paragraph (b)(2)(vi)(C) is added.

The additions read as follows:

§1.401(k)–2 ADP test.

* * * * *

(b) * * *

(1) * * *

(ii) * * * Similarly, a plan may permit an HCE with elective contributions for a year that includes both pre-tax elective contributions and designated Roth contributions to elect whether the excess contributions are to be attributed to pre-tax elective contributions or designated Roth contributions. * * *

* * * * *

(2) * * *

(vi) * * *

(C) *Corrective distributions attributable to designated Roth contributions*. Notwithstanding paragraphs (b)(2)(vi)(A) and (B) of this section, a distribution of excess contributions is not includible in gross income to the extent it represents a distribution of designated Roth contributions. However, the income allocable to a corrective distribution of excess contributions that are designated Roth contributions is included in gross income in accordance with paragraph (b)(2)(vi)(A) or (B) of this section (*i.e.*, in the same manner as income allocable to a corrective distribution of excess contributions that are pre-tax elective contributions).

* * * * *

Par. 5. Section 1.401(k)–6 is amended as follows:

1. The definitions of "Designated Roth account" and "Designated Roth contributions" are added after the definition of *Current year testing method*.

2. A new definition of "Pre-tax elective contributions" is added after the definition of *Pre-ERISA money purchase pension plan*.

The additions read as follows:

§1.401(k)–6 Definitions.

* * * * *

Designated Roth account. *Designated Roth account* means a separate account maintained by a plan to which only designated Roth contributions (including income, expenses, gains and losses attributable thereto) are made.

Designated Roth contributions. *Designated Roth contributions* means designated Roth contributions as defined in §1.401(k)–1(f)(1).

* * * * *

Pre-tax elective contributions. *Pre-tax elective contributions* means elective contributions under a qualified cash or deferred arrangement that are not designated Roth contributions.

* * * * *

Par. 6. Section 1.401(m)–0 is amended by adding an entry for §1.401(m)–2(b)(2)(vi)(C) to read as follows:

§1.401(m)–0 Table of contents.

* * * * *

§1.401(m)–2 ACP test.

* * * * *

(b) * * *

(2) * * *

(vi) * * *

(C) Corrective distributions attributable to designated Roth contributions.

* * * * *

Par. 7. Section 1.401(m)–2 is amended as follows:

1. The last sentence in paragraph (b)(2)(vi)(B) is amended by adding the phrase ", or as provided in paragraph (b)(2)(vi)(C) of this section."

2. Paragraph (b)(2)(vi)(C) is added.

The additions read as follows:

§1.401(m)–2 ACP test.

* * * * *

(b) * * *

(2) * * *

(vi) * * *

(C) *Corrective distributions attributable to designated Roth contributions*. Notwithstanding paragraphs (b)(2)(vi)(A) and (B) of this section, a distribution of

excess aggregate contributions is not includible in gross income to the extent it represents a distribution of designated Roth contributions. However, the income allocable to a corrective distribution of excess aggregate contributions that are designated Roth contributions is taxed in accordance with paragraph (b)(2)(vi)(A) or (B) of this section (*i.e.*, in the same manner as income allocable to a corrective distribution of excess aggregate contributions that are not designated Roth contributions).

* * * * *

Par. 8. Section 1.401(m)–5 is amended by adding a new definition of "Designated Roth contributions" after the definition of *Current year testing method* to read as follows:

§1.401(m)–5 Definitions.

* * * * *

Designated Roth contributions. *Designated Roth contributions* means designated Roth contributions as defined in §1.401(k)–1(f)(1).

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 9. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 10. In §602.101, paragraph (b) is amended by adding an entry for "1.401(k)–1" in numerical order to the table to read, in part, as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
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1.401(k)–1	1545–1930
* * * * *	

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

Approved December 13, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary for Tax Policy.

(Filed by the Office of the Federal Register on December 30, 2005, 8:45 a.m., and published in the issue of the Federal Register for January 3, 2006, 71 F.R. 6)

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

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

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

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for February 2006.

Rev. Rul. 2006–7

This revenue ruling provides various prescribed rates for federal income tax

purposes for February 2006 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2006–7 TABLE 1

Applicable Federal Rates (AFR) for February 2006

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	4.39%	4.34%	4.32%	4.30%
110% AFR	4.83%	4.77%	4.74%	4.72%
120% AFR	5.28%	5.21%	5.18%	5.15%
130% AFR	5.72%	5.64%	5.60%	5.57%
Mid-term				
AFR	4.40%	4.35%	4.33%	4.31%
110% AFR	4.85%	4.79%	4.76%	4.74%
120% AFR	5.29%	5.22%	5.19%	5.16%
130% AFR	5.74%	5.66%	5.62%	5.59%
150% AFR	6.64%	6.53%	6.48%	6.44%
175% AFR	7.75%	7.61%	7.54%	7.49%
Long-term				
AFR	4.61%	4.56%	4.53%	4.52%
110% AFR	5.08%	5.02%	4.99%	4.97%
120% AFR	5.54%	5.47%	5.43%	5.41%
130% AFR	6.02%	5.93%	5.89%	5.86%

REV. RUL. 2006–7 TABLE 2

Adjusted AFR for February 2006

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.20%	3.17%	3.16%	3.15%
Mid-term adjusted AFR	3.53%	3.50%	3.48%	3.47%
Long-term adjusted AFR	4.26%	4.22%	4.20%	4.18%

REV. RUL. 2006–7 TABLE 3

Rates Under Section 382 for February 2006

Adjusted federal long-term rate for the current month	4.26%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.40%

REV. RUL. 2006–7 TABLE 4	
Appropriate Percentages Under Section 42(b)(2) for February 2006	
Appropriate percentage for the 70% present value low-income housing credit	8.05%
Appropriate percentage for the 30% present value low-income housing credit	3.45%

REV. RUL. 2006–7 TABLE 5	
Rate Under Section 7520 for February 2006	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.2%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 31.6011(a)–1: Returns under Federal Insurance Contributions Act.

T.D. 9239

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 31

Time for Filing Employment Tax Returns and Modifications to the Deposit Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary regulations establishing the Employers' Annual Federal Tax Program (Form 944) (hereinafter referred to as the Form 944 Program). The temporary regulations relate to sections 6011 and 6302 of the Internal Revenue Code (Code) concerning reporting and paying income taxes withheld from wages and reporting and paying taxes under the Federal Insurance Contributions Act (FICA) (collectively, employment taxes). These temporary regulations provide requirements for filing returns under FICA and returns of income tax withheld under section 6011 and §§31.6011(a)–1 and 31.6011(a)–4 of the Employment Tax Regulations.

These temporary regulations generally require employers who receive written notification from the Commissioner of their qualification for the Form 944 Program to file a Form 944, "*Employer's Annual Federal Tax Return*," rather than Form 941, "*Employer's Quarterly Federal Tax Return*." In addition, these temporary regulations provide requirements for employers to make deposits of employment taxes under section 6302 and §31.6302–1. These temporary regulations permit employers in the Form 944 Program to deposit or remit their accumulated employment taxes annually with their Form 944 if they satisfy the provisions of the *de minimis* deposit rule, as modified. Also, these temporary regulations modify the lookback period used to determine an employer's status as a monthly or semi-weekly depositor.

The portions of this document that are final regulations provide necessary cross-references to the temporary regulations as well as technical revisions. The technical revisions correct the table of contents in §31.6302–0 and a cross-reference in §31.6302–1(e)(2) and remove all references to an IRS district director, as that position no longer exists within the IRS. In addition, a cross-reference to the temporary regulations under section 6011 was added to the final regulations under section 6071, regarding the time for filing returns. The text of the temporary regulations also serves, in part, as the text of the proposed regulations (REG–148568–04) set forth in this issue of the Bulletin. In addition to the provisions contained in these temporary regulations related to the Form 944 Program, the proposed regulations provide a modification to the *de minimis* deposit rule applicable to quarterly return filers.

DATES: *Effective Date:* These regulations are effective as of January 1, 2006.

Applicability Date: These regulations apply with respect to taxable years beginning on or after January 1, 2006. The applicability of §§31.6011–1T, 31.6011–4T, and 31.6302–1T will expire on or before December 30, 2009.

FOR FURTHER INFORMATION CONTACT: Raymond Bailey, (202) 622–4910 (filing requirements under section 6011), or Audra Dineen, (202) 622–4940 (deposit requirements under section 6302) (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

These temporary regulations amend the Regulations on Employment Taxes and Collection of Income Tax at Source (26 CFR part 31) under section 6011 relating to the Federal employment tax return filing requirements and section 6302 relating to the employment tax deposit requirements.

Section 31.6011(a)–1 of the Employment Tax Regulations provides rules requiring employers to file returns quarterly to report FICA taxes. Section 31.6011(a)–4 of the Employment Tax Regulations requires that every person required to make a return of income tax

withheld from wages pursuant to section 3402 shall make a return quarterly. Under these existing regulations, employers must file Form 941, "*Employer's Quarterly Federal Tax Return*," each quarter reporting FICA taxes and income tax withheld. Certain employers, however, file returns reporting FICA and income tax withheld annually, such as agricultural employers who file Form 943, "*Employer's Annual Federal Tax Return for Agricultural Employees*." §31.6011(a)–4(a)(3). Existing regulations also provide certain exceptions to the quarterly filing requirement for wages paid for domestic service.

Section 31.6302–1 of the Employment Tax Regulations provides rules for employers to make deposits of employment taxes. Under these rules, deposits of employment taxes reported on Form 941 are generally made either monthly or semi-weekly. In order for an employer to determine its status as a monthly or semi-weekly depositor, an employer determines the aggregate amount of employment taxes reported in the 12-month period ending the preceding June 30 (the lookback period). New employers are treated as having an employment tax liability of zero for any part of the lookback period before the date they started or acquired their business. All employers are subject to a "One-Day rule" requiring employment taxes to be deposited on the next banking day if the employer has accumulated $100,000 or more of employment taxes. If an employer fails to make timely deposits of employment taxes, then, absent reasonable cause, the employer will be subject to a penalty for failure to deposit under section 6656.

Section 31.6302–1(f)(4) (the *de minimis* deposit rule) provides that for quarterly and annual return periods, if the total amount of employment taxes for the return period is less than $2,500 and that amount is deposited or remitted with a timely filed return for that return period, the amount will be deemed to have been timely deposited. Under existing regulations, employers who file annual employment tax returns (such as Form 943 for agricultural workers) are required to deposit employment taxes at least monthly if their annual employment tax liability equals or exceeds the *de minimis* deposit rule amount of $2,500.

The purpose of these temporary regulations is to generally require employers who receive written notification of their qualification for the Form 944 Program to file an annual employment tax return, Form 944, rather than the quarterly Form 941 return. For these employers, Form 944 will replace Form 941. Form 944 will not replace Form 943 for agricultural employers or Schedule H, Form 1040, for employers with only household employees. Notwithstanding notification from the IRS of qualification for the Form 944 Program, employers who prefer to file Form 941 may be eligible to do so if they timely contact the IRS and satisfy one of the following two conditions: 1) the employer notifies the IRS of its preference to electronically file Forms 941 quarterly in lieu of filing Form 944 annually, or 2) the employer notifies the IRS that it anticipates its annual employment tax liability will exceed $1,000. Employers otherwise meeting the criteria of the Form 944 Program will be permitted to file Form 941 only if they receive written notification from the IRS that their filing requirement has been changed to Form 941.

Under these temporary regulations, most employers who file Form 944 will be able to remit employment taxes annually with their returns rather than making monthly or semi-weekly deposits. Form 944 will generally be due January 31 of the year following the year for which the return is filed. If the employer timely deposits all accumulated employment taxes on or before January 31 of the year following the year for which the return is filed, then the employer will have 10 extra calendar days to file Form 944 pursuant to §31.6071(a)–1(a).

The Form 944 Program is limited to employers meeting certain eligibility requirements described in the temporary regulations. Currently, the Form 944 Program will be limited to employers whose estimated annual employment tax liability is $1,000 or less. The IRS will send written notifications of qualification for the Form 944 Program to the employers that the IRS has estimated will have an annual employment tax liability of $1,000 or less (based on the employers' prior Form 941 reporting history). As this estimate may not reflect recent or imminent changes in an employer's payroll, employers receiving notices may contact the IRS to discuss their qualification if they anticipate that their annual employment tax liability will exceed $1,000. In addition, employers who do not receive a notice may contact the IRS to request to be in the Form 944 Program if they anticipate that their annual employment tax liability will be $1,000 or less. New employers will receive notification of qualification for the Form 944 Program if they notify the IRS that they anticipate their annual employment tax liability will be $1,000 or less. For example, new employers can indicate their estimated employment tax liability on their Form SS–4, *Application for Employer Identification Number*. The IRS and Treasury Department are considering expanding the Form 944 Program in the future and seek comments on the eligibility requirements and how best to change them.

If an employer is required to file Form 944 to report its employment tax liability for the current calendar year, the employer must file Form 944 even if the employer's actual employment tax liability for the current year exceeds the eligibility requirement threshold ($1,000 under these regulations). If the Form 944 shows that the employer's employment tax liability exceeds the eligibility threshold, then the employer will be required to file Form 941 to report its employment tax liability in the future. The IRS will send written notification to the employer that the employer's filing requirement has changed.

For employers in the Form 944 Program during the current or previous calendar year, the temporary regulations also modify the lookback period for determining whether an employer is a monthly or semi-weekly depositor. This change is necessary because once an employer begins to file annual Form 944 returns, it may not be possible to determine the employer's aggregate amount of employment tax liability during the lookback period set forth in the existing regulations (12-month period ending the preceding June 30). In the event that an employer exceeds the *de minimis* deposit amount, that employer will need to determine whether it is a monthly or semi-weekly depositor. Consequently, these temporary regulations change the lookback period for employers in the Form 944 Program during the current, or preceding, calendar year. With respect to those employers, the lookback period is the second calendar year preceding the current calendar year. For example, the

lookback period for calendar year 2007 is calendar year 2005.

These temporary regulations also modify the *de minimis* deposit rules in certain situations to accommodate employers in the Form 944 Program during the current, or preceding, calendar year. These modifications are designed to assist employers who qualified for the Form 944 Program because their annual employment tax liability satisfied the eligibility requirements ($1,000 or less), but ultimately had a total employment tax liability for the year exceeding the *de minimis* deposit amount ($2,500 under existing regulations). The deposit rules in §31.6302–1, including the *de minimis* deposit rule in §31.6302–1(f)(4), apply to employers who file Form 944. Therefore, these employers will not have to make deposits and can pay their employment tax liability when they timely file their Forms 944 on or before January 31 only if their total employment tax liability for the year is less than $2,500. Under the existing *de minimis* deposit rule, if an employer's employment tax liability equals or exceeds $2,500 for the year, the employer would be required to deposit employment taxes and, absent reasonable cause, would be subject to the penalty for failure to deposit if the employer did not make timely deposits. Any employer that accumulates $100,000 or more of employment taxes is subject to the One-Day rule of §31.6302–1(c)(3), and is required to deposit those taxes on the next banking day.

To assist employers whose tax liability exceeds the *de minimis* amount while in the Form 944 Program, these regulations modify the deposit rules in two ways. First, as employers who file Form 941 quarterly would be allowed a quarterly $2,500 *de minimis* amount when they timely filed their quarterly returns instead of an annual *de minimis* amount, these regulations modify the *de minimis* deposit rule to mirror the treatment employers would have if they continued to file Form 941 quarterly instead of Form 944 annually. Thus, these regulations allow employers in the Form 944 Program to apply a quarterly *de minimis* deposit rule if they deposit the employment taxes that accumulated during a quarter by the last day of the month following the close of the quarter (the day their quarterly Forms 941 would have been due). If an employer's employment tax liability for a quarter will not be *de minimis*, then the employer should make deposits either monthly or semi-weekly, depending on their deposit schedule, to avoid being subject to the failure-to-deposit penalty.

Second, because employers may not realize their prior year's employment tax liability exceeded the eligibility requirement (currently, $1,000 or less) until they file Form 944 on January 31 of the year following the year for which the return is filed, these employers might not realize that they will be required to file Form 941 in the current year until after the date on which to timely make their January deposit obligation(s) for the current year. Therefore, these regulations allow employers who were in the Form 944 Program in the prior year to avoid a failure-to-deposit penalty during the first month they fail to deposit any required deposit(s), if they fully pay their January employment taxes by March 15 of the current year. For example, an employer who was in the Form 944 Program during 2006 and had an employment tax liability for 2006 of $4,000 would not qualify for the Form 944 Program for 2007. Under these regulations, if the employer was a monthly depositor for 2007, it would be required to deposit the employment taxes it accumulated in January 2007 by February 15, 2007. If the employer does not deposit these accumulated taxes by February 15, 2007, then it will be deemed to have timely deposited if it deposits them by March 15, 2007.

Lastly, these regulations contain final regulations that provide cross-references to the temporary regulations, correct and amend the table of contents in §31.6302–0, correct a cross-reference in §31.6302–1(e)(2), and revise the regulations under section 6302 to remove all references to an IRS district director, a position that no longer exists in the IRS.

These temporary regulations are part of the IRS's effort to reduce taxpayer burden by requiring certain employers to file employment tax returns annually rather than quarterly and allowing them, in most circumstances, to remit employment taxes annually with their return. By reducing the number of returns employers are required to file per year, the IRS will reduce each eligible employer's burden.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act, please refer to the Special Analyses section of the preamble to the cross-referenced notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these final and temporary regulations are Raymond Bailey, Audra M. Dineen, and Emly B. Berndt of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 31 are to be amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Sections 1.6302–1 and 1.6302–2 are amended as follows:

Section	*Remove*	*Add*
1.6302–1(c) third sentence	to the district director (or director of a service center)	
1.6302–1(c) fourth sentence	the district director or director of a service center with	
1.6302–2(b)(6) last sentence	to the district director or director of a service center	

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

Par. 3. The authority citation for part 31 continues to read, in part, as follows:

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

Par. 4. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Section	*Remove*	*Add*
31.6302–1(e)(2) first sentence	§31.6011(a)(4) or (5)	§31.6011(a)–4 or §31.6011(a)–5
31.6302–1(k)(1) first sentence	District Director notice	Notice
31.6302–1(k)(1) first sentence	from the district director	
31.6302–1(k)(1) first sentence, second parenthetical	district director	Commissioner
31.6302(c)–1(a)(3) last sentence	to the district director or director of a service center	
31.6302(c)–1(b)(1) first sentence	from the district director	
31.6302(c)–1(b)(1) first sentence, third parenthetical	by the district director	
31.6302(c)–2(c) last sentence	to the district director or director of a service center	
31.6302(c)–3(b)(4) last sentence	to the district director or director of a service center	

Par. 5. Section 31.6011(a)–1 is amended by adding paragraph (a)(5) to read as follows:

§31.6011(a)–1 Returns under Federal Insurance Contributions Act.

(a) * * *

(5) [Reserved]. For further guidance, see §31.6011(a)–1T(a)(5).

* * * * *

Par. 6. Section 31.6011(a)–1T is added to read as follows:

§31.6011(a)–1T Returns under Federal Insurance Contributions Act (temporary).

(a)(1) through (a)(4) [Reserved]. For further guidance, see §31.6011(a)–1(a)(1) through (a)(4).

(5) *Employers in the Employers' Annual Federal Tax Program (Form 944)*—(i) *In general*. For taxable years beginning on or after January 1, 2006, employers notified of their qualification for the Employers' Annual Federal Tax Program (Form 944) are required to file Form 944, "*Employer's Annual Federal Tax Return*." The Internal Revenue Service (IRS) will notify employers in writing of their qualification for the Employers' Annual Federal Tax Program (Form 944). For provisions relating to the time and place for filing returns, see §§31.6071(a)–1 and 31.6091–1, respectively.

(ii) *Qualification for the Employers' Annual Federal Tax Program (Form 944)*. The IRS will send notifications of qualification for the Employers' Annual Federal Tax Program (Form 944) to employers with an estimated annual employment tax liability of $1,000 or less. New employ-

ers who timely notify the IRS that they anticipate their estimated annual employment tax liability to be $1,000 or less will be notified of their qualification for the Employers' Annual Federal Tax Program (Form 944). If an employer in the Employers' Annual Federal Tax Program (Form 944) reports an annual employment tax liability of more than $1,000, the IRS will notify the employer that the employer's filing status has changed and the employer will be required to file the quarterly Form 941 for succeeding tax years.

(iii) *Exception to qualification for the Employers' Annual Federal Tax Program (Form 944).* Notwithstanding notification by the IRS of qualification for the Employers' Annual Federal Tax Program (Form 944), an employer may file Form 941 if—

(A) One of the following conditions applies—

(*1*) The employer anticipates that its annual employment tax liability will exceed $1,000, or

(*2*) The employer prefers to electronically file Forms 941 quarterly in lieu of filing Form 944 annually;

(B) The employer contacts the IRS, pursuant to the instructions in the IRS' written notification, to request to file Form 941; and

(C) The IRS sends the employer a written notification that the employer's filing requirement has been changed to Form 941.

(b) through (f) [Reserved]. For further guidance, see §31.6011(a)–1(b) through (f).

Par. 7. Section 31.6011(a)–4 is amended by adding paragraph (a)(4) to read as follows:

§31.6011(a)–4 Returns of income tax withheld.

(a) * * *

(4) [Reserved]. For further guidance, see §31.6011(a)–4T(a)(4).

* * * * *

Par. 8. Section 31.6011(a)–4T is added to read as follows:

§31.6011(a)–4T Returns of income tax withheld (temporary).

(a)(1) through (a)(3) [Reserved]. For further guidance, see §31.6011(a)–4(a)(1) through (a)(3).

(4) *Employers in the Employers' Annual Federal Tax Program (Form 944)*—(i) *In general.* For taxable years beginning on or after January 1, 2006, employers notified of their qualification for the Employers' Annual Federal Tax Program (Form 944) are required to file a Form 944, "*Employer's Annual Federal Tax Return*." The Internal Revenue Service (IRS) will notify employers in writing of their qualification for the Employers' Annual Federal Tax Program (Form 944). For provisions relating to the time and place for filing returns, see §§31.6071(a)–1 and 31.6091–1, respectively.

(ii) *Qualification for the Employers' Annual Federal Tax Program (Form 944).* The IRS will send notifications of qualification for the Employers' Annual Federal Tax Program (Form 944) to employers with an estimated annual employment tax liability of $1,000 or less. New employers who timely notify the IRS that they anticipate their estimated annual employment tax liability to be $1,000 or less will be notified of their qualification for the Employers' Annual Federal Tax Program (Form 944). If an employer in the Employers' Annual Federal Tax Program (Form 944) reports an annual employment tax liability of more than $1,000, the IRS will notify the employer that the employer's filing status has changed and that the employer will be required to file the quarterly Form 941 for succeeding tax years.

(iii) *Exception to qualification for the Employers' Annual Federal Tax Program (Form 944).* Notwithstanding notification by the IRS of qualification for the Employers' Annual Federal Tax Program (Form 944), an employer may file Form 941 if—

(A) One of the following conditions applies—

(*1*) The employer anticipates that its annual employment tax liability will exceed $1,000, or

(*2*) The employer prefers to electronically file Forms 941 quarterly in lieu of filing Form 944 annually;

(B) The employer contacts the IRS, pursuant to the instructions in the IRS' written notification, to request to file Form 941; and

(C) The IRS sends the employer a written notification that the employer's filing requirement has been changed to Form 941.

(b) through (c) [Reserved]. For further guidance, see §31.6011(a)–4(b) through (c).

Par. 9. In §31.6071(a)–1, the first sentence in paragraph (a)(1) is revised to read as follows:

§31.6071(a)–1 Time for filing returns and other documents.

(a) * * *

(1) *Quarterly or annual returns.* Except as provided in subparagraph (4) of this paragraph, each return required to be made under §§31.6011(a)–1 and 31.6011(a)–1T, in respect of the taxes imposed by the Federal Insurance Contributions Act (26 U.S.C. §§3101–3128), or required to be made under §§31.6011(a)–4 and 31.6011(a)–4T, in respect of income tax withheld, shall be filed on or before the last day of the first calendar month following the period for which it is made. * * *

* * * * *

Par. 10. Section 31.6302–0 is amended by:

1. Adding new entries for §31.6302–1(b)(4), (c)(5) and (6), (d), (f)(4), and (f)(5).

2. Removing the entries for §31.6302–1(b)(5) and (i).

3. Redesignating the entries for §31.6302–1(h), (j), (k), and (m) as (i), (k), (m), and (n), respectively.

4. Adding new entries for §31.6302–1(h) and (j).

5. Revising the entry for newly designated §31.6302–1(k)(1).

6. Adding entries for §31.6302–1T.

The revision and additions read as follows:

§31.6302–0 Table of contents.

* * * * *

Section 31.6302–1 Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.

* * * * *

(b) * * *

(4) Lookback period.

(i) [Reserved].

(ii) [Reserved].

(c) * * *

(5) [Reserved].

(6) [Reserved].

(d) * * *

Example 6 [Reserved].

* * * * *

(f) * * *

(4) *De minimis* rule.

(i) *De minimis* deposit rule for quarterly and annual return periods beginning on or after January 1, 2001.

(ii) [Reserved].

(iii) [Reserved].

(5) * * *

Example 3. [Reserved].

* * * * *

(h) Time and manner of deposit — deposits required to be made by electronic funds transfer.

(1) In general.

(2) Applicability of requirement.

(i) Deposits for return periods beginning before January 1, 2000.

(ii) Deposits for return periods beginning after December 31, 1999.

(iii) Voluntary deposits.

(3) Taxes required to be deposited by electronic funds transfer.

(4) Definitions.

(i) Electronic funds transfer.

(ii) Taxpayer.

(5) Exemptions.

(6) Separation of deposits.

(7) Payment of balance due.

(8) Time deemed deposited.

(9) Time deemed paid.

* * * * *

(j) Voluntary payments by electronic funds transfer.

(k) * * *

(1) Notice exception.

* * * * *

Section 31.6302–1T Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992 (temporary).

(a) through (b)(4)(ii) [Reserved].

(b)(4)(i) In general.

(ii) Adjustments.

(c)(1) through (c)(4) [Reserved].

(c)(5) Exception to the monthly and semi-weekly deposit rules for employers in the Employers' Annual Federal Tax Program (Form 944).

(c)(6) Extension of time to deposit rule for employers in the Employers' Annual Federal Tax Program (Form 944) during the preceding year.

(d) *Examples 1* through *5* [Reserved].

Example 6. Extension of time to deposit rule for employers in the Employers' Annual Federal Tax Program (Form 944) during the preceding year satisfied.

(e) through (f)(4)(ii) [Reserved].

(f)(4)(iii) *De minimis* deposit rule for employers currently in the Employers' Annual Federal Tax Program (Form 944).

(f)(5) *Examples 1* and *2* [Reserved].

Example 3. *De minimis* deposit rule for employers currently in the Employers' Annual Federal Tax Program (Form 944) satisfied.

(g) through (n) [Reserved].

Par. 11. Section 31.6302–1 is amended by:

1. Revising paragraph (b)(4).

2. Adding paragraphs (c)(5) and (6), (d) *Example 6*, and (f)(5) *Example 3*.

3. Removing paragraph (b)(5).

4. Revising paragraph (f)(4).

The revisions and additions read as follows:

§31.6302–1 Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.

* * * * *

(b) * * *

* * * * *

(4) *Lookback period*—(i) [Reserved]. For further guidance, see §31.6302–1T(b)(4)(i).

(ii) [Reserved]. For further guidance, see §31.6302–1T(b)(4)(ii).

(c) * * *

* * * * *

(5) [Reserved]. For further guidance, see §31.6302–1T(c)(5).

(6) [Reserved]. For further guidance, see §31.6302–1T(c)(6).

(d) * * *

* * * * *

Example 6. For further guidance, see §31.6302–1T(d) *Example 6*.

* * * * *

(f) * * *

* * * * *

(4) *De minimis rule*—(i) *De minimis deposit rule for quarterly and annual return periods beginning on or after January 1, 2001*. If the total amount of accumulated employment taxes for the return period is less than $2,500 and the amount is fully deposited or remitted with a timely filed return for the return period, the amount deposited or remitted will be deemed to have been timely deposited.

(ii) [Reserved].

(iii) [Reserved]. For further guidance, see §31.6302–1T(f)(4)(iii).

(5) * * *

* * * * *

Example 3. For further guidance, see §31.6302–1T(f)(5) *Example 3*.

Par. 12. Section 31.6302–1T is added to read as follows:

§31.6302–1T Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992 (temporary).

(a) through (b)(3) [Reserved]. For further guidance, see §31.6302–1(a) through (b)(3).

(4) *Lookback period*—(i) *In general*. For employers who file Form 941, the lookback period for each calendar year is the twelve month period ended the preceding June 30. For example, the lookback period for calendar year 2006 is the period July 1, 2004 to June 30, 2005. The lookback period for employers who are in the Employers' Annual Federal Tax Program (Form 944), or were in it during the previous calendar year, is the second calendar year preceding the current calendar year. For example, the lookback period for calendar year 2006 is calendar year 2004. In determining status as either a monthly or semi-weekly depositor, an employer should determine the aggregate amount of employment tax liabilities reported on its return(s) (Form 941 or Form 944) for the lookback period. New employers shall be treated as having employment tax liabilities of zero for any part of the lookback period before the date the employer started or acquired its business.

(ii) *Adjustments*. The tax liability shown on an original return for the return period shall be the amount taken into account in determining whether more than

$50,000 has been reported during the lookback period. In determining the aggregate employment taxes for each return period in a lookback period, an employer does not take into account any adjustments for the return period made on a supplemental return filed after the due date of the return. However, adjustments made on a Form 941c, *Supporting Statement To Correct Information*, attached to a Form 941 or Form 944 filed for a subsequent return period are taken into account in determining the employment tax liability for the subsequent return period.

(c)(1) through (c)(4) [Reserved]. For further guidance, see §31.6302–1(c)(1) through (c)(4).

(5) *Exception to the monthly and semi-weekly deposit rules for employers in the Employers' Annual Federal Tax Program (Form 944).* Generally, an employer in the Employers' Annual Federal Tax Program (Form 944) may remit its accumulated employment taxes with its timely filed return and is not required to deposit under either the monthly or semi-weekly rules set forth in paragraphs (c)(1) and (2) of this section. An employer in the Employers' Annual Federal Tax Program (Form 944) whose actual employment tax liability exceeds the eligibility threshold, as set forth in §31.6011(a)–1T(a)(5)(ii) and §31.6011(a)–4T(a)(4)(ii), will not qualify for this exception and should follow the deposit rules set forth in this section.

(6) *Extension of time to deposit for employers in the Employers' Annual Federal Tax Program (Form 944) during the preceding year.* An employer who was in the Employers' Annual Federal Tax Program (Form 944) in the preceding year, but who is no longer qualified because its annual employment tax liability exceeded the eligibility threshold set forth in §31.6011(a)–1T(a)(5)(ii) and §31.6011(a)–4T(a)(4)(ii) in that preceding year, is required to deposit pursuant to §31.6302–1. The employer will be deemed to have timely deposited its January deposit obligation(s) under §31.6302–1(c)(1) through (4) for the first quarter of the year in which it must file quarterly using Form 941 if the employer deposits the amount of such deposit obligation(s) by March 15 of that year.

(d) *Examples 1* through *5* [Reserved]. For further guidance, see §31.6302–1(d) *Examples 1* through *5*.

Example 6. Extension of time to deposit for employers in the Employers' Annual Federal Tax Program (Form 944) during the preceding year satisfied. F (a monthly depositor) was notified to file Form 944 to report its employment tax liabilities for the 2006 calendar year. F filed Form 944 on January 31, 2007, reporting a total employment tax liability for 2006 of $3,000. Because F's annual employment tax liability for the 2006 taxable year exceeded $1,000 (the eligibility requirement threshold), F may not file Form 944 for calendar year 2007. Based on F's liability during the lookback period (calendar year 2005, pursuant to §31.6302–1T(b)(4)(i)), F is a monthly depositor for 2007. F accumulates $1,000 in employment taxes during January 2007. Because F is a monthly depositor, F's January deposit obligation is due February 15, 2007. F does not deposit these accumulated employment taxes on February 15, 2007. F accumulates $1,500 in employment taxes during February 2007. F's February deposit is due March 15, 2007. F deposits the $2,500 of employment taxes accumulated during January and February on March 15, 2007. Pursuant to §31.6302–1T(c)(6), F will be deemed to have timely deposited the employment taxes due for January 2007, and, thus, the IRS will not impose a failure-to-deposit penalty under section 6656 for that month.

(e) through (f)(4)(ii) [Reserved]. For further guidance, see §31.6302–1(e) through (f)(4)(ii).

(iii) *De minimis deposit rule for employers currently in the Employers' Annual Federal Tax Program (Form 944).* An employer in the Employers' Annual Federal Tax Program (Form 944) whose employment tax liability for the year equals or exceeds $2,500 but whose employment tax liability for a quarter of the year is *de minimis* pursuant to §31.6302–1(f)(4)(i) will be deemed to have timely deposited the employment taxes due for that quarter if the employer fully deposits the employment taxes accumulated during the quarter by the last day of the month following the close of that quarter. Employment taxes accumulated during the fourth quarter can be either deposited by January 31 or remitted with a timely filed return for the return period.

(5) *Examples 1* and *2* [Reserved]. For further guidance, see §31.6302–1(f)(5) *Examples 1* and *2*.

Example 3. De minimis deposit rule for employers currently in the Employers' Annual Federal Tax Program (Form 944) satisfied. K (a monthly depositor) was notified to file Form 944 to report its employment tax liabilities for the 2006 calendar year. In the first quarter of 2006, K accumulates employment taxes in the amount of $1,000. On April 28, 2006, K deposits the $1,000 of employment taxes accumulated in the 1st quarter. K accumulates another $1,000 of employment taxes during the second quarter of 2006. On July 31, 2006, K deposits the $1,000 of employment taxes accumulated in the 2nd quarter. K's business grows and accumulates $1,500 in employment taxes during the third quarter of 2006. On October 31, 2006, K deposits the $1,500 of employment taxes accumulated in the 3rd quarter. K accumulates another $2,000 in employment taxes during the fourth quarter. K files Form 944 on January 31, 2007, reporting a total employment tax liability for 2006 of $5,500 and submits a check for the remaining $2,000 of employment taxes with the return. K will be deemed to have timely deposited the employment taxes due for all of 2006, because K complied with the *de minimis* deposit rule provided in §31.6302–1T(f)(4)(iii). Therefore, the IRS will not impose a failure-to-deposit penalty under section 6656 for any month of the year. Under this *de minimis* deposit rule, as K was required to file Form 944 for calendar year 2006, if K's employment tax liability for a quarter is *de minimis*, then K may deposit that quarter's liability by the last day of the month following the close of the quarter. This new *de minimis* rule allows K to have the benefit of the same quarterly *de minimis* amount K would have received if K filed Form 941 each quarter instead of Form 944 annually. Thus, as K's employment tax liability for each quarter was *de minimis*, K could deposit quarterly.

(g) through (n) [Reserved]. For further guidance, see §31.6302–1(g) through (n).

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

Approved December 8, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary for Tax Policy.

(Filed by the Office of the Federal Register on December 30, 2005, 8:45 a.m., and published in the issue of the Federal Register for January 3, 2006, 71 F.R. 11)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2006. See Rev. Rul. 2006-7, page 399.

Section 7874.—Rules Relating to Expatriated Entities and Their Foreign Parents

26 CFR 1.7874–1T: Disregard of affiliate-owned stock (temporary).

T.D. 9238

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Guidance Under Section 7874 for Determining Ownership by Former Shareholders or Partners of Domestic Entities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 7874 of the Internal Revenue Code (Code) relating to the disregard of certain affiliate-owned stock in determining whether a corporation is a surrogate foreign corporation under section 7874(a)(2)(B) of the Code. The text of the temporary regulations also serves as the text of the proposed regulations (REG–143244–05) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective December 28, 2005.

Applicability Date: For the date of applicability, see §1.7874–1T(e).

FOR FURTHER INFORMATION CONTACT: Jefferson Vanderwolk, 202–622–3800 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains temporary amendments to 26 CFR part 1 under section 7874 of the Code relating to the determination of the percentage of stock in a foreign corporation held by former shareholders or partners of a domestic corporation or partnership (domestic entity) by reason of holding stock or a partnership interest in the domestic entity, for purposes of determining whether the foreign corporation is a surrogate foreign corporation under section 7874(a)(2)(B).

Section 7874 provides rules for expatriated entities and their surrogate foreign corporations. An expatriated entity is defined in section 7874(a)(2)(A) as a domestic corporation or partnership with respect to which a foreign corporation is a surrogate foreign corporation and any U.S. person related (within the meaning of section 267(b) or 707(b)(1)) to such domestic corporation or partnership. Generally, a foreign corporation is a surrogate foreign corporation under section 7874(a)(2)(B), if, pursuant to a plan or a series of related transactions:

(i) The foreign corporation directly or indirectly acquires substantially all the properties held directly or indirectly by a domestic corporation, or substantially all the properties constituting a trade or business of a domestic partnership;

(ii) After the acquisition at least 60 percent of the stock (by vote or value) of the foreign corporation is held by (in the case of an acquisition with respect to a domestic corporation) former shareholders of the domestic corporation by reason of holding stock in the domestic corporation, or (in the case of an acquisition with respect to a domestic partnership) by former partners of the domestic partnership by reason of holding a capital or profits interest in the domestic partnership (ownership percentage test); and

(iii) The expanded affiliated group that includes the foreign corporation does not have business activities in the foreign country in which the foreign corporation was created or organized that are substantial when compared to the total business activities of such group.

The tax treatment of expatriated entities and surrogate foreign corporations varies depending on the level of owner continuity. If the percentage of stock (by vote or value) in the surrogate foreign corporation held by former owners of the domestic entity by reason of holding an interest in the domestic entity is 80 percent or more, the surrogate foreign corporation is treated as a domestic corporation for all purposes of the Code. If such ownership percentage is 60 percent or more (but less than 80 percent) by vote or value, the surrogate foreign corporation is treated as a foreign corporation but any applicable corporate-level income or gain required to be recognized by the expatriated entity under section 304, 311(b), 367, 1001, 1248 or any other applicable provision with respect to the transfer or license of property (other than inventory or similar property) cannot be offset by net operating losses or credits (other than credits allowed under section 901). This treatment of an expatriated entity generally applies from the first date properties are acquired pursuant to the plan through the end of the 10-year period following the completion of the acquisition.

Section 7874(c)(2) provides that stock held by members of the expanded affiliated group which includes the foreign corporation is not taken into account for purposes of the ownership percentage test (affiliate-owned stock rule). Section 7874(c)(1) defines the term *expanded affiliated group* as an affiliated group defined in section 1504(a) but without regard to the exclusion of foreign corporations in section 1504(b)(3) and with a reduction of the 80 percent ownership threshold of section 1504(a) to a more-than-50 percent threshold.

The statute provides the Secretary of the Treasury significant regulatory authority. Section 7874(c)(6) authorizes the Secretary of the Treasury to prescribe such regulations as may be appropriate to determine whether a corporation is a surrogate foreign corporation, including regulations to treat warrants, options, contracts to acquire stock, convertible debt interests, and other similar interests as stock, and to treat stock as not stock. Section 7874(g) authorizes the Secretary of the Treasury to provide such regulations as are necessary to carry out the section.

The legislative history of section 7874 indicates that it was intended to apply to so-called inversion transactions in which a U.S. parent corporation of a multinational corporate group is replaced by a foreign parent corporation without significant change in the ultimate ownership of the group. See H.R. Conf. Rep. No. 108–755, 108th Cong., 2d Sess., at 568 (Oct. 7, 2004). The statute was also intended to apply to similar transactions in which a trade or business of a domestic partnership is transferred to a foreign corporation at least 60 percent of which is owned by former partners.

A key feature of section 7874 is the affiliate-owned stock rule. Congress intended to accomplish two main objectives with this rule. See Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress*, at 344. First, Congress intended that the ownership percentage test should be applied to prevent avoidance of the provisions when they otherwise should apply, including situations involving the use of so-called *hook stock*. In this context, hook stock is stock of the acquiring foreign corporation held by an entity that is at least 50 percent owned (by vote or value) directly or indirectly by the acquiring foreign corporation. If hook stock were respected as stock of the foreign corporation for purposes of section 7874(a)(2)(B)(ii), a taxpayer might implement an inversion and take the position that section 7874 was not applicable by ensuring that hook stock accounted for over 40 percent of the value and voting power of the foreign corporation's stock.

Second, Congress intended that the affiliate-owned stock rule could operate in specified situations to prevent the section from applying to certain transactions occurring within a group of corporations owned by the same common parent corporation before and after the transaction, such as the conversion of a wholly owned domestic subsidiary into a new wholly owned controlled foreign corporation. *Id*. In the absence of this rule, section 7874 could apply to internal group restructuring transactions involving the transfer of a wholly owned domestic corporation (or its assets) to a wholly owned foreign corporation, without a change in the parent corporation of the group.

The IRS and Treasury Department have concluded that the affiliate-owned stock rule should not operate in a manner that allows the avoidance of section 7874 in situations where it should apply. For example, the affiliate-owned stock rule should prevent the use of hook stock to avoid section 7874. On the other hand, the IRS and Treasury Department have also concluded that the rule should not operate in a manner that would result in section 7874 applying to certain types of transactions that are outside the intended scope of the section. For example, the type of concerns that Congress meant to address in enacting section 7874 do not result from certain internal group restructuring transactions involving the transfer to a foreign corporation of the stock or assets of a domestic corporation where minority shareholders have a relatively small percentage interest in such stock or assets before and after the transaction.

In addition, the IRS and Treasury Department believe that the affiliate-owned stock rule was not intended to cause section 7874 to apply to certain acquisitive business transactions, such as the acquisition of stock or assets of a domestic corporation by an unrelated foreign corporation where after the acquisition the former owners of the domestic entity do not own more than 50 percent (by vote or value) of the stock of any member of the expanded affiliate group. For example, the contribution of a domestic entity or its assets to a foreign joint venture corporation in exchange for a minority interest in the joint venture corporation should not result in the joint venture corporation's being treated, for purposes of the ownership percentage test, as wholly owned by the former owners of the domestic entity by operation of the affiliate-owned stock rule. In contrast, section 7874 may properly apply to the acquisition of an existing domestic joint venture entity by a foreign corporation which is at least 60 percent owned, after the acquisition, by the former owners of the acquired domestic entity. Congress intended the section to apply to transactions (other than internal group restructurings, as discussed previously) that effectively replace a domestic corporation or partnership with a foreign corporation at least 60 percent of which is held by former owners of the domestic entity.

Explanation of Provisions

The IRS and Treasury Department believe that guidance is necessary to ensure that the affiliate-owned stock rule cannot be used to avoid the application of section 7874, through the use of hook stock or otherwise, where that provision should apply. However, the IRS and Treasury Department also believe that guidance is needed to make sure that this test does not apply to certain transactions that are properly viewed as outside the scope of section 7874. Consequently, clarification is needed with respect to the application of the affiliate-owned stock rule.

The temporary regulation provides, as a general rule, that affiliate-owned stock is excluded from both the numerator and the denominator of the fraction that determines the stock ownership percentage for purposes of section 7874(a)(2)(B)(ii). This rule prevents the use of hook stock (and similar techniques) as means to remove an otherwise covered transaction from the scope of section 7874.

The temporary regulation also provides limited exceptions to the general rule pursuant to which affiliate-owned stock (other than hook stock) is included in the denominator of the fraction that determines the stock ownership percentage for purposes of section 7874(a)(2)(B)(ii) but is excluded from the numerator of that fraction. These exceptions are necessary to prevent section 7874 from applying to (1) certain transactions occurring as part of an internal group restructuring involving a domestic entity; and (2) certain acquisitive business transactions between unrelated parties where the former shareholders or partners of the domestic entity have a minority interest in the acquired properties after the acquisition.

With respect to internal group restructurings, the special rule applies where the common parent corporation owns directly or indirectly at least 80 percent of the domestic entity before the transaction, and continuing owners that are not members of the expanded affiliated group hold no more than 20 percent of the stock of the acquiring foreign corporation after the transaction.

With respect to transactions between unrelated parties, the special rule applies to the acquisition of a domestic entity or its assets by a foreign corporation where, after the acquisition, the former owners of the domestic entity do not own, in the aggregate, directly or indirectly, more than 50 percent of the stock (by vote or value) of any member of the expanded affiliated group that includes the acquiring foreign corporation.

The temporary regulation also provides a rule that prevents hook stock from being taken into account for purposes of (1) determining the percentage of ownership of an entity for purposes of determining whether the special rule is applicable; and (2) the application of the special rule itself.

The IRS and Treasury Department decided it was important to issue these regu-

lations to deal with affiliate-owned stock as soon as possible. As a result, these temporary regulations are being published without further delay and with the same effective date as section 7874, which applies for taxable years ending after March 4, 2003.

Request for Comments

The IRS and Treasury Department identified internal restructurings and acquisitions by unrelated parties as categories of transactions requiring a special rule regarding affiliate-owned stock in order to prevent unintended consequences under section 7874. Comments are requested as to any other categories of transactions that may give rise to unintended consequences under section 7874 and these regulations.

The IRS and Treasury Department are considering issuing subsequent public guidance that addresses additional issues under section 7874. This guidance may address issues related to (1) the determination of whether there has been a direct or indirect acquisition of substantially all the properties held directly or indirectly by a domestic corporation or substantially all the properties constituting a trade or business of a domestic partnership; (2) the requirement that such acquisition be pursuant to a plan or a series of related transactions; (3) the requirement, in the ownership percentage test, that ownership of stock be by reason of holding an interest in the domestic corporation or partnership; (4) the treatment of stock sold in a public offering that is related to the acquisition; (5) the requirement that the group's activities in the relevant foreign country are insubstantial when compared to the group's total business activities; (6) whether and to what extent options on stock and other similar interests are treated as stock for the purpose of determining whether a corporation is a surrogate foreign corporation; (7) the disregard of transfers of properties or liabilities if the transfers are part of a plan a principal purpose of which is to avoid the purposes of section 7874; and (8) any adjustments to the application of the section that are necessary to carry out its purposes, including adjustments necessary to prevent avoidance. The IRS and Treasury Department specifically request comments regarding appropriate rules in relation to these and other issues arising under section 7874.

The IRS and Treasury Department also are considering possible changes to §1.367(a)–3(c), which governs the tax consequences at the shareholder level of certain transactions similar to those addressed by section 7874, in light of the enactment of section 7874. Comments are requested in this regard.

Regulations Addressing Avoidance of the Purposes of Section 7874

The IRS and Treasury Department understand that taxpayers are implementing structures that result in the same overall tax consequences as structures that Congress intended to be subject to section 7874, but taxpayers are taking the position these structures are not within the scope of section 7874. For example, the IRS and Treasury Department understand that the shareholders (or partners) of a domestic corporation (or domestic partnership) may arrange to transfer their shares (or partnership interests) to a newly-formed foreign entity for which an entity classification election under Treasury regulation §301.7701–3 is made to treat such entity as a foreign partnership for Federal tax purposes. Taxpayers may take the position that these transactions are not subject to section 7874 because the foreign entity is not a foreign corporation for Federal tax purposes and thus is not a surrogate foreign corporation under section 7874(a)(2)(B). In some cases, taxpayers further take the position that the foreign entity, the interests in which are publicly traded, is treated as a partnership for Federal tax purposes.

The IRS and Treasury Department believe that such structures have the effect of inversion transactions. Section 7874(g) grants broad regulatory authority to make adjustments to the application of section 7874 to prevent the avoidance of the purpose of section 7874 through the use of non-corporate entities or other intermediaries. In addition, sections 7805(b)(2) and (3) provide exceptions in certain situations to the general prohibition against the issuance of retroactive regulations found in section 7805(b)(1). Accordingly, the IRS and Treasury Department are considering issuing regulations, which may be retroactive, addressing these structures. The IRS and Treasury Department specifically request comments regarding appropriate rules in relation to these and other uses of intermediary entities (and other techniques, including the use of exchangeable shares) to avoid the purpose of section 7874.

Effective Date

Section 1.7874–1T applies to taxable years ending after March 4, 2003.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f), this Treasury decision will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of this regulation is Jefferson VanderWolk, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in its development.

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Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.7874–1T also issued under 26 U.S.C. 7874(c)(6) and (g).

Par. 2. Section 1.7874–1T is added to read as follows:

§1.7874–1T Disregard of affiliate-owned stock (temporary).

(a) *Scope*. Section 7874(c)(2)(A) provides that stock of the foreign corporation referred to in section 7874(a)(2)(B) held by members of the expanded affiliated group that includes such foreign corporation (the EAG) shall not be taken into account in determining, for purposes of section 7874(a)(2)(B)(ii), the percentage of stock in such foreign corporation held, after the acquisition, by former shareholders or partners of the domestic corporation or partnership referred to in section 7874(a)(2)(B)(i) (the domestic entity) by reason of having held stock or a partnership interest in the domestic entity. This section provides rules under section 7874(c)(2)(A).

(b) *General rule*. Except as provided in paragraph (c) of this section, for purposes of the ownership percentage determination required by section 7874(a)(2)(B)(ii), stock held by one or more members of the EAG is not included in either the numerator or the denominator of the fraction that determines such percentage. For purposes of this §1.7874–1T, stock held by a partnership shall be considered as held proportionately by its partners.

(c) *Special rules*. For purposes of the ownership percentage determination required by section 7874(a)(2)(B)(ii), stock held by one or more members of the EAG shall be included in the denominator, but not in the numerator, of the fraction that determines the percentage if—

(1) (i) Before the acquisition, 80 percent or more of the stock (by vote or value) or the capital or profits interest in the domestic entity was owned directly or indirectly by the corporation that is the common parent of the EAG after the acquisition; and

(ii) After the acquisition, stock held by non-members of the EAG by reason of holding stock or a capital or profits interest in the domestic entity, if any, does not exceed 20 percent of the stock (by vote or value) of the foreign corporation; or

(2) After the acquisition, the former shareholders or partners of the domestic entity do not own, in the aggregate, directly or indirectly, more than 50 percent of the stock (by vote or value) of any member of the EAG.

(d) *Disregard of subsidiary-owned interests*. Stock or partnership interests owned by an entity in which at least 50 percent of the stock (by vote or value), or at least 50 percent of the capital or profits interest, is owned directly or indirectly by the issuer of such stock or by the partnership in question shall not be taken into account for purposes of—

(1) Determining the percentage of ownership of an entity under paragraphs (c)(1) and (c)(2) of this section; or

(2) Treating stock held by one or more members of the EAG as included in the denominator but not in the numerator under paragraph (c) of this section.

(e) *Examples*. The application of this section is illustrated by the following examples. It is assumed that all transactions in the examples occur after March 4, 2003. In all the examples, *the EAG* means the expanded affiliated group which includes the foreign corporation that has completed the direct or indirect acquisition referred to in section 7874(a)(2)(B)(i). In all the examples, if an entity or other person is not described as either domestic or foreign, it may be either domestic or foreign. The analysis of the following examples is limited to a discussion of issues under section 7874, even though the examples may raise other issues (for example, under section 367).

Example 1. Disregard of hook stock—(i) *Facts*. A is a domestic corporation with 100 shares of a single class of common stock outstanding. A's stock is held by a group of individuals. Pursuant to a plan, A forms F, a foreign corporation, and transfers to F the stock of several wholly owned foreign subsidiaries, in exchange for 90 shares of F stock. F then forms Merger Sub, a domestic corporation. Under a merger agreement and state law, Merger Sub merges into A, with A surviving the merger as a subsidiary of F. In exchange for their A stock, the former shareholders of A receive, in the aggregate, 100 shares of F stock. A continues to hold 90 shares of F stock.

(ii) *Analysis*. F has indirectly acquired substantially all the properties of A pursuant to a plan. After the acquisition, the former shareholders of A own 100 shares of F stock by reason of holding stock in A, and A owns 90 shares of F stock. Under paragraph (b) of this section, the 90 shares of F stock held by A, a member of the EAG, are not included in either the numerator or the denominator of the fraction that determines the percentage of F stock owned by former shareholders of A by reason of holding stock in A. Accordingly, the fraction is 100/100 and the percentage is 100%. If the condition stated in section 7874(a)(2)(B)(iii) regarding relatively insubstantial business activities in F's country of incorporation is satisfied, F is a surrogate foreign corporation which is treated as a domestic corporation under section 7874(b).

Example 2. Intra-group restructuring; wholly owned corporation—(i) *Facts*. USS, a domestic corporation, has 100 shares of common stock outstanding, all of which are owned by P, a corporation. As part of an internal restructuring within the P group, USS transfers all its assets to FS, a newly formed foreign corporation, in exchange for stock of FS, in a reorganization described in section 368(a)(1)(F). P exchanges its USS stock for FS stock under section 354.

(ii) *Analysis*. FS has acquired substantially all the properties held directly or indirectly by USS pursuant to a plan. P, the common parent of the EAG, held more than 80% of the stock of USS before the acquisition. After the acquisition, less than 20% of FS's stock is owned by non-members of the EAG. Under paragraph (c)(1) of this section, the FS stock owned by P by reason of holding stock in USS is included in the denominator but not in the numerator of the fraction that determines the percentage of FS stock owned by former shareholders of USS by reason of holding stock in USS. Accordingly, the fraction is 0/100 and the percentage is 0%. FS is not a surrogate foreign corporation.

Example 3. Intra-group restructuring; wholly owned corporation—(i) *Facts*. The facts are the same as in *Example 2* except that USS does not transfer any of its assets. P transfers all 100 shares of USS stock to FS in exchange for FS stock.

(ii) *Analysis*. FS has indirectly acquired substantially all the properties held directly or indirectly by USS pursuant to a plan. P, the common parent of the EAG, held more than 80% of the stock of USS before the acquisition. After the acquisition, less than 20% of FS's stock is owned by non-members of the EAG. Under paragraph (c)(1) of this section, the FS stock owned by P by reason of holding stock in USS is included in the denominator but not in the numerator of the fraction that determines the percentage of stock owned by former shareholders of USS by reason of holding stock in USS. Accordingly, the fraction is 0/100 and the percentage is 0%. FS is not a surrogate foreign corporation.

Example 4. Intra-group restructuring; less than wholly owned corporation—(i) *Facts*. The facts are the same as in *Example 2* except that P owns 85 shares of USS stock. The remaining 15 shares of USS stock are owned by A, a person unrelated to P. As part of an internal restructuring within the P group, P and A transfer all their USS stock to FS, in exchange for an equal number of shares of FS stock.

(ii) *Analysis*. FS has indirectly acquired substantially all the properties held directly or indirectly by USS pursuant to a plan. After the acquisition, P owns 85 shares of FS stock by reason of holding stock in USS, and A owns 15 shares of FS stock by reason of holding stock in USS. Before the acquisition, USS was more than 80% owned by P, which is the common parent of the EAG, and after the acquisition, less than 20% of FS's stock is owned by non-members of the EAG (*i.e.*, by A) by reason of holding stock in USS. Under paragraph (c)(1) of this section, the FS stock owned by P is included in the denominator, but is not included in the numerator, of the fraction that determines the percentage of FS stock owned by former shareholders of USS by reason of holding stock in USS. Accordingly, the fraction is 15/100 and the percentage is 15%. FS is not a surrogate foreign corporation. FS is a controlled foreign corporation.

Example 5. Formation of joint venture corporation—(i) *Facts*. M, a corporation, owns all the out-

standing stock of S, a domestic corporation engaged in business Y in the United States. B, a corporation unrelated to M, owns several foreign subsidiaries that are engaged in business Y outside the United States. M and B enter into an agreement under which each will transfer certain assets to FJV, a newly formed foreign corporation, in exchange for stock of FJV. FJV will conduct business Y on a worldwide basis. Pursuant to the plan, M transfers to FJV all the outstanding stock of S in exchange for 40 shares of FJV stock, and B transfers to FJV the stock of several foreign corporations in exchange for 60 shares of FJV stock. FJV has no other stock outstanding.

(ii) *Analysis*. FJV has indirectly acquired substantially all the properties held directly or indirectly by S pursuant to a plan. After the acquisition, M owns 40 shares of FJV stock by reason of holding stock in S, and B owns the remaining 60 shares of FJV stock. M does not own, directly or indirectly, more than 50% of the stock of any member of the EAG. Under paragraph (c)(2) of this section, the FJV stock owned by B is included in the denominator but not the numerator of the fraction that determines the percentage of FJV stock owned by former shareholders of S by reason of holding stock in S. Accordingly, the fraction is 40/100 and the percentage is 40%. FJV is not a surrogate foreign corporation.

Example 6. Acquisition of existing joint venture entity—(i) *Facts*. K and L are unrelated corporations. T is a domestic corporation with 100 shares of stock outstanding, 55 of which are held by K and 45 of which are held by L. K and L contribute their T stock to U, a newly formed foreign corporation, in exchange for an equal number of shares of U stock.

(ii) *Analysis*. U has indirectly acquired substantially all the properties held directly or indirectly by T pursuant to a plan. After the acquisition, K owns 55 shares of U stock by reason of holding stock in T, and L owns 45 shares of U stock by reason of holding stock in T. Under paragraph (b) of this section, the U stock held by K is not included in either the numerator or the denominator of the fraction that determines the percentage of U stock owned by former shareholders of T by reason of holding stock in T. Accordingly, the fraction is 45/45 and the percentage is 100%. If the EAG does not have substantial business activities in U's country of incorporation when compared to the total business activities of the EAG, U is a surrogate foreign corporation which is treated as a domestic corporation under section 7874(b).

Example 7. Intra-group restructuring; less than wholly owned partnership—(i) *Facts*. LLC, a Delaware limited liability company engaged in the conduct of a trade or business, is 90% owned by C, a corporation, and 10% owned by D, a person unrelated to C. LLC has not elected to be treated as an association taxable as a corporation. As part of an internal restructuring within the C group, C and D transfer their interests in LLC to E, a newly formed foreign corporation, in exchange for 90 shares and 10 shares, respectively, of E's common stock, which are all of the issued and outstanding shares of E.

(ii) *Analysis*. LLC is a domestic partnership for Federal income tax purposes. E has indirectly acquired substantially all the properties constituting a trade or business of LLC pursuant to a plan. After the acquisition, C holds 90% of E's stock by reason of holding a capital or profits interest in LLC, and D holds 10% of E's stock by reason of holding a capital or profits interest in LLC. Before the acquisition, LLC is more than 80% owned by C, the common parent of the EAG, and after the acquisition, less than 20% of E's stock is owned by non-members of the EAG (that is by D) by reason of holding a capital or profits interest in LLC. Under paragraph (c)(1) of this section, the E stock held by C is included in the denominator but not the numerator of the fraction that determines the percentage of E stock owned by former partners of LLC by reason of holding an interest in LLC. Accordingly, the fraction is 10/100 and the percentage is 10%. E is not a surrogate foreign corporation.

Example 8. Acquisition of 50–50 joint venture partnership—(i) *Facts*. The facts are the same as in *Example 7* except that C and D each own 50% of the capital and profits interests in LLC. C and D transfer their interests in LLC to G, a newly formed foreign corporation, in exchange for 50 shares each of G's common stock, which are all of the issued and outstanding shares of G.

(ii) *Analysis*. G has indirectly acquired substantially all the properties constituting a trade or business of LLC, a domestic partnership, pursuant to a plan. After the acquisition, C and D each hold 50% of G's stock by reason of holding an interest in LLC. G is not included in an expanded affiliated group after the acquisition. Accordingly, none of the stock of G is disregarded under this section in determining the percentage of G stock held by former partners of LLC by reason of holding an interest in LLC. Thus, the fraction is 100/100 and the percentage is 100%. If the EAG does not have substantial business activities in G's country of incorporation when compared to the total business activities of the EAG, G is a surrogate foreign corporation which is treated as a domestic corporation under section 7874(b).

(e) *Effective date*. This section applies to taxable years ending after March 4, 2003.

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

Approved December 13, 2005.

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

(Filed by the Office of the Federal Register on December 27, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 28, 2005, 70 F.R. 76685)

Part III. Administrative, Procedural, and Miscellaneous

Credit for New Qualified Alternative Motor Vehicles (Advanced Lean Burn Technology Motor Vehicles and Qualified Hybrid Motor Vehicles)

Notice 2006–9

SECTION 1. PURPOSE

This notice sets forth interim guidance, pending the issuance of regulations, relating to the new advanced lean burn technology motor vehicle credit under § 30B(a)(2) and (c) of the Internal Revenue Code and the new qualified hybrid motor vehicle credit under § 30B(a)(3) and (d). Specifically, this notice provides procedures for a vehicle manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) to certify to the Internal Revenue Service (Service) both:

(1) that a passenger automobile or light truck of a particular make, model, and model year meets certain requirements that must be satisfied to claim the new advanced lean burn technology motor vehicle credit under § 30B(a)(2) and (c) or the new qualified hybrid motor vehicle credit under § 30B(a)(3) and (d); and

(2) the amount of the credit allowable with respect to that vehicle.

This notice also provides guidance to taxpayers who purchase passenger automobiles and light trucks regarding the conditions under which they may rely on the vehicle manufacturer's (or, in the case of a foreign vehicle manufacturer, its domestic distributor's) certification in determining whether a credit is allowable with respect to the vehicle and the amount of the credit. The Service and the Treasury Department expect that the regulations will incorporate the rules set forth in this notice.

SECTION 2. BACKGROUND

Section 30B(a)(2) provides for a credit determined under § 30B(c) for certain new advanced lean burn technology motor vehicles. Section 30B(a)(3) provides for a credit determined under § 30B(d) for certain new qualified hybrid motor vehicles. The new advanced lean burn technology motor vehicle credit is the sum of: (1) a fuel economy amount that varies with the rated fuel economy of a qualifying vehicle compared to the 2002 model year city fuel economy for a vehicle in its weight class; and (2) a conservation credit based on the estimated lifetime fuel savings of the vehicle compared to fuel used by a vehicle in its weight class and with fuel economy equal to the 2002 model year city fuel economy. The new qualified hybrid motor vehicle credit for passenger automobiles and light trucks is computed under the same formula as the new advanced lean burn technology motor vehicle credit. Both the new advanced lean burn technology motor vehicle credit and the new qualified hybrid motor vehicle credit begin to phase out for a manufacturer's passenger automobiles and light trucks in the second calendar quarter after the calendar quarter in which at least 60,000 of the manufacturer's passenger automobiles and light trucks that qualify for either credit have been sold for use in the United States (determined on a cumulative basis for sales after December 31, 2005).

SECTION 3. SCOPE OF NOTICE

.01 *Vehicles Covered.* Both the new advanced lean burn technology motor vehicle credit and the new qualified hybrid motor vehicle credit apply to passenger automobiles and light trucks. The new qualified hybrid motor vehicle credit also applies to other vehicles, but the credit for vehicles that are not passenger automobiles and light trucks is computed under a different formula than that applicable to passenger automobiles and light trucks. This notice applies only to passenger automobiles and light trucks. Guidance regarding the credit for new qualified hybrid motor vehicles that are not passenger automobiles or light trucks will be provided in a separate notice. Guidance regarding the credits for other vehicles that are eligible for credits under § 30B (new qualified fuel cell motor vehicles and new qualified alternative fuel motor vehicles) will be provided in separate notices.

.02 *Rules Common to All Qualifying Vehicles.* This notice does not address a number of rules that are common to all motor vehicles that qualify for credits under § 30B. These rules include: (1) rules under which lessors may claim the credits allowable under § 30B; (2) the rule preventing the credits from being used to reduce alternative minimum tax liability; and (3) rules relating to recapture of the credit. The Service and Treasury Department expect to issue separate guidance relating to these rules.

SECTION 4. MEANING OF TERMS

The following definitions apply for purposes of this notice:

(1) *In General.* Terms used in this notice and not defined in this section have the same meaning as when used in § 30B.

(2) *Passenger Automobile and Light Truck.* Section 30B provides that the terms "passenger automobile" and "light truck" have the meaning given in regulations prescribed by the Administrator of the Environmental Protection Agency for purposes of the administration of Title II of the Clean Air Act (42 U.S.C. 7521 *et seq.*). Those regulations currently do not include a definition of these terms, but § 30B(b)(2)(B) provides the 2002 model year city fuel economy tables that must be used to determine the amount of the credit for passenger automobiles and light trucks. Those tables do not prescribe the fuel economy for vehicles having a gross vehicle weight of more than 8,500 pounds. Accordingly, until either the Environmental Protection Agency issues regulations or future guidance issued by the Service provides otherwise (whichever occurs first), any vehicle having a gross vehicle weight of more than 8,500 pounds will not be treated as a passenger automobile or light truck for purposes of this notice.

(3) *City Fuel Economy.* The term "city fuel economy" has the meaning prescribed in 40 CFR § 600.002–85(11).

(4) *Gasoline-Gallon-Equivalent.* In the case of a motor vehicle that does not use gasoline, the 2002 model year city fuel economy is determined on a gasoline-gallon-equivalent basis. The gasoline-gallon-equivalents for the 2002 model year city fuel economy may be obtained from the Environmental Protection Agency, Office of Transportation and Air Quality at the following address:

Mailing Address
USEPA Headquarters
Ariel Rios Building
1200 Pennsylvania Avenue, N.W.
Mail Code: 6401A
Washington, DC 20460

Courier Address
USEPA Headquarters
Ariel Rios Building
1200 Pennsylvania Avenue, N.W.
Room 6502A
Washington, DC 20004

(5) *Vehicle Inertia Weight Class*. The term "vehicle inertia weight class" means, with respect to a motor vehicle, its inertia weight class determined under 40 CFR § 86.129–94. Under 40 CFR § 86.082–2, the inertia weight class is the class (a group of test weights) into which a vehicle is grouped based on its loaded vehicle weight in accordance with the provisions of 40 CFR part 86.

SECTION 5. MANUFACTURER'S CERTIFICATION AND QUARTERLY REPORTS

.01 *When Certification Permitted*. A vehicle manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) may certify to purchasers that a passenger automobile or light truck of a particular make, model, and model year meets all requirements (other than those listed in section 5.02 of this notice) that must be satisfied to claim the new advanced lean burn technology motor vehicle credit or the new qualified hybrid motor vehicle credit, and the amount of the credit allowable under § 30B(a)(2) and (c) or § 30B(a)(3) and (d) with respect to the vehicle, if the following requirements are met:

(1) The manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) has submitted to the Service, in accordance with section 6 of this notice, a certification with respect to the vehicle and the certification satisfies the requirements of section 5.03 of this notice;

(2) The manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) has received an acknowledgment of the certification from the Service.

.02 *Purchaser's Reliance*. Except as provided in section 5.07 of this notice, a purchaser of a passenger automobile or light truck may rely on the manufacturer's (or, in the case of a foreign vehicle manufacturer, its domestic distributor's) certification concerning the vehicle and the amount of the credit allowable with respect to the vehicle (including cases in which the certification is received after the purchase of the vehicle). The purchaser may claim a credit in the certified amount with respect to the vehicle if the following requirements are satisfied:

(1) The vehicle is placed in service by the taxpayer after December 31, 2005, and is purchased on or before December 31, 2010.

(2) The original use of the vehicle commences with the taxpayer.

(3) The vehicle is acquired for use or lease by the taxpayer, and not for resale.

(4) The vehicle is used predominantly in the United States.

.03 *Content of Certification*. The certification must contain the information required in section 5.03(1) of this notice and the additional information required in section 5.03(2) or section 5.03(3), whichever applies.

(1) *All Vehicles*. For all vehicles, the certification must contain—

(a) The name, address, and taxpayer identification number of the certifying entity;

(b) The make, model, model year, and any other appropriate identifiers of the motor vehicle;

(c) A statement that the vehicle is made by a manufacturer;

(d) The type of credit for which the vehicle qualifies (that is, either the new advanced lean burn technology motor vehicle credit, or the new qualified hybrid motor vehicle credit for passenger automobiles and light trucks);

(e) The amount of the credit for the vehicle (showing computations);

(f) The gross vehicle weight rating of the vehicle;

(g) The vehicle inertia weight class of the vehicle;

(h) The city fuel economy of the vehicle;

(i) A statement that the vehicle complies with the applicable provisions of the Clean Air Act;

(j) A copy of the certificate that the vehicle meets or exceeds the applicable Bin 5 Tier II emission standard (if the vehicle has a gross vehicle weight rating of 6,000 pounds or less), or the applicable Bin 8 Tier II emission standard (if the vehicle has a gross vehicle weight rating of more than 6,000 pounds, but not more than 8,500 pounds) established in regulations prescribed by the Administrator of the Environmental Protection Agency under § 202(i) of the Clean Air Act for that make and model year vehicle;

(k) A statement that the vehicle complies with the applicable air quality provisions of state law of each state that has adopted the provisions under a waiver under § 209(b) of the Clean Air Act or a list identifying each state that has adopted applicable air quality provisions with which the vehicle does not comply;

(l) A statement that the vehicle complies with the motor vehicle safety provisions of 49 U.S.C. §§ 30101 through 30169;

(m) A declaration, applicable to the certification and any accompanying documents, signed by a person currently authorized to bind the manufacturer (or, in the case of a foreign vehicle manufacturer, it domestic distributor) in these matters, in the following form:

"Under penalties of perjury, I declare that I have examined this certification, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of this certification are true, correct, and complete."

(2) *New Advanced Lean Burn Technology Motor Vehicles*. A certification relating to a new advanced lean burn technology motor vehicle must also contain a statement that the vehicle has an internal combustion engine that—

(a) Is designed to operate primarily using more air than is necessary for complete combustion of the fuel;

(b) Incorporates direct injection; and

(c) Achieves at least 125 percent of the 2002 model year city fuel economy.

(3) *New Qualified Hybrid Motor Vehicles*. A certification relating to a new qualified hybrid motor vehicle must also contain—

(a) A statement that the motor vehicle draws propulsion energy from onboard sources of stored energy that are both an internal combustion or heat engine using consumable fuel, and a rechargeable energy storage system;

(b) A copy of the certificate that the motor vehicle meets or exceeds the equivalent qualifying California low emission vehicle standard under § 243(e)(2) of the Clean Air Act for that make and model year; and

(c) Evidence that the maximum power available from the rechargeable energy storage system during a standard 10 second pulse power or equivalent test is at least 4 percent of the sum of the power and the SAE net power of the internal combustion or heat engine;

.04 *Acknowledgment of Certification*. The Service will review the original signed certification and issue an acknowledgment letter to the vehicle manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) within 30 days of receipt of the request for certification. This acknowledgment letter will state whether purchasers may rely on the certification.

.05 *Quarterly Reporting of Sales of Qualified Vehicles*. A manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) that has received an acknowledgment of its certification from the Service must submit to the Service, in accordance with section 6 of this notice, a report of the number of qualified vehicles sold by the manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) to a retail dealer during the calendar quarter. For this purpose, a qualified vehicle is any passenger automobile or light truck that is a new advanced lean burn technology motor vehicle or a new qualified hybrid motor vehicle. The quarterly report must contain the following information:

(1) The name, address, and taxpayer identification number of the reporting entity;

(2) The number of qualified vehicles sold by the reporting entity to a retail dealer during the calendar quarter;

(3) The make, model, model year, and any other appropriate identifiers of the qualified vehicles sold during the calendar quarter; and

(4) A declaration, applicable to the quarterly report and any accompanying documents, signed by a person currently authorized to bind the manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) in these matters, in the following form:

"Under penalties of perjury, I declare that I have examined this report, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of this report are true, correct, and complete."

.06 *Acknowledgment of Quarterly Report*. The Service will review the original signed quarterly report and issue an acknowledgment letter to the vehicle manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) within 30 days of receipt of the request for certification. This acknowledgment letter will state whether purchasers may continue to rely on the certification.

.07 *Effect of Erroneous Certification, Erroneous Quarterly Reports, or Failure to Make Timely Quarterly Reports*.

(1) *Erroneous Certification or Quarterly Report*. The acknowledgment that the Service provides for a certification is not a determination that a vehicle qualifies for the credit, or that the amount of the credit is correct. The Service may, upon examination (and after any appropriate consultation with the Department of Transportation or the Environmental Protection Agency), determine that the vehicle is not a new advanced lean burn technology motor vehicle or new qualified hybrid motor vehicle or that the amount of the credit determined by the manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) to be allowable with respect to the vehicle is incorrect. In either event, or in the event that the manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) makes an erroneous quarterly report, the manufacturer's (or, in the case of a foreign vehicle manufacturer, its domestic distributor's) right to provide a certification to future purchasers of the advanced lean burn technology or hybrid motor vehicles will be withdrawn, and purchasers who acquire a vehicle after the date on which the Service publishes an announcement of the withdrawal may not rely on the certification. Purchasers may continue to rely on the certification for vehicles they acquired on or before the date on which the announcement of the withdrawal is published (including in cases in which the vehicle is not placed in service and the credit is not claimed until after that date), and the Service will not attempt to collect any understatement of tax liability attributable to such reliance. Manufacturers (or, in the case of foreign vehicle manufacturers, their domestic distributors) are reminded that an erroneous certification or an erroneous quarterly report may result in the imposition of penalties:

(a) under § 7206 for fraud and making false statements; and

(b) under § 6701 for aiding and abetting an understatement of tax liability in the amount of $1,000 ($10,000 in the case of understatements by corporations) per return on which a credit is claimed in reliance on the certification).

(2) *Failure to Make Timely Quarterly Report*. If a manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) fails to make a quarterly report in accordance with section 5.05 of this notice and at the time specified in section 6.02 of this notice, the acknowledgment letter issued under section 5.04 of this notice may be withdrawn, and purchasers will not be entitled to rely on the related certification for quarters beginning after the date on which the Service publishes an announcement of the withdrawal (generally, quarters beginning after the due date of the report). If the quarterly report is filed subsequently, the Service may reissue the acknowledgment letter and retract the withdrawal announcement.

SECTION 6. TIME AND ADDRESS FOR FILING CERTIFICATION AND QUARTERLY REPORTS

.01 *Time for Filing Certification*. In order for a certification under section 5 of this notice to be effective for new advanced lean burn technology motor vehicles and new qualified hybrid motor vehicles placed in service during a calendar year, the certification must be received by the Service not later than December 31st of that calendar year.

.02 *Time for Filing Quarterly Reports*. A report of sales of qualified vehicles during a quarter must be filed with the Service

at the address specified in section 6.03 of this notice not later than the last day of the first calendar month following the quarter to which the report relates.

.03 *Address for Filing*. Certifications and quarterly reports under section 5 of this notice must be sent to:

Internal Revenue Service
Industry Director, Large and Mid-Size Business, Heavy Manufacturing and Transportation
Metro Park Office Complex — LMSB
111 Wood Avenue, South
Iselin, New Jersey 08830

SECTION 7. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1988.

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

The collections of information in this notice are in section 5. This information is required to be collected and retained in order to ensure that vehicles meet the requirements for the new advanced lean burn technology motor vehicle credit under § 30B(a)(2) and (c) or the new qualified hybrid motor vehicle credit under § 30B(a)(3) and (d). This information will be used to determine whether the vehicle for which the credit is claimed by a taxpayer is property that qualifies for the credit. The collection of information is required to obtain a benefit. The likely respondents are corporations and partnerships.

The estimated total annual reporting burden is 280 hours.

The estimated annual burden per respondent varies from 35 hours to 45 hours, depending on individual circumstances, with an estimated average burden of 40 hours to complete the certification required under this notice. The estimated number of respondents is 7.

The estimated annual frequency of responses is on occasion.

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

SECTION 8. DRAFTING INFORMATION

The principal author of this notice is Nicole R. Cimino of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Cimino at (202) 622–3120 (not a toll-free call).

Part IV. Items of General Interest

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

Time for Filing Employment Tax Returns and Modifications to the Deposit Rules

REG–148568–04

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9239) relating to the annual filing of Federal employment tax returns and requirements for employment tax deposits for employers in the Employers' Annual Federal Tax Program (Form 944) (hereinafter referred to as the "Form 944 Program"). Those temporary regulations provide requirements for filing returns to report the Federal Insurance Contributions Act (FICA) taxes and income tax withheld under section 6011 of the Internal Revenue Code (Code) and §§31.6011(a)–1 and 31.6011(a)–4. Those regulations also require employers qualified for the Form 944 Program to file Federal employment tax returns annually. In addition, those regulations provide requirements for employers to make deposits of tax under FICA and the income tax withholding provisions of the Code (collectively, employment taxes) under section 6302 of the Code and §31.6302–1. The text of those regulations serves, in part, as the text of these proposed regulations. In addition to rules related to the Form 944 Program, these proposed regulations provide an additional method for quarterly return filers to determine whether the amount of accumulated employment taxes is considered *de minimis*. This document also provides notice of a public hearing.

DATES: Written or electronic comments must be received by April 3, 2006. Outlines of topics to be discussed at the public hearing scheduled for April 26, 2006, at 10 a.m. must be received by April 5, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–148568–04), 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–148568–04), 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/regs* or via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–148568–04). The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations relating to section 6011, Raymond Bailey, (202) 622–4910; concerning the proposed regulations relating to section 6302, Audra M. Dineen, (202) 622–4940; concerning submissions of comments and the hearing, Treena Garrett, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend the Regulations on Employment Taxes and Collection of Income Tax at Source (26 CFR Part 31) under sections 6011 and 6302. These amendments are designed to require employers qualified for the Form 944 Program to file Federal employment tax returns annually and to permit most employers in the Form 944 Program to remit their accumulated employment taxes annually with their return. The text of those temporary regulations also serves, in part, as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations. These proposed regulations are one part of the IRS's effort to reduce taxpayer burden by requiring certain employers to file Federal employment tax returns annually rather than quarterly and by permitting certain employers to remit employment taxes annually with their return.

De Minimis Deposit Rule

In addition to establishing the Form 944 Program, these proposed regulations will provide a safe harbor for small employers that have an unexpected increase in their deposit liability for a quarterly return period. The proposed regulations provide an alternate method for determining whether the employer's employment tax obligations are *de minimis*, which is based on its employment taxes due for the prior return period. This special rule applies only to employers filing quarterly tax returns and therefore has no application to the Form 944 Program.

Under the existing regulations, deposits of taxes reported on Form 941, "*Employer's Quarterly Federal Tax Return*," generally are due monthly or semi-weekly. If an employer fails to make timely deposits of employment taxes, then, absent reasonable cause, the employer will be subject to the penalty for failure to deposit under section 6656. Currently, §31.6302–1(f)(4) (the *de minimis* deposit rule) provides that, for quarterly and annual return periods, if the aggregate amount of employment taxes for the return period is less than $2,500 and that amount is deposited or remitted with a timely filed return for that return period, the amount will be deemed to have been timely deposited and the employer will not be subject to the penalty for failure to deposit. Thus, currently under the *de minimis* deposit rule, employers remitting their employment taxes with their timely filed quarterly returns will only be deemed to have timely deposited their taxes if the amount of taxes due is less than $2,500 for that quarter. Similarly, under the current *de minimis* deposit rule, employers remitting their employment taxes with their timely filed annual returns will only be deemed to have timely deposited if the

amount of taxes due is less than $2,500 for the entire year.

Under the proposed amendments, employers may remit their employment taxes with their timely filed quarterly returns and be deemed to have timely deposited if the amount of the taxes due for the current quarter *or for the prior quarter* is less than $2,500. This special rule can be illustrated by the following example: an employer has less than $50,000 in employment taxes reported during the lookback period and is therefore a monthly depositor under §31.6302–1(b)(2). The employer's employment tax liabilities for the first and second quarters of 2004 were $2,450 and $2,400, respectively. In the third quarter of 2004, however, the employer's employment tax liability was $2,550. Under the existing *de minimis* deposit rule, if the employer remits the $2,550 with its third quarter return, the amount is not considered timely deposited for that quarter and, therefore, the employer would be assessed the section 6656 penalty for failure to deposit. Modifying the *de minimis* deposit rule to allow employers to base the determination on the employment taxes due for the immediately preceding quarter provides a safe harbor for employers regarding their deposit obligations. Thus, in this example, when the employer had an increase in its employment tax liability for the third quarter of 2004, its remittance would still be deemed to have been timely deposited because the taxes for the immediately preceding return period were *de minimis*. The proposed amendment has no application to the One-Day rule in §31.6302–1(c)(2), which requires employers to make a deposit on the next banking day if they accumulate $100,000 or more of employment taxes.

Special Analyses

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

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. In addition, the IRS and Treasury Department are considering expanding the Form 944 program in the future and seek comments on the eligibility requirements and how best to change them. All comments will be available for public inspection and copying.

A public hearing has been scheduled for April 26, 2006, beginning at 10 a.m. in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area 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 electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by April 5, 2006. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Raymond Bailey, Audra M. Dineen, and Emly B. Berndt of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

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

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

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

Par. 2. Section 31.6011(a)–1 is amended by revising paragraph (a)(5) to read as follows:

§31.6011(a)–1 Returns under Federal Insurance Contributions Act.

(a) * * *

(5) [The text of proposed §31.6011(a)–1(a)(5) is the same as the text of §31.6011(a)–1T(a)(5) published elsewhere in this issue of the Bulletin].

* * * * *

Par. 3. Section 31.6011(a)–4 is amended by revising paragraph (a)(4) to read as follows:

§31.6011(a)–4 Returns of income tax withheld.

(a) * * *

(4) [The text of proposed §31.6011(a)–4(a)(4) is the same as the text of §31.6011(a)–4T(a)(4) published elsewhere in this issue of the Bulletin].

* * * * *

Par. 4. Section 31.6302–1 is amended by revising paragraphs (b)(4), (c)(5) and 6, (d) *Example 6*, (f)(4), and (f)(5) *Example 3* to read as follows:

§31.6302–1 Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.

* * * * *

(b) * * *

(4) * * *

(i) [The text of the proposed §31.6302–1(b)(4)(i) is the same as the text of §31.6302–1T(b)(4)(i) published elsewhere in this issue of the Bulletin].

(ii) [The text of the proposed §31.6302–1(b)(4)(ii) is the same as the text of §31.6302–1T(b)(4)(ii) published elsewhere in this issue of the Bulletin].

(c) * * *

(5) [The text of proposed §31.6302–1(c)(5) is the same as the text of §31.6302–1T(c)(5) published elsewhere in this issue of the Bulletin].

(6) [The text of proposed §31.6302–1(c)(6) is the same as the text of §31.6302–1T(c)(6) published elsewhere in this issue of the Bulletin].

(d) * * *

Example 6. [The text of proposed §31.6302–1(d) *Example 6* is the same as the text of §31.6302–1T(d) *Example 6* published elsewhere in this issue of the Bulletin].

* * * * *

(f) * * *

(4) *De minimis rule*—(i) *De minimis deposit rule for quarterly and annual return periods beginning on or after January 1, 2001.* If the total amount of accumulated employment taxes for the return period is *de minimis* and the amount is fully deposited or remitted with a timely filed return for the return period, the amount deposited or remitted will be deemed to have been timely deposited. The total amount of accumulated employment taxes is *de minimis* if it is less than $2,500 for the return period or if it is *de minimis* pursuant to paragraph (f)(4)(ii) of this section.

(ii) *De minimis deposit rule for quarterly return periods.* For purposes of paragraph (f)(4)(i) of this section, if the total amount of accumulated employment taxes for the immediately preceding quarter was less than $2,500, unless paragraph (c)(3) of this section applies to require a deposit at the close of the next banking day, then the employer will be deemed to have timely deposited the employer's employment taxes for the current quarter if the employer complies with the time and method of payment requirements contained in paragraph (f)(4)(i) of this section.

(iii) [The text of proposed §31.6302–1(f)(4)(iii) is the same as the text of §31.6302–1T(f)(4)(iii) published elsewhere in this issue of the Bulletin].

(5) * * *

Example 3. [The text of proposed §31.6302–1(f)(5) *Example 3* is the same as the text of §31.6302–1T(f)(5) *Example 3* published elsewhere in this issue of the Bulletin]

* * * * *

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

(Filed by the Office of the Federal Register on December 30, 2005, 8:45 a.m., and published in the issue of the Federal Register for January 3, 2006, 71 F.R. 46)

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

Guidance Under Section 7874 for Determining Ownership by Former Shareholders or Partners of Domestic Entities

REG–143244–05

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9238) relating to the disregard of affiliate-owned stock in determining the percentage of stock of a foreign corporation held by former shareholders or partners of a domestic entity, in order to determine whether the foreign corporation is a surrogate foreign corporation under section 7874 of the Internal Revenue Code (Code). The text of those regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by April 6, 2006. Outlines of topics to be discussed at the public hearing scheduled for April 27, 2006 at 10 a.m., must be received by April 6, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–143244–05), 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–143244–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at: *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–143244–05).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jefferson VanderWolk at (202) 622–3810; concerning submission and delivery of comments and the public hearing, Robin R. Jones, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to section 7874. The temporary regulations set forth rules on disregarding affiliate-owned stock in determining the percentage of stock of a foreign corporation held by former shareholders or partners of a domestic entity by reason of holding stock or a partnership interest in the domestic entity, for purposes of determining whether the foreign corporation is a surrogate foreign corporation under section 7874(a)(2)(B). The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

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

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. 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.

A public hearing has been scheduled for April 27, 2006, at 10 a.m., in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area 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 electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by April 6, 2006. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.7874–1 also issued under 26 U.S.C. 7874(c)(6) and (g). * * *

Par. 2. Section 1.7874–1 is added to read as follows:

§1.7874–1 Disregard of affiliate-owned stock.

[The text of proposed §1.7874–1 is the same as the text of §1.7874–1T published elsewhere in this issue of the Bulletin].

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

(Filed by the Office of the Federal Register on December 27, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 28, 2005, 70 F.R. 76732)

Application of Section 409A to Nonqualified Deferred Compensation Plans; Correction

Announcement 2006–11

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document corrects a notice of proposed rulemaking (REG–158080–04, 2005–43 I.R.B. 786) that was published in the **Federal Register** on Tuesday, October 4, 2005 (70 FR 57930), regarding the application of section 409A to nonqualified deferred compensation plans. The regulations affect service providers receiving amounts of deferred compensation, and the service recipients for whom the service providers provide services.

FOR FURTHER INFORMATION CONTACT: Stephen Tackney, (202) 927–9639 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–158080–04) that is the subject of this correction is under section 409A of the Internal Revenue Code.

Need for Correction

As published, REG–158080–04 contains an error that may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG–158080–04) that was the subject of FR. Doc. 05–19379, is corrected as follows:

On page 57930, column 1, in the preamble, under the paragraph heading "FOR FURTHER INFORMATION CONTACT:", lines 4 thru 8, the language "concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard A. Hurst at (202) 622–7116 (not toll-free numbers).". is corrected to read "concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard A. Hurst at (202) 622–7180 (not toll-free numbers).".

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

(Filed by the Office of the Federal Register on January 12, 2006, 8:45 a.m., and published in the issue of the Federal Register for January 17, 2006, 71 F.R. 2496)

Deemed Election to Be an Association Taxable as a Corporation for a Qualified Electing S Corporation; Correction

Announcement 2006–12

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document adds the text that was inadvertently removed from the Code of Federal Regulations in T.D. 9203, 2005–25 I.R.B. 1285, which was published in the **Federal Register** on Monday, May 23, 2005 (70 FR 29452).

DATES: This correction is effective on May 23, 2005.

FOR FURTHER INFORMATION CONTACT: Jian H. Grant, (202) 622–3050 (not a toll-free number).

SUPPLEMENTAL INFORMATION:

Background

This document adds §301.7701–3T to the Code of Federal Regulations. The final regulations (T.D. 9203) that are the subject of this correction are under section 7701 of the Internal Revenue Code.

Need for Correction

As published, §301.7701–3T was inadvertently removed in its entirety from the Code of Federal Regulations in T.D. 9203.

* * * * *

Correction of Publication

Accordingly, 26 CFR part 301 is corrected as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.7701–3T is added to read as follows:

§301.7701–3T Classification of certain business entities (temporary).

(a) through (c)(1)(i) [Reserved]. For further guidance, see §301.7701–3(a) through (c)(1)(i).

(ii) Further notification of elections. An eligible entity required to file a Federal tax or information return for the taxable year for which an election is made under §301.7701–3(c)(1)(i) must attach a copy of its Form 8832 to its Federal tax or information return for that year. If the entity is not required to file a return for that year, a copy of its Form 8832, "*Entity Classification Election*," must be attached to the Federal income tax or information return of any direct or indirect owner of the entity for the taxable year of the owner that includes the date on which the election was effective. An indirect owner of the entity does not have to attach a copy of the Form 8832 to its return if an entity in which it has an interest is already filing a copy of the Form 8832 with its return. If an entity, or one of its direct or indirect owners, fails to attach a copy of a Form 8832 to its return as directed in this section, an otherwise valid election under §301.7701–3(c)(1)(i) will not be invalidated, but the non-filing party may be subject to penalties, including any applicable penalties if the Federal tax or information returns are inconsistent with the entity's election under §301.7701–3(c)(1)(i). In the case of returns for taxable years beginning after December 31, 2002, the copy of Form 8832 attached to a return pursuant to this paragraph (c)(1)(ii) is not required to be a signed copy.

(c)(1)(iii) through (h)(3) [Reserved]. For further guidance, see §301.7701–3(c)(1)(iii) through (h)(3).

Guy R. Traynor,
Federal Register Liaison, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on January 19, 2006, 8:45 a.m., and published in the issue of the Federal Register for January 20, 2006, 71 F.R. 3219)

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.

Numerical Finding List[1]

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2005–27 through 2005–52 is in Internal Revenue Bulletin 2005–52, dated December 27, 2005.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2005–27 through 2005–52 is in Internal Revenue Bulletin 2005–52, dated December 27, 2005.