Internal Revenue bulletin

Bulletin No. 2007-10
March 5, 2007

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.

SPECIAL ANNOUNCEMENT

Announcement 2007–28, page 683.

This document contains a copy of the news release issued by the Office of the Deputy Commissioner, International, on February 13, 2007, extending the deadline to March 30, 2007 for the settlement offered to certain foreign embassy staff.

INCOME TAX

Rev. Rul. 2007–10, page 660.

Insurance companies; interest rate tables. Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 2006 and 2007. Rev. Rul. 92–19 supplemented in part.

T.D. 9311, page 635.
REG–147144–06, page 680.

Final, temporary, and proposed regulations under section 367(a) of the Code provide rules for entering into gain recognition agreements. The regulations clarify the effect that various transactions have on existing gain recognition agreements. Final regulations update certain cross-references in current regulations.

Notice 2007–22, page 670.

This notice provides guidance on rollovers from health Flexible Spending Arrangements (health FSAs) and Health Reimbursement Arrangements (HRAs) to Health Savings Accounts (HSAs) under amendments to the Code by section 302 of the Health Opportunity Patient Empowerment Act of 2006 included in the Tax Relief and Health Care Act of 2006. Notices 2002–45 and 2005–86 modified. Rev. Ruls. 69–141, 2002–41, 2003–102, 2005–24, and 2006–36 modified.

Rev. Proc. 2007–23, page 675.

This procedure provides administrative guidance permitting the use of a "Net Consideration Method" of accounting for certain patent cross licensing arrangements. Under the method, only cash and other non-patent-right consideration are taken into account for withholding and capitalization purposes. The procedure also requests comments on the types of arrangements that should be covered by the method.

Announcement 2007–24, page 681.

This announcement notifies Archer MSA trustees and custodians of the obligation to report the number of Archer MSAs established between (1) January 1, 2005, and June 30, 2005, and (2) January 1, 2006, and June 30, 2006.

TAX CONVENTIONS

Announcement 2007–23, page 665.

The United States and the United Kingdom of Great Britain and Northern Ireland (on behalf of the Bailiwick of Jersey) have exchanged diplomatic notes evidencing an agreement for the reciprocal exemption of income from the international operation of ships for taxable years beginning on or after January 1, 1997.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

Rev. Proc. 2007–22, page 675.
This procedure modifies the payment procedures for user fees applicable to the processing of Form 8802, *Application for United States Residency Certification,* to allow for the electronic payment of such fees effective April 2, 2007. Rev. Proc. 2006–35 modified.

Announcement 2007–25, page 682.
This document contains corrections to final and temporary regulations (T.D. 9303, 2007–5 I.R.B. 379) providing guidance regarding the qualification of certain transactions as reorganizations described in section 368(a)(1)(D) of the Code.

Announcement 2007–26, page 682.
This document contains corrections to proposed regulations by cross-reference to temporary regulations (REG–125632–06, 2007–5 I.R.B. 415) providing guidance regarding the qualification of certain transactions as reorganizations described in section 368(a)(1)(D) of the Code.

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.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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

Place missing child here.

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

Section 106.—Contributions by Employer to Accident and Health Plans

A notice provides guidance on rollovers from health Flexible Spending Arrangements (health FSAs) and Health Reimbursement Arrangements (HRAs) to Health Savings Accounts (HSAs). See Notice 2007-22, page 670.

Section 223.—Health Savings Accounts

A notice provides guidance on rollovers from health Flexible Spending Arrangements (health FSAs) and Health Reimbursement Arrangements (HRAs) to Health Savings Accounts (HSAs). See Notice 2007-22, page 670.

Section 263.—Capital Expenditures

A revenue procedure provides administrative guidance permitting the use of a "Net Consideration Method" of accounting for certain patent cross licensing arrangements. Under the method, only cash and other non-patent-right consideration are taken into account for withholding and capitalization purposes. See Rev. Proc. 2007-23, page 675.

Section 263A.—Capitalization and Inclusion in Inventory Costs of Certain Expenses

A revenue procedure provides administrative guidance permitting the use of a "Net Consideration Method" of accounting for certain patent cross licensing arrangements. Under the method, only cash and other non-patent-right consideration are taken into account for withholding and capitalization purposes. See Rev. Proc. 2007-23, page 675.

Section 367.—Foreign Corporations

26 CFR 1.367(a)–3: Treatment of transfers of stock or securities to foreign corporations.

T.D. 9311

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

Certain Transfers of Stock or Securities by U.S. Persons to Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations under section 367(a) of the Internal Revenue Code (Code) regarding gain recognition agreements. The final regulations are necessary to update cross-references in the current regulations. The temporary regulations are necessary to respond to comments requested in Notice 2005–74. The regulations primarily affect U.S. persons that transfer stock or securities to foreign corporations or corporations engaged in transactions that affect existing gain recognition agreements. The text of these temporary regulations also serves as the text of the proposed regulations (REG–147144–06) set forth in the notice of proposed rulemaking on this subject published elsewhere in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective February 5, 2007.

Applicability Dates: For dates of applicability, see §§1.367(a)–3T(f) and 1.367(a)–8T(h).

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–147144–06), 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–147144–06), 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–147144–06).

FOR FURTHER INFORMATION CONTACT: Daniel McCall, (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and pending receipt and evaluation of public comments, 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 1545–2056. Response to these collections of information is mandatory.

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 control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing the burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking (REG–147144–06) published elsewhere in this issue of the Bulletin.

Books and records relating to these collections of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax

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

Background

Section 367(a)(1) provides that if, in connection with any exchange described in section 332, 351, 354, 356, or 361, a United States person (U.S. transferor) transfers property to a foreign corporation (transferee foreign corporation), such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. Section 367(a)(2), (3) and (6) provides exceptions to this general rule and grants regulatory authority to provide additional exceptions and to limit the statutory exceptions.

Exceptions to the general rule of section 367(a)(1) for certain transfers by a U.S. transferor of the stock or securities of a corporation (transferred corporation) to a transferee foreign corporation are provided in §1.367(a)–3 (initial transfer). In some cases, these exceptions require, among other things, that the U.S. transferor file a gain recognition agreement (GRA), as provided in §1.367(a)–8. Section 1.367(a)–3(b)(1)(ii) and (c)(1)(iii)(B). Pursuant to a GRA, the U.S. transferor agrees, among other things, to include in income the gain realized, but not recognized, on the initial transfer of the stock or securities, and pay any applicable interest, upon certain events (triggering events) that occur before the close of the fifth full taxable year following the year of the initial transfer. Section 1.367(a)–8(b)(1)(iii) and (3)(i).

Section 1.367(a)–8(e)(1) and (2) provides that dispositions of the stock or securities of the transferred corporation are generally triggering events. Similarly, §1.367(a)–8(e)(3) provides that dispositions of substantially all (within the meaning of section 368(a)(1)(C)) of the assets of the transferred corporation are generally treated as deemed dispositions of the stock or securities of the transferred corporation and therefore are also triggering events. Finally, dispositions of stock of the transferee foreign corporation can also be triggering events. See §1.367(a)–8(f)(2)(ii).

Notwithstanding these rules, §1.367(a)–8 provides that various nonrecognition transactions are not triggering events if certain requirements are satisfied. For example, §1.367(a)–8(g) provides exceptions for certain transactions involving the U.S. transferor, the transferee foreign corporation, and the transferred corporation. Although these exceptions clearly contemplate some nonrecognition transactions, the current regulations are unclear whether, and if so how, the exceptions apply to various asset reorganizations involving section 361 exchanges by the U.S. transferor, the transferee foreign corporation, and the transferred corporation.

Section 1.367(a)–8 also provides that certain nonrecognition transactions are not triggering events because the GRA is terminated without further effect. For example, §1.367(a)–8(h)(3) lists certain nonrecognition transactions that terminate the GRA, provided that immediately after the transaction the basis in the transferred stock is not greater than the U.S. transferor's basis in the stock that, immediately before the initial transfer, necessitated the GRA.

On September 28, 2005, the IRS and the Treasury Department issued Notice 2005–74, 2005–2 C.B. 726, see §601.601(d)(2), which announced the intention to amend the regulations under section 367(a) to address the effect on GRAs of certain asset reorganizations involving the U.S. transferor, the transferee foreign corporation, and the transferred corporation. The notice was issued in response to comments that the current regulations do not adequately address various asset reorganizations involving the U.S. transferor, the transferee foreign corporation, and the transferred corporation. Notice 2005–74 addressed the most common of these reorganizations and requested comments on other transactions (for example, certain upstream and downstream reorganizations).

Notice 2005–74 generally provided that, if particular requirements are satisfied, certain asset reorganizations of the U.S. transferor, the transferee foreign corporation, or the transferred corporation will not constitute triggering events. A key premise of the notice was that the covered transactions involved situations where the ability to collect tax is sufficiently preserved in the event of a subsequent trigger of the GRA (that is, the obligor under the GRA remains unchanged as a result of the asset reorganization). In light of taxpayer comments and further study, however, the IRS and Treasury Department have determined that there are additional instances where the ability to collect tax after these asset reorganizations and certain other nonrecognition transactions (as defined in section 7701(a)(45)) is sufficiently preserved so that these transactions also should not constitute a triggering event if particular requirements are met. The IRS and Treasury Department also have concluded that other portions of the current section 367(a) regulations addressing GRAs should be revised.

Explanation of Provisions

A. *Overview*

The temporary regulations adopt the rules announced in Notice 2005–74, with a number of modifications discussed below. Notice 2005–74 only provided guidance on a particular range of transactions, namely certain asset reorganizations, that are insufficiently addressed in the current regulations. The temporary regulations respond to comments and provide guidance on the effect on GRAs of transactions that are not addressed in the current regulation or Notice 2005–74. The temporary regulations also make additional changes to the existing regulations. For example, the temporary regulations modify and clarify procedural requirements attendant to entering into GRAs. Finally, the temporary regulations reorganize the current regulation so that distinct paragraphs address triggering events, exceptions to triggering events, and events that terminate a GRA. The IRS and Treasury Department continue to consider issuing additional public guidance that further revises §1.367(a)–8.

B. *Effect of Certain Asset Reorganizations and Nontaxable Liquidations on Gain Recognition Agreements*

1. *Transfers of transferee foreign corporation stock by U.S. transferor*

a) *Asset reorganizations*

Notice 2005–74 provided that if, in a section 361 transaction, a U.S. transferor transfers all or a portion of the stock or securities of the transferee foreign corporation to an acquiring domestic corpora-

tion (successor U.S. transferor) pursuant to certain asset reorganizations, the exchanges made pursuant to the asset reorganization will trigger the gain recognition agreement, unless various conditions are satisfied. These conditions are: (1) the U.S. transferor must have been a member of a consolidated group (original consolidated group) at the time of the initial transfer and the common parent of such group (original common parent) entered into the original GRA; (2) immediately after the asset reorganization, the successor U.S. transferor is a member of the original consolidated group (consolidation continuity requirement); and (3) the original common parent enters into a new GRA with respect to the transfer subject to the original GRA, modified by substituting the successor U.S. transferor for the original U.S. transferor. A notice of the asset reorganization also must be provided with the successor U.S. transferor's next annual certification.

For this purpose, an asset reorganization is defined as a reorganization described in section 368(a)(1) involving the transfer of assets by a corporation to another corporation pursuant to section 361, except that such term shall include reorganizations described in section 368(a)(1)(D) or (G) only if the requirements of section 354(b)(1)(A) and (B) are met.

The IRS and Treasury Department received several comments that the consolidation continuity requirement was unduly restrictive because it focused on maintaining the same obligor for a GRA following the asset reorganization. Commentators asserted that an equal or better ability to collect the tax due as a result of a triggering event subsequent to such a reorganization may be preserved in certain instances where the consolidation continuity requirement would not be satisfied. However, these same commentators noted that if there were no consolidation continuity requirement, such that a U.S. transferor that is a member of a consolidated group at the time of the initial transfer could be acquired in a later asset reorganization by a corporation (successor corporation) that is not a member of such group without triggering the GRA, the actions of the successor corporation could inappropriately affect the liability of the original consolidated group under the GRA. As a result, the commentators requested that the consolidation continuity requirement be curtailed or eliminated, while at the same time not inappropriately exposing the original consolidated group to the liabilities arising from the actions of the successor corporation.

The IRS and Treasury Department generally agree with these views. Therefore, the temporary regulations eliminate the consolidation continuity requirement and address concerns about the liability of a consolidated group that disposes of a U.S. transferor subject to a GRA.

Specifically, the temporary regulations provide that when a U.S. transferor transfers all or a portion of the stock of the transferee foreign corporation to an acquiring corporation in an asset reorganization, the exchanges made pursuant to the reorganization will not be triggering events and the GRA will terminate without further effect, but only if certain requirements are satisfied. These requirements ensure that the ability to collect tax is sufficiently preserved and that the terms of the GRA are administrable.

First, the acquiring corporation (successor U.S. transferor) must be a domestic corporation, and the successor U.S. transferor or the common parent of the consolidated group of which the successor U.S. transferor is a member (as applicable) must enter into a new GRA to recognize gain with respect to the initial transfer during the remaining term of the original GRA (with certain modifications).

Second, with its next certification, the successor U.S. transferor must provide to the IRS the new GRA, notice of the transaction, and Form 8838 (*Consent To Extend the Time To Assess Tax Under Section 367 – Gain Recognition Agreement*) to extend the period of assessment of tax on the initial transfer.

Third, unless the successor U.S. transferor is a member of the same consolidated group of which the U.S. transferor was a member immediately before the asset reorganization, the person entering into the new GRA must elect that, if the new GRA is triggered in whole or in part, the person will include the required amount in the year of the triggering event (as opposed to the year of the initial transfer). Requiring an inclusion in these circumstances only in the year of a subsequent triggering event when the U.S. transferor is no longer owned by the same consolidated group is necessary, among other reasons, because the successor U.S. transferor may not have existed in the year of the initial transfer. In such a case, the successor U.S. transferor would not be able to amend a return for the year of the initial transfer to include any tax due as a result of a subsequent triggering event. Moreover, the requirement is appropriate even if the successor U.S. transferor did exist in the year of the initial transfer because its tax year for the year of the initial transfer may be closed. In sum, this requirement assures the GRA rules are administrable and that the ability to collect tax is sufficiently preserved. If these requirements are met, the original GRA will terminate without further effect.

The IRS and Treasury Department have decided to eliminate the consolidation continuity requirement because these three requirements adequately address the government's concern in this area by, among other things, preserving the ability to collect the tax due as a result of a triggering event subsequent to a covered asset reorganization. In many asset reorganizations, the successor U.S. transferor will have an equal or greater ability to pay the tax due in the case of a subsequent triggering event than would the original U.S. transferor. Furthermore, the current regulations generally do not impose any financial or other requirements on the ability of a U.S. transferor to enter into a GRA. But see §1.367(a)–8(d) (imposing a security requirement in certain situations). Consequently, the IRS and Treasury Department believe that even if in some circumstances an acquisition of a U.S. transferor may affect the ability to collect the tax due as a result of a subsequent triggering event (for example, the U.S. transferor is acquired from a consolidated group by another consolidated group whose value is less than that of the original consolidated group), the requirements above nonetheless sufficiently preserve the ability to collect the tax that would be due if the new GRA were triggered and ensure that the terms of the GRA are administrable.

As described in this section, the temporary regulations require that the acquirer be a domestic corporation because, among other reasons, the IRS and Treasury Department are concerned that if a foreign acquirer is allowed to enter into a new GRA, it may be difficult for the IRS to

collect any tax due in the event of a subsequent trigger of the GRA. However, the IRS and Treasury Department continue to study whether it would be appropriate to allow a domestic corporate shareholder of the U.S. transferor to enter into a new GRA when a U.S. transferor is acquired by a foreign corporation in an asset reorganization under conditions similar to those provided in §1.367(a)–3T(e). The IRS and Treasury Department welcome more detailed comments on specific approaches that could extend these rules to foreign acquisitions of the U.S. transferor.

b) *Nontaxable liquidations*

The current regulations provide that, if a corporate U.S. transferor liquidates in a transaction that qualifies under sections 332 and 337, the GRA is triggered unless (1) the U.S. transferor filed a consolidated income tax return with a U.S. parent corporation both in the year of the initial transfer and the year of the liquidation, and (2) the common parent enters into a new GRA, with certain modifications. Section 1.367(a)–8(f)(2)(ii).

The temporary regulations provide a similar rule. However, the temporary regulations eliminate the consolidation continuity requirement, so the U.S. transferor is no longer required to be a member of the same consolidated group in the year of the initial transfer and the year of the liquidation. Consequently, the temporary regulations provide that where a U.S. transferor disposes of the stock of the foreign transferee corporation in a liquidation that qualifies under sections 332 and 337, the disposition will not constitute a triggering event provided that: (1) the distributee (successor U.S. transferor) is a domestic corporation described in section 332(b)(1); (2) the successor U.S. transferor or, if the successor U.S. transferor is a member of a consolidated group, the common parent of the successor U.S. transferor's group, enters into a new GRA covering the remaining term of the original GRA (with certain modifications); (3) where the successor U.S. transferor is not a member of the original consolidated group immediately after the liquidation, the person entering into the GRA agrees that if there is a subsequent triggering event, the taxpayer will recognize the gain in the year of the triggering event (as opposed to the year of the initial transfer); and (4) the successor U.S. transferor provides, with its next annual certification, Form 8838 to extend the period of assessment of the tax on the initial transfer. If these conditions are satisfied, the original GRA will terminate without further effect.

For reasons similar to those discussed above in the context of asset reorganizations involving the U.S. transferor, the IRS and Treasury Department believe that the temporary regulations sufficiently address the government's concerns in this area, including preserving the ability to collect tax due as a result of a subsequent triggering event. As a result, it is not necessary for the U.S. transferor to be a member of the same consolidated group in the year of the transfer and the year of the liquidation. In addition, the IRS and Treasury Department believe that it is appropriate to require an inclusion in the year of a subsequent triggering event if the successor U.S. transferor was not a member of a consolidated group with the U.S. transferor immediately before the liquidation for reasons similar to those discussed regarding asset reorganizations involving the U.S. transferor.

2. *Transfers of transferred corporation stock or securities by transferee foreign corporation in an asset reorganization*

Notice 2005–74 provided that if, in a section 361 transaction, a transferee foreign corporation transfers stock or securities of a transferred corporation to a foreign acquiring corporation in an asset reorganization, the exchanges made pursuant to the reorganization will be a triggering event, unless certain conditions are met. These conditions require that the U.S. transferor, common parent, or new common parent corporation, as applicable, enter into a new GRA, with certain modifications. In addition, the U.S. transferor also is required to provide the new GRA and a notice of the asset reorganization with its next annual certification.

For purposes of this rule, Notice 2005–74 retained the same definition of asset reorganization as used for the provision dealing with transfers of transferee corporation stock, with certain modifications. Specifically, Notice 2005–74 excludes the following asset reorganizations: (1) triangular asset reorganizations described in §1.358–6(b); and (2) asset reorganizations where, after the reorganization, the same corporation is both the transferee foreign corporation (or successor transferee foreign corporation, as applicable) and the transferred corporation (or the successor transferred corporation, as applicable).

The temporary regulations generally incorporate these rules and provide that if the above conditions are satisfied the original GRA will terminate without further effect. However, even if these conditions are satisfied, the temporary regulations provide specific gain recognition rules if the transferee foreign corporation transfers stock or securities of the transferred corporation in an asset reorganization and the U.S. transferor recognizes gain under section 356(a)(1). See section C of this preamble.

As noted in this preamble, Notice 2005–74 excluded from the definition of the term asset reorganization any triangular asset reorganizations of the transferee foreign corporation and transferred corporation and certain upstream and downstream reorganizations. In response to comments and upon further study by the IRS and Treasury Department, the temporary regulations address the treatment of triangular asset reorganizations of the transferee foreign corporation and certain upstream and downstream reorganizations. See sections G and H of this preamble.

3. *Transfers of substantially all of a transferred corporation's assets*

Notice 2005–74 provides that if a transferred corporation transfers substantially all its assets in an asset reorganization, the exchanges made pursuant to the reorganization will be a triggering event, unless certain conditions are met. These conditions require that the U.S. transferor, U.S. parent corporation or new U.S. parent corporation, as applicable, enters into a new GRA, with certain modifications. The U.S. transferor also is required to provide the new GRA and the notice of the asset reorganization with its next annual certification. The definition of asset reorganization is the same as that used in asset reorganizations involving the transferee foreign corporation.

The temporary regulations generally incorporate these rules and provide that if these conditions are met, the original GRA

will terminate without further effect. However, even if these conditions are satisfied, the temporary regulations provide specific gain recognition rules (described in section C of this preamble) if the transferred corporation transfers substantially all of its assets in an asset reorganization and the transferee foreign corporation recognizes gain under section 356(a)(1). In addition, although the definition of asset reorganization excludes triangular asset reorganizations and downstream mergers of the transferee foreign corporation, the temporary regulations address the tax treatment of these transactions. See sections G and H of this preamble.

C. *Special Rules Regarding Nonrecognition Transactions Involving Money or Other Property*

The current regulations provide that certain nonrecognition transactions are not triggering events if particular requirements are satisfied. However, commentators have stated that the current regulations provide that certain nonrecognition transactions at the transferee foreign corporation or transferred corporation level in which any money or other property (as described in sections 351(b) or 356(a)) is received in exchange are triggering events without exception. These commentators assert that it is not appropriate to trigger an entire GRA as a result of receiving a relatively minor amount of "boot" in the nonrecognition transaction. These commentators also note that the current regulations do not address clearly the treatment of transfers of transferee foreign corporation stock by a U.S. transferor in a nonrecognition transaction in which the U.S. transferor receives boot.

The IRS and Treasury Department agree that the receipt of boot under section 351(b) or 356(a)(1) in connection with the disposition of transferred corporation stock or securities, or substantially all of a transferred corporation's assets, should not automatically trigger all the gain under a GRA. Accordingly, the temporary regulations provide that if certain conditions are met, the entire GRA will not be triggered when a transferee foreign corporation disposes of transferred corporation stock or securities in a nonrecognition transaction simply because the transferee foreign corporation receives boot.

However, the IRS and Treasury Department believe that the GRA should be triggered to the extent that gain would be recognized in such a transaction by a transferee foreign corporation or a transferred corporation, before taking into account basis increases that may apply to the stock or securities disposed of as a result of triggering the GRA. The current, as well as the temporary regulations, provide that if a U.S. transferor is required to recognize gain because of a triggering event, then certain basis increases are allowed as of the date of the initial transfer. Therefore, in determining the amount of gain that is recognized under the GRA in such a transaction, the temporary regulations provide that the U.S. transferor first must recognize that amount of gain that the transferee foreign corporation or transferred corporation would have recognized under 351(b) or 356(a)(1), before taking into account the basis increases that are allowed under the regulations as of the date of the initial transfer. Second, if the U.S. transferor has not recognized all the gain realized, but not recognized, on the initial transfer, then its new GRA will reflect any remaining unrecognized gain on the initial transfer. Third, after the consequences of the transaction are determined under the temporary regulations, then the taxpayer must determine the amount of gain, if any, that the transferee foreign corporation or transferred corporation must recognize under 351(b) or 356(a)(1). In determining the amount to be recognized, the basis of the stock disposed of shall reflect the basis increase allowed as a result of the gain recognized under the GRA by the U.S. transferor.

This special rule limiting recognition of gain in otherwise nonrecognition transactions involving boot applies only if the U.S. transferor complies with the otherwise applicable requirements of the exception to recognizing all of the gain subject to the GRA when there is a triggering event. This special rule is intended to require the U.S. transferor to recognize only an appropriate amount of income, without automatically triggering the entire GRA.

The IRS and Treasury Department also believe that additional guidance is needed on the treatment of transfers of transferee foreign corporation stock by a U.S. transferor in a nonrecognition exchange in which the U.S. transferor receives boot. Therefore, the temporary regulations treat the disposition of transferee foreign corporation stock in a nonrecognition transaction by the U.S. transferor when the U.S. transferor receives money or other property as described in section 351(b) or 356(a) as a termination of the GRA in whole or in part. Consequently, if a new GRA is filed, then the U.S. transferor will recognize gain under the new GRA in the event of a subsequent triggering event in the amount of the gain realized, but not recognized, in the initial transfer less any gain recognized by the U.S. transferor under section 351(b) and 356(a)(1) in connection with the nonrecognition transaction. If, however, a new GRA is not filed in connection with the nonrecognition transaction, then the original GRA is triggered, and the U.S. transferor must recognize the gain that was realized, but not recognized, on the initial transfer less any gain recognized by the U.S. transferor under section 351(b) or 356(a)(1) in connection with the nonrecognition transaction.

D. *Effect of Consolidation and Deconsolidation on Gain Recognition Agreements*

Commentators noted that the current regulation does not adequately address the effect on GRAs of certain transactions involving consolidated groups. For example, the commentators noted that it is not clear what effect a U.S. transferor becoming a member of a consolidated group has on an existing GRA. The current regulations do provide, however, that if a U.S. transferor is a member of a consolidated group at the time of the initial transfer and ceases to be a member of the group during the term of the GRA, the common parent of such group that entered into the GRA continues to be liable under the original GRA. Section 1.367(a)–8(b)(5)(ii). Several commentators have raised concerns that such a result is not appropriate because the actions of an acquirer could unilaterally affect the liability of the original consolidated group under the GRA.

The IRS and Treasury Department agree that the effect of these transactions needs to be clarified and rationalized. Accordingly, in response to these concerns, the temporary regulations provide specific rules addressing these transactions. In par-

ticular, the IRS and Treasury Department believe that the U.S. parent corporation of a consolidated group should not continue to be liable under a GRA with respect to a U.S. transferor that is no longer a member of such group.

The temporary regulations provide that when a U.S. transferor becomes a member of a consolidated group (including a transaction where it joins such a group after being a member of another consolidated group) the transaction is a triggering event unless certain conditions are met. If these conditions are satisfied, the original GRA is terminated without further effect. These conditions require the U.S. parent corporation of the consolidated group that the U.S. transferor joins (1) to enter into a new GRA for the remaining term of the original GRA and (2) to elect to recognize gain in the taxable year of any subsequent triggering event (as opposed to the year of the initial transfer). A notice of the consolidation transaction must also be filed with the next annual certification. The IRS and Treasury Department believe that these requirements ensure that a GRA remains in effect after a U.S. transferor joins a consolidated group. These requirements are also consistent with §1.1502–77(a), which provides that the common parent is the sole agent for each member of the consolidated group.

In addition, the temporary regulations also cover situations in which a U.S. transferor ceases to be a member of a consolidated group and does not become a member of a new consolidated group. In these cases, the transaction is a triggering event, unless certain conditions are met. If these conditions are satisfied, the original GRA is terminated without further effect. These conditions require the U.S. transferor (1) to enter into a new GRA for the remaining term of the original gain recognition agreement and (2) to elect that in the event of a subsequent triggering event the U.S. transferor will recognize gain in the year of the triggering event. The U.S. transferor must also provide notice of the deconsolidation with the next annual certification.

E. *U.S. Transferor Goes Out of Existence in a Transaction Giving Rise to a Gain Recognition Agreement*

The current regulation provides that when a U.S. transferor goes out of existence in a transaction giving rise to a GRA, gain generally qualifies for nonrecognition treatment only if the U.S. transferor is owned by a single U.S. parent corporation, the U.S. transferor and its parent corporation file a consolidated Federal income tax return for the taxable year that includes the transfer, and the parent of the consolidated group enters into a GRA. Section 1.367(a)–8(f)(2)(i). The current regulation provides that a U.S. transferor that is controlled by five or fewer domestic corporations may request a ruling that the transaction qualifies for nonrecognition treatment. Section 1.367(a)–8(f)(2)(i).

Notice 2005–74, in turn, provides a rule that treats all members of the U.S. parent's consolidated group for the taxable year that includes the transfer as a single corporation for purposes of §1.367(a)–8(f)(2)(i). Thus, a U.S. transferor that is not directly owned by a single U.S. parent corporation may still qualify for nonrecognition, without requesting a ruling, when the U.S. transferor goes out of existence in a transaction giving rise to a GRA, if it is indirectly wholly owned by members of a consolidated group.

The IRS and Treasury Department believe it is necessary to provide additional guidance on how GRAs are entered into when a U.S. transferor is controlled by multiple corporate shareholders with which the U.S. transferor does not join in filing a consolidated return. Moreover, the IRS and Treasury Department believe that in this area a single rule should apply both in consolidated and nonconsolidated situations. As a result, the temporary regulations provide unified rules, replacing both the current regulations and Notice 2005–74, in situations in which a U.S. transferor goes out of existence in a transaction giving rise to a GRA.

The temporary regulations generally provide that when a U.S. transferor goes out of existence in a transaction giving rise to a GRA, the gain may qualify for nonrecognition treatment if (1) the requirements of section 367(a)(5) and any regulations under that paragraph are satisfied such that five or fewer domestic corporations control the U.S. transferor and appropriate basis adjustments are made, (2) the requirements of §1.367(a)–3(c)(1) are satisfied if the transferred corporation is domestic, (3) all domestic corporate shareholders of the U.S. transferor that own at least five percent of either the total voting power or the total fair market value of the stock of the transferee foreign corporation immediately after the transaction enter into GRAs with respect to their *pro rata* share of the gain in the transferred stock or securities that designate such domestic corporate shareholders as U.S. transferors for purposes of §§1.367(a)–3(b) and (c) and 1.367(a)–8T, and (4) all domestic corporate shareholders that enter into GRAs elect to recognize any gain upon a subsequent trigger of the GRA in the year of the triggering event.

The temporary regulations eliminate the current regulation's option to request a private letter ruling because guidance is now provided on how GRAs are entered into by five or fewer domestic corporations that control a U.S. transferor satisfying section 367(a)(5). In addition, the temporary regulations clarify that the terms of section 367(a)(5) must be satisfied (along with other requirements) to avoid gain recognition on the U.S. transferor's section 361 transfer of stock or securities to a foreign acquiring corporation. Therefore, the rule in Notice 2005–74 treating consolidated group members as a single corporation is incorporated by reference to section 367(a)(5), which provides that all members of the same affiliated group are treated as one corporation. Lastly, because these rules address how gain recognition may be avoided under section 367(a)(1) on the initial transfer itself, rather than the effect of subsequent transactions on existing GRAs, these rules have been removed from §1.367(a)–8 and included instead in §1.367(a)–3T(e).

F. *Transfers of Transferred Corporation's Assets*

Under the current regulations, dispositions of substantially all of the assets of the transferred corporation (within the meaning of section 368(a)(1)(C)) are generally treated as deemed dispositions of the stock or securities of the transferred corporation and therefore are triggering events. Section 1.367(a)–8(e)(3). In Revenue Ruling 57–518, 1957–2 C.B. 253, see §601.601(d)(2), the IRS stated that what constitutes "substantially all of the properties" as the term is used in section 368(a)(1)(C) "will depend upon the facts and circumstances in each case rather than

upon any particular percentage." However, Revenue Procedure 77–37, 1977–2 C.B. 568, see §601.601(d)(2), provides that for ruling purposes, the transfer by a corporation of 70 percent of its gross assets or 90 percent of its assets net of liabilities will generally be deemed to be a transfer of substantially all of the assets of a corporation.

Commentators have noted that defining substantially all by reference to section 368(a)(1)(C) may not be appropriate in the context of the GRA rules. The IRS and Treasury Department, however, generally believe that defining "substantially all" for these purposes by reference to the definition of the term under section 368(a)(1)(C) is appropriate. Nonetheless, the IRS and Treasury Department believe that it is important to clarify the scope of the term "substantially all," as used in the current regulation and the temporary regulations. One commentator suggested that if a transferred corporation disposes of less than 70 percent of its gross assets or 90 percent of its assets net of liabilities, the transfer will not be treated as a disposition of substantially all of the assets of the transferred corporation for purposes of §1.367(a)–8(e)(3), and thus, such a disposition would not trigger a GRA. This suggestion is not correct. If, upon considering the facts and circumstances, a transferred corporation has disposed of substantially all its assets, such a transaction is a triggering event, even if the transferred corporation disposes of less than 70 percent of a corporation's gross assets or 90 percent of its assets net of liabilities. The "substantially all" safe harbor provided in Revenue Procedure 77–37 is intentionally high so that the IRS does not need to engage in a factually detailed analysis before issuing a letter ruling. As a result, in the context of GRAs, the Revenue Procedure's threshold does not mean that a disposition of substantially all the assets does not occur upon the disposition of a lesser amount of assets. Therefore, the temporary regulations provide that whether a transferred corporation has disposed of substantially all of its assets is determined under all the facts and circumstances.

G. *Transactions that Terminate the GRA*

1. *Taxable dispositions of transferee foreign corporation stock*

Section 1.367(a)–8(h)(1) provides that a GRA will terminate, in whole or in part, as a result of certain taxable dispositions of the transferee foreign corporation stock by the U.S. transferor. A key premise for this termination rule is that the basis in the transferee foreign corporation stock received by the U.S. transferor in the initial transfer is assumed to reflect the basis in the transferred stock or securities.

The IRS and Treasury Department continue to believe this termination rule is appropriate. As a result, the temporary regulations generally retain this rule. However, the temporary regulations modify the termination rule to ensure that a GRA terminates only when the transferee foreign corporation stock disposed of in fact reflects the basis of the transferred stock or securities. This termination rule only applies to transferee foreign corporation stock that is received (or deemed received) in the initial transfer. The IRS and Treasury Department understand that in some cases, taxpayers may take the position that the basis in the transferee foreign corporation stock does not reflect the basis of the transferred stock or securities. For example, taxpayers may take the position that the basis in such transferee foreign corporation stock received also reflects the basis of other property that had a built-in loss when it was transferred to the transferee foreign corporation. Thus, the termination rule in the temporary regulations will apply only when the basis of the transferee foreign corporation stock received (or deemed received) in the initial transfer properly reflects the sum of the aggregate basis of the transferred stock or securities immediately before the initial transfer, plus any increase in the basis of such stock or securities as a result of recognizing gain on the transfer. In addition, for purposes of this basis determination, basis increases to the transferee foreign corporation stock as a result of income inclusions (for example, pursuant to section 961) shall not be taken into account.

In cases where the basis of the relevant transferee foreign corporation stock exceeds the basis of the transferred stock or securities, however, the temporary regulations allow the U.S. transferor to take advantage of this termination rule if it elects to reduce its basis in the transferee foreign corporation stock such that it does not exceed the basis it had in the transferred stock or securities. If the U.S. transferor makes this election, the basis reduction will be effective immediately before the taxable disposition that terminates the GRA. In addition, if the U.S. transferor makes this election, it may increase its basis in other stock of the transferee foreign corporation it holds, if any, by a corresponding amount but not above the fair market value of such stock.

Similar rules apply in the case of partial dispositions of transferee foreign corporation stock and dispositions of transferee foreign corporation stock in nonrecognition transactions in which a portion of the realized gain is recognized.

2. *Certain inbound distributions or transfers of the transferred stock*

Section 1.367(a)–8(h)(3) provides that a distribution of the transferred stock in a transaction qualifying under section 355 or sections 332 and 337 will terminate the GRA if the U.S. transferor's basis in the transferred stock or securities that it receives in the section 355 or 332 and 337 transaction does not exceed the basis the U.S. transferor had in the transferred stock or securities immediately before the initial transfer. In response to comments, however, the temporary regulations allow the U.S. transferor to take advantage of this termination rule if it elects to reduce the basis of the transferred stock or securities if the basis exceeds the basis the U.S. transferor had in the transferred stock or securities immediately before the initial transfer. For purposes of this basis determination, basis increases to the transferred stock as a result of income inclusions (for example, pursuant to section 961) shall not be taken into account. If the U.S. transferor elects to reduce basis in the transferred stock or securities it receives, the U.S. transferor shall increase its basis in other transferee foreign corporation stock (if any) by a corresponding amount but not above the fair market value of such stock.

Although the temporary regulations generally provide that a GRA terminates in certain section 332 liquidations of the transferee foreign corporation, the IRS

and Treasury Department are studying to what extent this rule should apply when the transferee foreign corporation has a minority shareholder and therefore recognizes gain under section 336 in connection with the section 332 liquidation. As noted in the request for comments, although the IRS and Treasury Department generally believe it is appropriate to terminate entirely the GRA in a section 332 liquidation, in other circumstances it may not be appropriate. For example, if after an initial transfer, a wholly-owned transferee foreign corporation issues a minority interest to a foreign shareholder, completely terminating the GRA upon a section 332 liquidation of the transferee foreign corporation does not account for the fact that the U.S. transferor has indirectly disposed of up to 20 percent of its interest in the transferred stock or securities. Therefore, when the temporary regulations are finalized, the IRS and Treasury Department may address the effect that section 336 gain has on a gain recognition agreement when a transferee foreign corporation with a minority shareholder liquidates under section 332.

The temporary regulations expand the current rule to terminate GRAs when certain U.S. persons other than the original U.S. transferor receive the stock or securities that was transferred in the initial transfer. For example, if the transferred corporation is distributed to a domestic corporation or U.S. individual other than the U.S. transferor in a section 355 "split off," the GRA would terminate if the domestic corporation or U.S. individual receives the transferred stock or securities with a basis that is not greater than the basis the U.S. transferor had in the transferred stock or securities immediately before the initial transfer.

Finally, and in response to comments requested in Notice 2005–74, the temporary regulations also expand the current rule to provide that the GRA will terminate in additional transactions where the U.S. transferor or a domestic corporation receives the transferred stock or securities with a basis that is not greater than the basis the U.S. transferor had in the transferred stock or securities immediately before the initial transfer. These transactions are upstream asset reorganizations where the U.S. transferor acquires the assets of the transferee foreign corporation, downstream asset reorganizations where the transferred corporation acquires the assets of the transferee foreign corporation, and certain other asset reorganizations where a domestic corporation acquires the assets of the transferee foreign corporation. Consequently, the temporary regulations generally provide that the GRA terminates in particular circumstances when the transferred stock or securities are held with the correct basis by certain U.S. persons, even if the U.S. person is not the original U.S. transferor.

However, the IRS and Treasury Department believe that it is not appropriate for the GRA to terminate when the transferred stock or securities may then be disposed of, directly or indirectly, by a foreign shareholder without being subject to U.S. tax. Therefore, this termination rule is limited to section 332 liquidations, section 355 distributions, and asset reorganizations where the domestic corporation that holds the transferred stock or securities after the transaction is either the U.S. transferor or a member of the same consolidated group of which the U.S. transferor is then a member. The IRS and Treasury Department continue to study whether it would be appropriate to expand the scope of the rule to transactions where the acquirer is not a member of the same consolidated group of which the U.S. transferor is then a member and request comments regarding such a rule.

H. *Triangular Reorganizations of Transferee Foreign Corporation and Transferred Corporation*

Notice 2005–74 provides rules that allow a U.S. transferor to avoid gain recognition on certain asset reorganizations of the transferee foreign corporation and transferred corporation. However, Notice 2005–74 restricts the definition of "asset reorganization" to exclude triangular asset reorganizations of the transferee foreign corporation and transferred corporation.

In response to comments and after further study, the temporary regulations address the treatment of certain triangular asset reorganizations. Specifically, they provide that if the transferee foreign corporation or transferred corporation is acquired in a triangular asset reorganization, the exchanges made pursuant to the reorganization will not be triggering events if certain requirements are satisfied. For purposes of this rule, a triangular asset reorganization is limited to a transaction in which the acquiring subsidiary is foreign. The additional requirements are as follows. First, the U.S. transferor or common parent must enter into a new GRA to recognize gain with respect to the initial transfer during the remaining term of the original GRA, with certain modifications. In the case of a triangular asset reorganization of the transferee foreign corporation, the U.S. transferor also must make certain designations depending on whether the parent corporation of the foreign acquiring subsidiary is foreign or domestic and depending on the type of triangular asset reorganization. Finally, the U.S. transferor must provide notice of the transaction with its next annual certification.

I. *Other Changes*

The current regulations refer to "stock of the transferred corporation" in some paragraphs but refer to "stock or securities of the transferred corporation" in other paragraphs. The temporary regulations refer to "stock or securities of the transferred corporation" because either stock or securities, or both, may be subject to a GRA when transferred to a transferee foreign corporation by a U.S. person. In contrast, the temporary regulations generally refer only to stock, and not securities, of the transferee foreign corporation. The rules applying to a disposition of the transferee foreign corporation are concerned primarily with transactions in which the U.S. transferor loses or decreases its control of the transferee foreign corporation, which does not occur when a U.S. transferor disposes of securities of the transferee foreign corporation.

The current regulation provides a reasonable cause exception to triggering a GRA when the person required to file the GRA fails to comply in any material respect with the terms of a GRA, or when the person fails to meet the timeliness requirement for submitting a GRA. The temporary regulations retain this reasonable cause exception but provide additional guidance on how the person should submit a request for reasonable cause relief. The temporary regulations also provide that the Area Director or Director of Field Operations, as applicable, shall notify the

person in writing within 120 days of the filing if the person will be granted reasonable cause relief or if additional time is required to make the determination. The 120-day period runs from the date that the IRS notifies the person that its request has been received. Once this period begins, the person shall be deemed to have established reasonable cause if it is not again notified within 120 days.

Effective Dates

With the exception of the special boot rules described in section C of this preamble, these temporary regulations apply to GRAs filed with respect to transfers of stock or securities occurring on or after March 7, 2007. The boot rules described in section C of this preamble apply to GRAs filed with respect to transfers of stock or securities occurring on or after 180 days after February 5, 2007. However, GRAs that are filed after March 7, 2007 in connection with transactions entered into pursuant to a contract that was binding before February 5, 2007 are not subject to these regulations, but taxpayers may elect to apply the rules of these regulations to such a GRA. For all open years, taxpayers may apply rules of these regulations that were not already effective under §1.367(a)–8 to GRAs filed before March 7, 2007. Similar effective date rules are provided for those transfers discussed in section E of this preamble (regarding a U.S. transferor that goes out of existence in a transaction giving rise to a GRA).

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 5 U.S.C. 553(b) and (d) do not apply to these regulations. For applicability of the Regulatory Flexibility Act, please refer to the cross-referenced notice of proposed rulemaking published elsewhere in this Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Request for Comments

The IRS and Treasury Department are considering issuing subsequent public guidance to address additional issues under section 367(a). Accordingly, comments are requested regarding the application of §1.367(a)–8, including whether other transactions should be excepted from being treated as triggering events pursuant to rules similar to those contained in the temporary regulations. For example, comments are requested as to the most appropriate treatment of divisive reorganizations qualifying under section 368(a)(1)(D) or (G), involving the U.S. transferor corporation, the transferee foreign corporation, and the transferred corporation. Comments also are requested on how a GRA is affected by a subsequent transaction to which section 304 applies involving transferee foreign corporation stock or transferred corporation stock. The IRS and Treasury Department believe that the rules in the temporary regulations generally deal with many transactions to which section 304 applies but request specific comments on any issues raised.

In addition, the IRS and Treasury Department request comments on the rule in §1.367(a)–8T(b)(3)(iii), which imposes interest on the additional tax, if any, that is required to be paid as a result of a triggering event. Specifically, comments are requested on whether interest should be imposed even when no additional tax is ultimately due as a result of a triggering event because, for example, a taxpayer has sufficient net operating losses to offset the tax that would otherwise be due as a result of a triggering event. If an interest charge is not required in such a case, a taxpayer may be viewed as inappropriately benefiting from deferring the realized but unrecognized gain on the initial transfer until a later year. However, there are other instances where the current regulations clearly permit such a benefit (for example, under §1.367(a)–8(h)(1)(i) in certain taxable dispositions of the stock of the transferee foreign corporation).

As described in section B.1.a of this preamble, comments are requested on whether a GRA should not be triggered, if certain conditions similar to those provided in §1.367(a)–3T(e) are met, when a U.S. transferor is acquired by a foreign corporation in an asset reorganization. Specifically, the IRS and Treasury Department request comments on how to reconcile the terms of the GRA that would be filed pursuant to §1.367(a)–3T(e) with the terms of a new GRA that would be filed to avoid triggering the original GRA. For example, the transferee foreign corporation under the outstanding GRA (and under the new GRA filed to avoid triggering the outstanding GRA) would be the transferred corporation with respect to the GRA filed pursuant to §1.367(a)–3T(e).

Finally, and as described in section G.2 of this preamble, the IRS and Treasury Department are studying to what extent the GRA termination rule should apply when the transferee foreign corporation liquidates in a transaction described in section 332 but also recognizes gain under section 336 because of a minority shareholder. Comments are requested on how the termination rule should address such a transaction, taking into consideration potentially different results depending on whether the minority shareholder is also subject to a GRA or is, for example, instead a foreign person who was issued transferee foreign corporation stock after the initial transfer.

For information on how to submit comments or request a public hearing, see the section "Comments and Requests for a Public Hearing," set forth in the notice of proposed rulemaking published elsewhere in this issue of the Bulletin.

Drafting Information

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

* * * * *

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 is amended by adding new entries to read as follows:

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

Section 1.367(a)–3T(e) also issued under 367(a) and (b).* * *

Section 1.367(a)–8T also issued under 367(a) and (b).* * *

Par. 2. For each entry in the table in the "Section" column, remove the language in the "Remove" column and add the language in the "Add" column in its place.

Section	Remove	Add
1.367(a)–3(d)(3), Example 1(ii), fourth sentence	§1.367(a)–8(e)	§1.367(a)–8T(d)(1)
1.367(a)–3(d)(3), Example 1(ii), fourth sentence	§1.367(a)–8(b)(1)(vii)	§1.367(a)–8T(b)(1)(vii)
1.367(a)–3(d)(3), Example 1(ii), fifth sentence	§1.367(a)–8(b)(1)(vii)	§1.367(a)–8T(b)(1)(vii)
1.367(a)–3(d)(3), Example 1A(ii), first sentence	§1.367(a)–8(a)(3)	§1.367(a)–8T(a)(3)
1.367(a)–3(d)(3), Example 4(i), first sentence	§1.367(a)–8(e)(3)(i)	§1.367(a)–8T(d)(2)
1.367(a)–3(d)(3), Example 4(ii), first sentence	§1.367(a)–8(e)(3)(i)	§1.367(a)–8T(d)(2)
1.367(a)–3(d)(3), Example 4(ii), second sentence	§1.367(a)–8(h)(2), because A and W filed a consolidated Federal income tax return prior to the transaction,	§1.367(a)–8T(g)(2), because A owned an amount of stock in W described in section 1504(a)(2) immediately before the transaction,
1.367(a)–3(d)(3), Example 6(ii), last sentence	§1.367(a)–8(e)(3)(i)	§1.367(a)–8T(d)(2)
1.367(a)–3(d)(3), Example 7A(ii), last sentence	§1.367(a)–8(b)(5)	§1.367(a)–8T(b)(5)
paragraph (d)(3), Example 7A(ii), last sentence	and (e)(3)(i).	and V satisfies the requirements contained in §1.367(a)–8T(e)(1)(iii).
1.367(a)–3(d)(3), Example 8(ii), second to last sentence	§1.367(a)–8(e)(3)(i)	§1.367(a)–8T(d)(2)
1.367(a)–3(d)(3), Example 11(ii), sixth sentence	§1.367(a)–8(e)	§1.367(a)–8T(d)(1)
1.367(a)–3(d)(3), Example 11(ii), sixth sentence	§1.367(a)–8(b)(1)(vii)	§1.367(a)–8T(b)(1)(vii)
1.367(a)–3(e)(1)(A), first sentence	(e)	(g)
1.367(a)–3(e)(1)(F), third sentence	(g)	(j)
1.367(a)–3(e)(2), first sentence	(e)(1) and (g)	(g)(1) and (j)
1.367(a)–3(e)(2), second sentence	(e)(2)	(g)(2)
1.367(a)–3(e)(2)(G), first sentence	(e)(1)(G)	(g)(1)(G)
1.367(a)–3(g)(1), first sentence	(g)(2)	(j)(2)
1.367(a)–3(g)(2)(i), first sentence	(g)(2)(iii), (g)(2)(iv)	(j)(2)(iii), (j)(2)(iv)
1.367(a)–3(g)(2)(ii), first sentence	(g)(2)(iii) or (iv)	(j)(2)(iii) or (iv)
1.367(a)–3(g)(2)(ii), fourth sentence	§1.367(a)–3(f)	§1.367(a)–3(h)
1.367(a)–3(g)(2)(iii), first sentence	(g)(2)(ii)	(j)(2)(ii)
1.367(a)–3(g)(2)(iv), first sentence	(g)(2)(i) and (ii)	(j)(2)(i) and (ii)
1.367(b)–4(b)(1)(iii), Example 4(i), last sentence	§1.367(a)–8(f)(2)	§1.367(a)–3T(e)

Par. 3. Section 1.367(a)–3 is amended as follows:

1. The second sentence of paragraph (a) is revised.

2. The first sentence of paragraph (d)(2)(iii) is revised.

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

4. The title and introductory text of paragraph (d)(2)(v) is revised.

5. The last two sentences of paragraph (d)(3), *Example 1A*(ii) are revised.

6. The last two sentences of paragraph (d)(3), *Example 5A*(ii) are revised.

7. The first and second sentences of paragraph (d)(3), *Example 7*(ii) are revised.

8. The third sentence of paragraph (d)(3), *Example 7A*(ii) is revised.

9. The last sentence of paragraph (d)(3), *Example 9*(ii) is revised.

10. The title of paragraph (d)(3), *Example 10* is revised.

11. The third sentence of paragraph (d)(3), *Example 12*(ii) is revised.

12. Redesignating paragraphs (e), (f), and (g) as paragraphs (g), (h), and (j), respectively.

13. Adding new paragraphs (e) and (i).

The revisions and addition read as follows:

§1.367(a)–3 Treatment of transfers of stock or securities to foreign corporations.

(a) * * * In general, a transfer of stock or securities by a U.S. person to a foreign corporation that is described in section 351, 354 (including a reorganization described in section 368(a)(1)(B) and including an indirect stock transfer described in paragraph (d) of this section), 356 or section 361(a) or (b) is subject to section 367(a)(1) and, therefore, is treated as a taxable exchange, unless one of the exceptions set forth in paragraph (b) of this section (regarding transfers of foreign stock or securities), paragraph (c) of this section (regarding transfers of domestic stock or securities), or paragraph (e) of this section (regarding transfers of stock or securities in a section 361 exchange) applies. * * *

* * * * *

(d) * * *

(2)(iii) * * * For purposes of determining the amount of gain that a U.S. person is required to include in income as a result of a triggering event, see §1.367(a)–8T(b)(3)(i) and (d).

(iv) * * * The U.S. transferor's agreement to recognize gain, as provided in §1.367(a)–8, shall include appropriate provisions consistent with the principles of §1.367(a)–3 and §1.367(a)–8, including, for example, as an additional triggering event an indirect disposition of the transferred stock or securities. For example, in the case of a triangular section 368(a)(1)(B) reorganization described in paragraph (d)(1)(iii)(A) of this section, a triggering event shall include an indirect disposition of the transferred stock or securities by the transferee foreign corporation, such as a disposition of the stock of the acquiring corporation (either foreign or domestic) by the transferee foreign corporation. In the case of a triangular section 368(a)(1)(B) reorganization described in paragraph (d)(1)(iii)(B) of this section, a disposition of the stock of the acquiring corporation by the domestic issuing corporation in a taxable transaction shall, for example, terminate the gain recognition agreement if the principles of §1.367(a)–8T(g)(1)(i)(A) and (B) are satisfied. See *Examples 5* and *5A* of this section.

(v) *Determination of whether substantially all of the transferred corporation's assets are disposed of.* For purposes of applying §1.367(a)–8T(d)(2) to determine whether substantially all of the assets of the transferred corporation have been disposed of, the following assets shall be taken into account (but only if such assets are not fully taxable under section 367 in the taxable year that includes the indirect transfer)—

* * * * *

(3) * * *

Example 1A. * * *

(ii) * * * If A leaves the P group, the gain recognition agreement would be triggered pursuant to §1.367(a)–8T(d)(4), unless the exception provided under §1.367(a)–8T(e)(8) applies.

* * * * *

Example 5A * * *

(ii) * * * If Y sold substantially all of its assets (within the meaning of section 368(a)(1)(C)), the gain recognition agreement would be terminated because U owned an amount of stock in Y described in section 1504(a)(2) immediately before the transaction and Y is a domestic corporation. See §1.367(a)–8T(g)(2). In addition, if F disposed of the stock of S in a taxable transaction the gain recognition agreement would be terminated if the principles of §1.367(a)–8T(g)(1)(i)(A) and (B) are satisfied.

* * * * *

Example 7. * * *

(ii) * * * The disposition by R, the transferred corporation, of substantially all of its assets would terminate the gain recognition agreement if the assets were disposed of in a taxable transaction because V owned an amount of stock in Z described in section 1504(a)(2) immediately before the transaction, and R is a domestic corporation. See §1.367(a)–8T(g)(2). Because the assets were transferred in an exchange to which section 351 applies, such transfer does not trigger the gain recognition agreement if V complies with the requirements contained in §1.367(a)–8T(e)(1)(iii). * * *

Example 7A. * * *

(ii) * * * Thus, the gain recognition agreement would terminate because V owned an amount of stock in Z described in section 1504(a)(2) immediately before the transaction, and R is a domestic corporation. See §1.367(a)–8T(g)(2).* * *

* * * * *

Example 9. * * *

(ii) * * * To determine whether there is a triggering event under §1.367(a)–8T(d)(2), both the Business A assets in M and the Business B assets in R must be considered.

Example 10. Concurrent application of asset transfer and indirect stock transfer rules in section 368(a)(1)(A)/(a)(2)(D) reorganization—(i) Facts. * * *

* * * * *

Example 12. * * *

(ii) * * * E's transfer of its N stock could qualify for nonrecognition treatment if D satisfies the requirements in §1.367(a)–3T(e).* * *

* * * * *

(e) [Reserved]. For further guidance, see §1.367(a)–3T(e).

(f) [Reserved]. For further guidance, see §1.367(a)–3T(f).

* * * * *

(i) [Reserved].

* * * * *

Par. 4. Section 1.367(a)–3T is added to read as follows:

§1.367(a)–3T Treatment of transfers of stock or securities to foreign corporations (temporary).

(a) through (d) [Reserved]. For further guidance, see §1.367(a)–3(a) through (d).

(e) *Transfers by a domestic corporation to a foreign corporation in a section 361 exchange*—(1) *General rule*. Notwithstanding paragraphs (b) and (c) of this section, if the U.S. transferor is a domestic corporation that transfers stock or securities to a foreign corporation in a section 361 exchange that would otherwise be subject to section 367(a)(1) under paragraph (a) of this section, such transfer shall not be subject to section 367(a)(1) if—

(i) The conditions set forth in the second sentence of section 367(a)(5) and any regulations under that section have been satisfied, such that, for example, the U.S. transferor is controlled (within the meaning of section 368(c)) by 5 or fewer domestic corporations and appropriate basis adjustments are made;

(ii) In the case of transferred property that is stock or securities of a domestic corporation, the conditions set forth in paragraph (c) of this section are satisfied;

(iii) All domestic corporate shareholders of the U.S. transferor immediately before the transaction that own 5 percent or more (applying the attribution rules of section 318, as modified by section 958(b)) of the total voting power or the total fair market value of the stock of the transferee foreign corporation immediately after the transaction enter into gain recognition agreements as provided in §1.367(a)–8T with respect to their *pro rata* share (determined by the relative fair market value of the U.S. transferor stock or securities owned) of the gain that was realized but not recognized on the transfer of the stock or securities of the transferred corporation that, in addition to the terms of §1.367(a)–8T(b), designate such domestic corporate shareholders as U.S. transferors for purposes of paragraphs (b) and (c) of this section and §1.367(a)–8T; and

(iv) All domestic corporate shareholders that enter into gain recognition agreements pursuant to paragraph (e)(1)(iii) of this section make the election described in §1.367(a)–8T(b)(1)(vii).

(2) *Certain triangular asset reorganizations*. If a transaction described in paragraph (e)(1) of this section qualifies as a triangular asset reorganization described in §1.358–6(b)(2)(i) through (iii), or in sections 368(a)(1)(G) and (a)(2)(D), the principles of §1.367(a)–3(d)(2)(iv) shall apply with respect to any gain recognition agreements filed in connection with such transaction.

(3) *Example*. The provisions of paragraph (e)(1) of this section are illustrated in the following example:

Example. (i) *Facts*. US1 and US2, domestic corporations, own 60% and 40%, respectively, of the fair market value of UST, also a domestic corporation. US1 and US2 are not members of the same consolidated group and are unrelated. UST owns 100% of FC, a foreign corporation. In year 1, UST transfers 100% of the stock of FC to FA, a foreign corporation, in a reorganization described in section 368(a)(1)(A) after which US1 and US2 own 6% and 4%, respectively, of the stock of FA. At the time of the initial transfer, the section 1248 amount with respect to the FC stock is $0. The notice requirement under §1.367(b)–1(c) is satisfied. Section 7874 does not apply to FA's acquisition of the stock of FC. US1 and US2 satisfy the conditions set forth in the second sentence of section 367(a)(5), including making appropriate basis adjustments. Pursuant to paragraph (e)(1) of this section, US1 enters into a gain recognition agreement to recognize its *pro rata* share of the gain realized but not recognized on UST's transfer of the stock of FC to FA, designates itself as a U.S. transferor for purposes of paragraph (b) of this section and §1.367(a)–8T, and makes the election described in §1.367(a)–8T(b)(1)(vii). US2 does not enter into a gain recognition agreement with respect to its *pro rata* share of the gain realized but not recognized on UST's transfer of the stock of FC to FA because US2 owns less than 5 percent of the stock of FA. In year 4, FA sells 30% of the FC stock for cash.

(ii) *Result*. Because the requirements of paragraph (e)(1)(i) through (iv) of this section are satisfied, the transfer of the FC stock by UST to FA in the year 1 reorganization is not subject to section 367(a)(1). In addition, because FA partially disposes of the stock of FC in year 4, US1 must recognize 30% of its *pro rata* share of the gain realized but not recognized on the initial transfer of the FC stock to FA pursuant to §1.367(a)–8T(d)(1)(iii). The proportion of gain recognized by US1 is determined by reference to the relative fair market value of the UST stock owned by US1 at the time of the initial transfer. Thus, US1 must include 18% of the gain realized, but not recognized, on the initial transfer (the 30% of the transferred property that was disposed of multiplied by the amount of gain subject to the gain recognition agreement (corresponding to the 60% of the fair market value of UST stock that US1 held immediately before the initial transfer)), and pay any applicable interest.

(iii) *Alternate facts*. The facts are the same as in paragraph (i) of this *Example*, except that US1 and US2 are members of a consolidated group in which USP is the common parent. US2 is also a 5-percent transferee shareholder as a result of applying the attribution rules of section 318, as modified by section 958(b). The result is the same as in paragraph (ii) of this *Example*, except that under §1.367(a)–8T(a)(3)(i)(A) USP files gain recognition agreements on behalf of both US1 and US2. Thus, US1 and US2 must include in income in year 4 18% and 12%, respectively, of the gain realized, but not recognized, on the initial transfer (the 30% of the transferred property that was disposed of multiplied by the amount of gain subject to the gain recognition agreement (corresponding to the 60% and 40% of the fair market value of UST stock that US1 and US2, respectively, held immediately before the initial transfer)), and pay any applicable interest.

(f) *Effective date*—(1) *General rule*. The rules of this §1.367(a)–3T(e) apply to transfers of stock or securities occurring on or after March 7, 2007. However, these rules do not apply to transfers of stock or securities occurring on or after March 7, 2007, if such transfer was entered into pursuant to a written agreement which was (subject to customary conditions) binding before February 5, 2007, and at all times thereafter. Solely for purposes of this paragraph (f), a transfer described in the preceding sentence shall be deemed to be a transfer occurring before March 7, 2007. For matters covered in this section for periods before March 7, 2007 but on or after July 20, 1998, the rule of §1.367(a)–8(f)(2)(i) (see 26 CFR part 1, revised April 1, 2006) applies.

(2) *Transfers before effective date*—(i) *General rule*. Taxpayers may apply the rules of §1.367(a)–3T(e) to transfers before March 7, 2007 and after July 20, 1998, for all open taxable years ending on or after July 20, 1998. This paragraph (f)(2)(i) applies only to rules in §1.367(a)–3T(e) that were not already effective under the rules of §1.367(a)–8(f)(2)(i).

(ii) *Special filing rule*. This paragraph (f)(2)(ii) provides the time and manner in which taxpayers may apply paragraph (f)(2)(i) of this section. Notwithstanding the rules provided in §1.367(a)–8T(a)(2), all agreements, certifications, or other information related to the gain recognition agreement that should have been filed on or before March 7, 2007 with respect to a transfer shall be treated as having been timely filed, provided they are attached to a Federal income tax return amending the taxpayer's Federal income tax return for the taxable year in which they should have been attached. The amended return described in the preceding sentence must be filed before August 6, 2007. A taxpayer that wishes to apply paragraph (f)(2)(i) of this section but that fails to meet the filing requirement described in the preceding sentence must request reasonable cause relief as provided in §1.367(a)–8T(e)(10).

(3) *Expiration*. The applicability of this section expires on or before February 1, 2010.

* * * * *

Par. 5. Section 1.367(a)–8 is amended by revising paragraphs (a) through (i) to read as follows:

§1.367(a)–8 Gain recognition agreement requirements.

(a) through (i) [Reserved]. For further guidance, see §1.367(a)–8T(a) through (h).

Par. 6. Section 1.367(a)–8T is added to read as follows:

§1.367(a)–8T Gain recognition agreement requirements (temporary).

(a) *In general*. This section specifies the terms and conditions for an agreement to recognize gain entered into pursuant to §§1.367(a)–3(b) through (d) and 1.367(a)–3T(e) to qualify for nonrecognition treatment under section 367(a).

(1) *Definitions*. The following definitions apply for purposes of this section:

(i) *Asset reorganization*. Except as otherwise provided in this paragraph (a)(1)(i), the term *asset reorganization* means a reorganization described in section 368(a)(1) involving the transfer of assets by a corporation to another corporation pursuant to section 361, except that such term shall include reorganizations described in section 368(a)(1)(D) or (G) only if the requirements of section 354(b)(1)(A) and (B) are met. For purposes of paragraphs (e)(3)(ii) and (e)(3)(iii) of this section, the following reorganizations are excluded from the term "asset reorganization":

(A) Triangular asset reorganizations described in §1.358–6(b)(2)(i) through (iii) or in sections 368(a)(1)(G) and (a)(2)(D). For rules applicable to triangular asset reorganizations described in §1.358–6(b)(2)(i) through (iii) or in sections 368(a)(1)(G) and (a)(2)(D), see paragraph (e)(4) of this section.

(B) Asset reorganizations where, after the reorganization, the same corporation is both the transferee foreign corporation (or successor transferee foreign corporation, as applicable) and the transferred corporation (or the successor transferred corporation, as applicable); for example, the acquisition of the transferee foreign corporation's assets by the transferred corporation in a reorganization described in section 368(a)(1). For rules applicable to certain upstream and downstream reorganizations involving the transferee foreign corporation and transferred corporation, see paragraphs (e)(6) and (g)(3) of this section.

(ii) The term *common parent* means a corporation that controls an affiliated group of corporations that files its Federal income tax returns on a consolidated basis.

(iii) The term *consolidated group* has the meaning set forth in §1.1502–1(h).

(iv) The term *disposition* means any transfer that would constitute a disposition for any purpose of the Internal Revenue Code and the regulations thereunder. It also includes an indirect disposition of the stock of the transferred corporation as described in §1.367(a)–3(d). It does not, however, include a redemption of stock under section 302(d) to the extent the redemption is treated as a distribution to which section 301(c)(1) applies.

(v) The term *gain recognition agreement* means an agreement described in paragraph (b) of this section.

(vi) The term *initial transfer* means a transfer in connection with which a gain recognition agreement is filed in connection with an exchange described in §§1.367(a)–3(b) through (d) and 1.367(a)–3T(e).

(vii) The term *nonrecognition transaction* means any disposition of property in a transaction in which gain or loss is not recognized in whole or in part for purposes of subtitle A.

(viii) The term *transferee foreign corporation* means the foreign corporation the stock of which is received in an exchange described in section 367(a) by a U.S. transferor.

(ix) *Transferred corporation*. Other than in the case of an indirect stock transfer, the term *transferred corporation* means the corporation the stock or securities of which are transferred by a U.S. transferor to a foreign corporation in an exchange described in section 367(a)(1). In the case of an indirect stock transfer, the term *transferred corporation* has the meaning set forth in §1.367(a)–3(d)(2)(ii).

(x) The term *triggering event* means an event described in paragraph (d) of this section, except as provided in paragraphs (e) (exceptions to triggering events) and (g) (terminations of gain recognition agreements) of this section.

(xi) The term *U.S. transferor* means a U.S. person (as defined in §1.367(a)–1T(d)(1)) that transfers stock or securities of the transferred corporation in exchange for stock or securities of the transferee foreign corporation in an exchange described in section 367(a). For the application of the rules of this section to indirect transfers involving partnerships and interests therein, see §1.367(a)–1T(c)(3).

(2) *Filing requirements for gain recognition agreements*. A U.S. transferor's gain recognition agreement must be attached to, and filed by the due date (including extensions) of, the U.S. transferor's income tax return for the taxable year that includes the date of the initial transfer, except that if the U.S. transferor is a member of a consolidated group for the taxable year in which the transfer was made, the agreement must be attached to the consolidated group's tax return. If a new gain recognition agreement is entered into pursuant to an exception in paragraph (e) of this section, the agreement must be attached to, and filed by the due date (including extensions) of, the applicable income tax return for the taxable year that includes the date of the triggering event. If the timeliness requirement of this paragraph (a)(2) is not satisfied, see paragraph (e)(10) of this section.

(3) *Who must sign*—(i) *General rule*. The gain recognition agreement must be signed under penalties of perjury by the appropriate party corresponding to the following categories of U.S. transferor. A gain recognition agreement may also be signed by an agent authorized to do so under a general or specific power of attorney.

(A) In the case of a corporate U.S. transferor, a responsible officer, except that if the U.S. transferor (or successor U.S. transferor designated in a new gain recognition agreement entered into under paragraph (e) of this section) is a member, but not the common parent of a consolidated group for the taxable year in which the transfer was made (or for the taxable year in which a new gain recognition agreement is entered into under paragraph (e) of this section) the agreement must be entered into by the common parent and signed by a responsible officer of such common parent.

(B) In the case of an individual U.S. transferor (including a partner who is treated as a U.S. transferor by virtue of §1.367(a)–1T(c)(3)), the individual.

(C) In the case of a trust or estate, a trustee, executor, or equivalent fiduciary.

(D) In the case of a bankruptcy case under Title 11, United States Code, a debtor in possession or trustee.

(ii) *Signature requirement*. When a gain recognition agreement, certification, or other information is required under this section to be attached to and filed by the due date (including extensions) of a U.S. Federal income tax return and signed under penalties of perjury by the person who signs the return, the attachment and filing of an unsigned copy is considered

to satisfy such requirement, provided the taxpayer retains the original in its records in the manner specified by §1.6001–1(e).

(b) *Gain recognition agreement*—(1) *Contents*. The gain recognition agreement must set forth the following information, with the heading "GAIN RECOGNITION AGREEMENT UNDER §1.367(a)–8T" and with paragraphs labeled to correspond with the numbers set forth as follows:

(i) A statement that the document submitted constitutes the U.S. transferor's agreement to recognize gain in accordance with the requirements of this section.

(ii) A description of the property transferred as described in paragraph (b)(2) of this section.

(iii) The U.S. transferor's agreement to recognize gain, as described in paragraph (b)(3) of this section.

(iv) A waiver of the period of limitations as described in paragraph (b)(4) of this section.

(v) An agreement to file with the U.S. transferor's tax returns for the five full taxable years following the year of the initial transfer a certification as described in paragraph (b)(5) of this section.

(vi) A statement that arrangements have been made in connection with the transferred property to ensure that the U.S. transferor will be informed of any triggering events.

(vii) A statement as to whether, if all or a portion of the gain recognition agreement is triggered under paragraph (d) of this section, the taxpayer elects to include the required amount in the year of the triggering event rather than in the year of the initial transfer.

(2) *Description of property transferred*. (i) The agreement shall include a description of each property transferred by the U.S. transferor, an estimate of the fair market value of the property as of the date of the initial transfer, a statement of the cost or other basis of the property and any adjustments thereto, and the date on which the property was acquired by the U.S. transferor.

(ii) The U.S. transferor must provide the following information:

(A) The type or class, amount, and characteristics of the stock or securities transferred, as well as the name, address, and place of incorporation of the issuer of the stock or securities, and the percentage (by voting power and value) that the stock (if any) represents of the total stock outstanding of the transferred corporation.

(B) The name, address and place of incorporation of the transferee foreign corporation, and the percentage of stock (by voting power and value) that the U.S. transferor received or will receive in the transaction.

(C) If stock or securities are transferred pursuant to §1.367(a)–3T(e), a statement that the conditions set forth in the second sentence of section 367(a)(5) and any regulations under that section have been satisfied, and an explanation of any basis or other adjustments made pursuant to section 367(a)(5) and any regulations under that paragraph.

(D) If the transferred corporation is a domestic corporation, the taxpayer identification number of the transferred corporation, together with a statement describing whether, and if so, how, section 7874 applies to the transfer, and a statement that all of the requirements of §1.367(a)–3(c)(1) are satisfied.

(E) If the transferred corporation is a foreign corporation, a statement as to whether the U.S. transferor was a section 1248 shareholder, as defined in §1.367(b)–2(b), of the transferred corporation immediately before the exchange, and, if so, a statement as to whether the U.S. transferor is a section 1248 shareholder with respect to the transferee foreign corporation stock received, and whether any reporting requirements or other rules contained in regulations under section 367(b) are applicable, and, if so, whether they have been satisfied.

(F) If the transaction involved the transfer of assets other than stock or securities and the transaction was subject to the indirect stock transfer rules of §1.367(a)–3(d), a statement as to whether the reporting requirements under section 6038B have been satisfied with respect to the transfer of property other than stock or securities, and an explanation of whether gain was recognized under section 367(a)(1) and whether section 367(d) was applicable to the transfer of such assets, or whether any tangible assets qualified for nonrecognition treatment under section 367(a)(3) (as limited by section 367(a)(5) and §§1.367(a)–4T through 1.367(a)–6T).

(3) *Terms of agreement*—(i) *General rule*. If before the close of the fifth full taxable year (not less than 60 months) following the close of the taxable year of the initial transfer, there is a triggering event, then, unless an election is made under paragraph (b)(1)(vii) of this section, by the 90th day thereafter the U.S. transferor must file an amended Federal income tax return for the year of the initial transfer and recognize thereon the gain realized, but not recognized, upon the initial transfer, with interest. If an election under paragraph (b)(1)(vii) of this section was made, then, if a triggering event occurs, the U.S. transferor must include the gain realized, but not recognized, on the initial transfer in income on its Federal income tax return for the taxable year that includes the date of the triggering event. In accordance with paragraph (b)(3)(iii) of this section, interest must be paid on any additional tax due. If a taxpayer properly makes the election under paragraph (b)(1)(vii) of this section but later fails to include in income the gain realized, but not recognized, on the initial transfer, the Commissioner may, in his discretion, include the gain in the taxpayer's income in the year of the initial transfer.

(ii) *Offsets*. No special limitations apply with respect to net operating losses, capital losses, credits against tax, or similar items.

(iii) *Reporting of interest and gain*. If additional tax is required to be paid pursuant to paragraph (b)(3)(i) of this section, then interest must be paid on that amount at the rates determined under section 6621 with respect to the period between the date that was prescribed for filing the U.S. transferor's Federal income tax return for the year of the initial transfer and the date on which the additional tax for that year is paid. If the election in paragraph (b)(1)(vii) of this section is made, a taxpayer should include the amount of gain as taxable income on its Federal income tax return (together with other income or loss items) and include the amount of interest in its payment (or reduce the amount of any refund due by the amount of the interest). A taxpayer must also attach to its Federal income tax return a separate schedule with the heading "Calculation of Section 367 Tax and Interest," on which the amount of tax attributable to the gain and the interest required to be paid under this section are separately identified and calculated.

(iv) *Basis adjustments*—(A) *Transferee foreign corporation*. If a U.S. transferor is

required to recognize gain under this section as a result of a triggering event, then the transferee foreign corporation's basis in the transferred stock or securities shall be increased (as of the date of the initial transfer) by the amount of gain required to be recognized (but not by any tax or interest required to be paid on such amount) by the U.S. transferor.

(B) *U.S. transferor*. If a U.S. transferor is required to recognize gain as a result of a triggering event, then the U.S. transferor's basis in the stock of the transferee foreign corporation received (or deemed received) in the initial transfer shall be increased by the amount of gain required to be recognized (as of the date of the initial transfer) (but not by any tax or interest required to be paid on such amount).

(C) *Other adjustments*. Other appropriate adjustments to basis that are consistent with the principles of this paragraph (b)(3)(iv) may be made if the U.S. transferor is required to recognize gain under this section. In no case, however, shall the transferred corporation's net asset basis be increased as a result of the U.S. transferor recognizing gain under this section as a result of a triggering event.

(D) *Example*. The principles of this paragraph (b)(3) are illustrated by the following example:

Example. (i) *Facts*. D, a domestic corporation owning 100 percent of the stock of S, a foreign corporation, transfers all of the S stock to F, a foreign corporation, in an exchange described in section 368(a)(1)(B). The section 1248 amount with respect to the S stock at the time of the transfer is $0. In the exchange, D receives 20 percent of the voting stock of F. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). All of the requirements of §1.367(a)–3(b)(1) are satisfied, and D enters into a gain recognition agreement to qualify for nonrecognition treatment and does not make the election contained in paragraph (b)(1)(vii) of this section. Two years after the initial transfer, F transfers all of the S stock to F1, a foreign corporation, in an exchange to which section 351 applies, and D complies with the requirements of paragraph (e)(1)(ii) of this section. Four years after the initial transfer, D transfers its entire 20 percent interest in F's voting stock to a domestic partnership in exchange for an interest in the partnership and complies with the requirements of paragraph (e)(1)(i) of this section. D complies with the notice requirement under §1.367(b)–1(c) for each transaction subject to section 367(b). Because D complies with the requirements of paragraph (e) for each transaction that would otherwise be a triggering event, D is not required to recognize the gain that was realized, but not recognized, on the initial transfer. Five years after the initial transfer, S disposes of substantially all (as described in paragraph (d)(2) of this section) of its assets, and D is required by the terms of the gain recognition agreement to recognize all the gain that it realized on the initial transfer of the stock of S.

(ii) *Result*. As a result of the triggering event and paragraph (b)(3)(iv) of this section, the amount of gain required to be recognized as a result of S's disposition of substantially all its assets (but not the tax or interest required to be paid on such amount) is reflected by an increased basis (as of the date of the initial transfer) in D's partnership interest, the partnership's interest in the 20 percent voting stock of F, F's stock of F1, and F1's stock of S. S, however, is not permitted to increase its basis in its assets for purposes of determining the direct or indirect U.S. tax results, if any, on the sale of its assets.

(4) *Waiver of period of limitation*. The U.S. transferor must file, with the gain recognition agreement, a waiver of the period of limitation on assessment of tax upon the gain realized on the initial transfer. The waiver shall be executed on Form 8838 "*Consent To Extend the Time To Assess Tax Under Section 367—Gain Recognition Agreement*" and shall extend the period for assessment of such tax to a date not earlier than the eighth full taxable year following the taxable year of the initial transfer. The waiver shall also contain such other terms with respect to assessment as may be considered necessary by the Commissioner to ensure the assessment and collection of the correct tax liability for each year for which the waiver is required. The waiver must be signed by a person who would be authorized to sign the agreement pursuant to the provisions of paragraph (a)(3) of this section.

(5) *Annual certification*. The U.S. transferor must file with its income tax return for each of the five full taxable years following the taxable year of the initial transfer a certification that there has not been a triggering event, and a description of any exception under paragraph (e) of this section if such an exception is relied upon for the position that there has not been a triggering event. The U.S. transferor must include with its annual certification a statement describing any dispositions of assets by the transferred corporation that are not made in the ordinary course of business. The annual certification pursuant to this paragraph (b)(5) must be signed by a person who would be authorized to sign the agreement pursuant to the provisions of paragraph (a)(3) of this section.

(c) *Use of security*. The U.S. transferor may be required to furnish a bond or other security that satisfies the requirements of §301.7101–1 of this chapter if the Area Director, Field Examination, Small Business/Self Employed or the Director of Field Operations, Large and Mid-Size Business (Director) determines that such security is necessary to ensure the payment of any tax on the gain realized, but not recognized, upon the initial transfer. Such bond or security generally will be required only if the stock or securities transferred are a principal asset of the U.S. transferor and the Director has reason to believe that a disposition of the stock or securities may be contemplated.

(d) *Triggering events*. If there is a triggering event described in this paragraph (d) during the term of the gain recognition agreement, the U.S. transferor must include in income the gain realized, but not recognized, upon the initial transfer as provided in paragraph (b)(3)(i) of this section. In addition, the U.S. transferor must pay any interest required by paragraph (b)(3)(iii) of this section. See §1.367(a)–3(d)(2)(iv) for additional triggering events when a gain recognition agreement has been filed in connection with an indirect stock transfer. Except to the extent provided in paragraphs (e) and (g) of this section, if any of the following events occur during the term of the gain recognition agreement, it shall constitute a triggering event:

(1) *Disposition of stock or securities of the transferred corporation*—(i) *In general*. A disposition, in whole or in part, by the transferee foreign corporation (or any other person) of the transferred stock or securities received by the transferee foreign corporation in the initial transfer. For purposes of this section, a reference to transferred stock or securities shall also include stock or securities of the transferred corporation the basis of which is determined (directly or indirectly) in whole or in part, by reference to the basis of the stock or securities transferred in the initial transfer. A disposition of all or a portion of the stock or securities of the transferred corporation by installment sale is treated as a disposition of the stock or securities in the year of the installment sale.

(ii) *Example*. The provisions of this paragraph (d)(1)(i) are illustrated by the following example:

Example. *Interaction between trigger of gain recognition agreement and subpart F rules*—(i) *Facts*. USP, a domestic corporation, owns all of

the stock of two foreign corporations, CFC1 and CFC2. USP's section 1248 amount with respect to CFC2 is $30. USP has a basis of $50 in its stock of CFC2; the stock of CFC2 has a fair market value of $100. In a transaction described in sections 351 and 368(a)(1)(B), USP transfers the stock of CFC2 to CFC1 in exchange for additional stock of CFC1 with a basis of $50. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). To qualify for nonrecognition treatment under section 367(a), USP enters into a gain recognition agreement for $50 under this section. No election under paragraph (b)(1)(vii) of this section is made. USP also complies with the notice requirement under §1.367(b)–1(c). Two years after the initial transfer, CFC1 sells the stock of CFC2 for $120. At the time of the sale, the section 1248 amount with respect to the CFC2 stock continues to be $30. The $70 of gain recognized on the sale of CFC2 stock would give rise to a $70 subpart F inclusion to USP under section 951(a)(1)(A).

(ii) *Result*—(A) *Trigger of gain recognition agreement with no election*. CFC1's sale of CFC2 stock is a triggering event. As a result, USP must amend its return for the year of the initial transfer and include $50 in income (as well as pay any applicable interest), $30 of which will be recharacterized as a dividend pursuant to section 1248. Under paragraph (b)(3)(iv) of this section, as of the date of the initial transfer, CFC1 has a basis of $100 in its CFC2 stock, and USP has a basis in its CFC1 stock of $100. As a result of the sale of CFC2 stock by CFC1, USP will have a $20 subpart F inclusion under section 951(a)(1)(A).

(B) *Trigger of gain recognition agreement with election*. Assume the same facts as in paragraph (i) of this *Example*, except that USP elected under paragraph (b)(1)(vii) of this section to include the amount of gain realized, but not recognized, on the initial transfer, $50, in the year of the triggering event rather than in the year of the initial transfer. The result is the same as above, except that USP will include the $50 of gain on its tax return for the year of the triggering event, together with interest. For purposes of determining the amount of the $50 gain characterized as a dividend pursuant to section 1248, if any, of the $50 inclusion, USP will take into account the section 1248 amount of CFC2 at the time of the disposition in the year of the triggering event.

(iii) *Partial dispositions*. If the transferee foreign corporation or any other person disposes of only a portion of the stock or securities of the transferred corporation, then the U.S. transferor is required to recognize only a proportionate amount of the gain realized, but not recognized, upon the initial transfer. The proportion required to be recognized shall be determined by reference to the fair market value of the transferred stock or securities disposed of and the total fair market value of the transferred stock or securities immediately before the disposition.

(2) *Disposition of substantially all of the transferred corporation's assets*. A disposition of substantially all of the transferred corporation's assets (including stock in a subsidiary corporation or an interest in a partnership) by the transferred corporation or any other person. Solely for purposes of this section, the term *substantially all* has the meaning provided under section 368(a)(1)(C). Accordingly, the determination of whether substantially all of the transferred corporation's assets have been disposed of shall be made under all the facts and circumstances. For purposes of this paragraph (d)(2), dispositions of stock in connection with an asset reorganization of a corporation all or a portion the stock of which is owned by the transferred corporation, or a liquidation of a corporation the stock of which is owned by the transferred corporation in an amount satisfying the requirements of section 1504(a)(2) and to which sections 332 and 337 apply, shall not be taken into account. If the initial transfer was an indirect stock transfer, see §1.367(a)–3(d)(2)(v). If the transferred corporation is a domestic corporation, see paragraph (g)(2) of this section. For an example of when a disposition of substantially all the transferred corporation's assets by a person other than the transferred corporation is a triggering event under this paragraph (d)(2), see paragraph (e)(6)(ii) of this section.

(3) *Disposition of the stock of the transferee foreign corporation*—(i) *General rule*. A disposition in whole or in part, by the U.S. transferor of the stock of the transferee foreign corporation that is received (or deemed received) in the initial transfer. For purposes of this section, a reference to stock described in the preceding sentence shall also include stock of the transferee foreign corporation the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of the stock of the transferee foreign corporation that is received (or deemed received) in the initial transfer.

(ii) *Partial dispositions*. If the U.S. transferor disposes of only a portion of the stock of the transferee foreign corporation that is received (or deemed received) in the initial transfer, then the U.S. transferor is required to recognize only a proportionate amount of the gain realized, but not recognized, upon the initial transfer. The proportion required to be recognized shall be determined by reference to the fair market value of the transferee foreign corporation stock disposed of and the total fair market value of the transferee foreign corporation stock immediately before the disposition.

(4) *Deconsolidation*. A U.S. transferor that is a member of a consolidated group ceases to be a member of the consolidated group, other than by reason of an acquisition of the assets of the U.S. transferor in a transaction to which section 381(a) applies, or by reason of joining a new consolidated group as part of the same transaction. However, in the case of a transaction to which section 381(a) applies, see paragraph (d)(3) of this section (providing that a triggering event includes a disposition of the stock of the transferee foreign corporation).

(5) *Consolidation*. A U.S. transferor becomes a member of a consolidated group.

(6) *Individual U.S. transferor becomes a non-citizen nonresident*. A U.S. transferor that is an individual loses U.S. citizenship, or a U.S. transferor that is a long-term resident ceases to be taxed as a lawful permanent resident (as defined in section 877(e)(2)). Immediately before the date that the U.S. transferor loses U.S. citizenship or ceases to be taxed as a long-term resident, the gain recognition agreement will be triggered. No additional inclusion is required under section 877 with respect to the transferred stock or securities, and a gain recognition agreement under section 877 may not be used to avoid taxation under section 367(a) resulting from the trigger of the section 367(a) gain recognition agreement.

(7) *Death of an individual; trust or estate goes out of existence*. An individual U.S. transferor dies, or a U.S. transferor that is a trust or estate goes out of existence.

(8) *Failure to comply*. The failure to comply in any material respect with the requirements of this section or with the terms of a gain recognition agreement (for example, a failure to file an annual certification or Form 8838). Such a material failure to comply shall extend the period for assessment of tax until three years after the date on which the Director of Field Operations or Area Director receives actual notice of the failure to comply.

(e) *Exceptions*. Notwithstanding paragraph (d) of this section, the following events shall not constitute triggering events:

(1) *Certain nonrecognition transactions*—(i) *Dispositions of stock of the transferee foreign corporation by the U.S. transferor*—(A) *Transfers to a corporation or partnership*. Except to the extent provided in paragraph (g)(1)(iv) of this section, a disposition of stock of the transferee foreign corporation by the U.S. transferor in an exchange to which section 351, 354 (but only in a reorganization described in section 368(a)(1)(B)), or 721 applies, will not be a triggering event under paragraph (d)(3) of this section, and the original gain recognition agreement shall terminate without further effect, if the U.S. transferor complies with requirements similar to those contained in paragraph (e)(1)(ii) of this section, providing for notice and an agreement to recognize gain in the case of a direct or indirect disposition of the stock previously held by the U.S. transferor. See paragraph (e)(3)(i) of this section for dispositions of the transferee foreign corporation stock in certain asset reorganizations.

(B) *Liquidations of the U.S. transferor under sections 332 and 337*. The disposition of the transferee foreign corporation stock pursuant to a liquidation of the U.S. transferor under sections 332 and 337 will not be a triggering event under paragraph (d)(3) of this section, and the original gain recognition agreement shall terminate without further effect, if the following conditions are satisfied:

(*1*) The distributee is a domestic corporation described in section 332(b)(1).

(*2*) The domestic distributee corporation (successor U.S. transferor) enters into a new gain recognition agreement pursuant to which it agrees to recognize gain (during the remaining term of the original gain recognition agreement), with respect to the initial transfer, modified by substituting the successor U.S. transferor in place of the original U.S. transferor, and agreeing to treat the successor U.S. transferor as the original U.S. transferor for purposes of this section. If, however, in connection with a liquidation described in section 332, the U.S. transferor recognizes gain under section 336 with respect to a portion of the stock of the transferee foreign corporation, and the conditions described in paragraph (g)(1) of this section are satisfied, the new gain recognition agreement that the successor U.S. transferor enters into shall reflect the gain realized, but not recognized, on the initial transfer (subject to adjustment for prior partial dispositions) less that proportion corresponding to gain recognized under section 336. The proportion is determined by reference to the relative fair market values of the transferee foreign corporation stock received (or deemed received) in the initial transfer on which the U.S. transferor recognized gain under section 336 and the total fair market value of the transferee foreign corporation stock received (or deemed received) by the U.S. transferor in the initial transfer that is distributed by the U.S. transferor in the liquidation.

(*3*) The successor U.S. transferor makes the election described in paragraph (b)(1)(vii) of this section. However, if the U.S. transferor was a member of a consolidated group in the year of the initial transfer, and the successor U.S. transferor is also a member of the original consolidated group immediately after the liquidation, no such election must be made.

(*4*) The successor U.S. transferor provides with its next annual certification (described in paragraph (b)(5) of this section) the new gain recognition agreement, a notice of the liquidation, and Form 8838 to extend the period for assessment of the tax on the initial transfer to a date not earlier than the eighth full taxable year following the taxable year of the initial transfer.

(ii) *Transfers of stock or securities of the transferred corporation by the transferee foreign corporation to a corporation or partnership*. Except to the extent provided in paragraph (f)(1)(i) of this section, a disposition of stock or securities of the transferred corporation by the transferee foreign corporation in an exchange to which section 351, 354 (but only in a reorganization described in section 368(a)(1)(B)), or 721 applies, will not be a triggering event described in paragraph (d)(1) of this section, and the original gain recognition agreement shall terminate without further effect, if the following conditions are satisfied:

(A) The transferee foreign corporation receives (or is deemed to receive) in exchange for the property disposed of, stock in a corporation, or an interest in a partnership, that acquired the transferred stock or securities (or receives stock in a corporation that controls the corporation acquiring the transferred stock or securities in the case of a triangular section 368(a)(1)(B) reorganization).

(B) The U.S. transferor provides a notice of the transfer with its next annual certification under paragraph (b)(5) of this section, setting forth—

(*1*) A full description of the transfer;

(*2*) The applicable nonrecognition provision; and

(*3*) The name, address, and taxpayer identification number (if any) of the new transferee of the transferred stock or securities.

(C) The U.S. transferor provides with its next annual certification a new gain recognition agreement pursuant to which it agrees to recognize gain (during the remaining term of the original gain recognition agreement) with respect to the initial transfer, and in which it agrees that any of the following events also constitutes a triggering event:

(*1*) A disposition of the stock or securities or partnership interest that the transferee foreign corporation received in exchange for the transferred stock or securities (other than in a disposition which itself qualifies under the rules of paragraph (e) of this section).

(*2*) The corporation or partnership that acquired the transferred stock or securities disposes of such property (other than in a disposition which itself qualifies under the rules of paragraph (e) of this section).

(*3*) Any other disposition that has the effect of an indirect disposition of the transferred stock or securities.

(iii) *Transfers of the transferred corporation's assets to a corporation or partnership*. Except to the extent provided in paragraph (f)(1)(ii) of this section, a disposition of substantially all of the transferred corporation's assets by the transferred corporation in an exchange to which section 351, 354 (but only in a reorganization described in section 368(a)(1)(B)—for example, where stock in a subsidiary corporation comprises substantially all of the transferred corporation's assets), or 721 applies, will not be a triggering event under paragraph (d)(2) of this section, and the original gain recognition agreement shall terminate without further effect, if the transferred corporation receives (or is deemed to receive) in exchange for all or a portion of its assets stock in a corporation or an interest in a partnership that acquired the assets of the transferred corporation

(or receives stock in a corporation that controls the corporation acquiring the assets) and the U.S. transferor complies with requirements similar to those contained in paragraph (e)(1)(ii) of this section, (providing for notice and an agreement to recognize gain in the case of a direct or indirect disposition of the assets previously held by the transferred corporation). See paragraph (e)(3)(iii) of this section for dispositions of substantially all of the transferred corporation's assets in certain asset reorganizations.

(2) *Recapitalizations*—(i) *Transferred corporation*. Except to the extent provided in paragraph (f)(1) of this section, a transaction described in section 368(a)(1)(E) of the transferred corporation will not be a triggering event under paragraph (d)(1) of this section. The description of this exception that is required to be filed with the annual certification under paragraph (b)(5) of this section must include a description of the type or class, amount, and characteristics of the stock or securities that the transferred corporation issued in the reorganization.

(ii) *Transferee foreign corporation*. A section 368(a)(1)(E) reorganization of the transferee foreign corporation will not be a triggering event under paragraph (d)(3) of this section. The description of this exception that is required to be filed with the annual certification under paragraph (b)(5) of this section must include a description of the type or class, amount, and characteristics of the stock or securities that the transferee foreign corporation issued in the reorganization. See paragraph (g)(1) of this section for rules regarding the recognition of gain by the U.S. transferor in connection with nonrecognition exchanges.

(3) *Certain asset reorganizations*—(i) *Transfers of transferee foreign corporation's stock by U.S. transferor*. Except to the extent provided in paragraph (g)(1)(iv) of this section, if the U.S. transferor transfers all or a portion of the stock of the transferee foreign corporation to a domestic acquiring corporation (successor U.S. transferor) pursuant to an asset reorganization, the exchanges made pursuant to such asset reorganization will not be triggering events described in paragraph (d)(3) of this section, and the original gain recognition agreement shall terminate without further effect, if the following conditions are satisfied:

(A) The common parent of the original consolidated group, successor U.S. transferor, or new common parent, as applicable, enters into a new gain recognition agreement pursuant to which the successor U.S. transferor agrees to recognize gain (during the remaining term of the original gain recognition agreement) with respect to the initial transfer, modified by substituting the successor U.S. transferor in place of the original U.S. transferor and agreeing to treat the successor U.S. transferor as the original U.S. transferor for purposes of this section.

(B) The successor U.S. transferor or new common parent, as applicable, makes the election described in paragraph (b)(1)(vii) of this section. However, if the U.S. transferor was a member of a consolidated group in the year of the initial transfer, and the successor U.S. transferor is also a member of the original consolidated group immediately after the asset reorganization, no such election must be made.

(C) The successor U.S. transferor provides with its next annual certification (described in paragraph (b)(5) of this section)—

(*1*) The new gain recognition agreement;

(*2*) A notice of the transfer setting forth a full description of the transfer (including the date of such transfer), and the successor U.S. transferor's name, address, and taxpayer identification number; and

(*3*) Form 8838 to extend the period for assessment of the tax on the initial transfer to a date not earlier than the eighth full taxable year following the taxable year of the initial transfer.

(ii) *Transfers of transferred corporation stock or securities by transferee foreign corporation to a foreign acquiring corporation*. Except to the extent provided in paragraph (f)(1) of this section, if the transferee foreign corporation transfers all or a portion of the stock or securities of the transferred corporation to a foreign acquiring corporation (successor transferee foreign corporation) in an asset reorganization, the exchanges made pursuant to such reorganization will not be triggering events described in paragraph (d)(1) or (d)(3) of this section, and the original gain recognition agreement shall terminate without further effect, if the following conditions are satisfied:

(A) The U.S. transferor or common parent, as applicable, enters into a new gain recognition agreement pursuant to which the U.S. transferor agrees to recognize gain (during the remaining term of the original gain recognition agreement), with respect to the initial transfer, substituting the successor transferee foreign corporation in place of the original transferee foreign corporation, and agreeing to treat the successor transferee foreign corporation as the original transferee foreign corporation for purposes of this section.

(B) The U.S. transferor provides with its next annual certification (described in paragraph (b)(5) of this section) the new gain recognition agreement and a notice of the transfer setting forth a full description of the transfer (including the date of such transfer), and the successor transferee foreign corporation's name, address, and taxpayer identification number (if any).

(iii) *Transfers of substantially all of the transferred corporation's assets*. Except to the extent provided in paragraph (f)(2) of this section, if the transferred corporation transfers substantially all of its assets to an acquiring corporation (successor transferred corporation) pursuant to an asset reorganization, the exchanges made pursuant to such asset reorganization will not be triggering events under paragraph (d)(1) or (d)(2) of this section, and the original gain recognition agreement shall terminate without further effect, if the following conditions are satisfied:

(A) The U.S. transferor or common parent, as applicable, enters into a new gain recognition agreement pursuant to which the U.S. transferor agrees to recognize gain (during the remaining term of the original gain recognition agreement), with respect to the initial transfer, modified by—

(*1*) Substituting the successor transferred corporation in place of the original transferred corporation and agreeing to treat the successor transferred corporation as the original transferred corporation for purposes of this section; and

(*2*) Treating only the assets acquired by the successor transferred corporation from the original transferred corporation pursuant to the asset reorganization as the assets subject to the triggering event rules under paragraph (d)(2) of this section.

(B) The U.S. transferor provides with its next annual certification (described in paragraph (b)(5) of this section) the new

gain recognition agreement and a notice of the transfer setting forth a full description of the transfer (including the date of such transfer), and the successor transferred corporation's name, address, and taxpayer identification number (if any).

(iv) *Example*. The rules of paragraph (e)(3) of this section are illustrated by the following examples:

Example 1. (i) *Facts*. UST, a domestic corporation incorporated under the laws of State A, owns 100% of the stock of TFD, a foreign corporation. In year 1, UST transfers all of the TFD stock to TFC, a foreign corporation, in an exchange to which section 351 applies. In the exchange, UST receives 100% of the stock of TFC. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). All of the requirements of §1.367(a)–3(b)(1) are satisfied, and UST enters into a gain recognition agreement. UST also complies with the notice requirement under §1.367(b)–1(c). In year 3, UST transfers its assets in a section 361(a) exchange to USA, a newly formed domestic corporation incorporated under the laws of State B, in exchange for stock of USA, and UST distributes such stock to its shareholders in a transaction described in section 368(a)(1)(F).

(ii) *Result*. The transfer of the TFC stock by UST to USA pursuant to the section 368(a)(1)(F) reorganization is a triggering event under paragraph (d)(3) of this section. If, however, UST complies with the requirements contained in paragraph (e)(3)(i) of this section, the transfer will not be a triggering event.

(iii) *Alternate facts*. The facts are the same as in paragraph (i) of this *Example 1*, except that the acquiring corporation is foreign instead of domestic. Because paragraph (e)(3)(i) of this section provides an exception to a triggering event under paragraph (d)(3) of this section only if the acquiring corporation in the asset reorganization is a domestic corporation, the section 368(a)(1)(F) reorganization is a triggering event without exception. See also section 367(a)(5) and §§1.367(a)–1T(f) and 1.367(a)–3T(e) (providing that certain corporate shareholders of a U.S. transferor may enter into a gain recognition agreement when the U.S. transferor goes out of existence in a section 361 initial transfer).

Example 2. (i) *Facts*. UST, a domestic corporation, owns 100% of the stock of three foreign corporations, FC1, FC2 and FC3. In year 1, USP transfers 100% of the stock of FC1 to FC2 in an exchange to which section 351 applies. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). All of the requirements of §1.367(a)–3(b)(1) are satisfied, and UST enters into a gain recognition agreement. UST also complies with the notice requirement under §1.367(b)–1(c). In year 4, in a reorganization described in section 368(a)(1)(D), FC2 transfers all of its assets, including the stock of FC1, to FC3 in exchange for FC3 stock. FC2 transfers the FC3 stock to UST in exchange for FC2 stock held by UST, and the FC2 stock is canceled.

(ii) *Analysis*. The transfer of FC1 stock to FC3 and the exchange of FC2 stock for FC3 stock by UST pursuant to the reorganization described in section 368(a)(1)(D) are triggering events under paragraphs (d)(1) and (d)(3) of this section. If, however, UST complies with the requirements contained in paragraph (e)(3)(ii) of this section, the transfers will not be triggering events.

Example 3. (i) *Facts*. UST, a domestic corporation, owns 100% of the stock of two foreign corporations, FC1 and FC2. In year 1, UST transfers 100% of the stock of FC1 to FC2 in an exchange to which section 351 applies. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). All of the requirements of §1.367(a)–3(b)(1) are satisfied, and UST enters into a gain recognition agreement. UST also complies with the notice requirement under §1.367(b)–1(c). In year 4, in a reorganization described in section 368(a)(1)(C), FC1 transfers all of its assets to FC3, an unrelated foreign corporation, in exchange for FC3 stock. FC1 transfers the FC3 stock to FC2 in exchange for the FC1 stock held by FC2 and the FC1 stock is canceled.

(ii) *Analysis*. FC1's transfer of all of its assets to FC3 and FC2's exchange of FC1 stock for FC3 stock pursuant to the reorganization described in section 368(a)(1)(C) are triggering events under paragraphs (d)(2) and (d)(1) of this section, respectively. If, however, UST complies with the requirements contained in paragraph (e)(3)(iii) of this section, the transfers will not be triggering events.

(4) *Certain triangular reorganizations*—(i) *Triangular asset reorganizations of the transferee foreign corporation*. For purposes of this paragraph (e)(4), the term *triangular asset reorganization* means a triangular reorganization described in §1.358–6(b)(2)(i) through (iii) or in sections 368(a)(1)(G) and (a)(2)(D) where the acquiring subsidiary is foreign. Except to the extent provided in paragraph (f)(1) or (g)(1)(iv) of this section, the exchanges made pursuant to a triangular asset reorganization of the transferee foreign corporation will not be triggering events under paragraph (d)(1) or (d)(3) of this section, and the original gain recognition agreement shall terminate without further effect, if the following conditions are satisfied:

(A) The U.S. transferor or common parent, as applicable, enters into a new gain recognition agreement pursuant to which the U.S. transferor agrees to recognize gain (during the remaining term of the original gain recognition agreement), with respect to the initial transfer, and in which the U.S. transferor agrees to—

(*1*) If the parent corporation of the foreign acquiring subsidiary is foreign, treat such foreign parent as the original transferee foreign corporation for purposes of this section and treat as a triggering event a disposition of the stock of the foreign acquiring subsidiary, or, in the case of a reorganization described in section 368(a)(2)(E), the corporation originally identified as the transferee foreign corporation; and

(*2*) If the parent corporation of the foreign acquiring subsidiary is domestic, treat the foreign acquiring subsidiary as the original transferee foreign corporation for purposes of this section, and apply the principles of paragraph (g) of this section to taxable dispositions by the domestic parent corporation of the foreign acquiring subsidiary or, in the case of a reorganization described in section 368(a)(2)(E), the corporation originally identified as the transferee foreign corporation. In the case of a reorganization described in section 368(a)(2)(E) where the transferee foreign corporation is the merged corporation, rather than the surviving corporation, then the surviving corporation shall be treated as the transferee foreign corporation for purposes of this section.

(B) The U.S. transferor provides with its next annual certification (described in paragraph (b)(5) of this section) the new gain recognition agreement and a notice of the transfer setting forth a full description of the transfer (including the date of such transfer) and the name, address, and taxpayer identification number (if any) for the parent corporation of the foreign acquiring subsidiary.

(ii) *Triangular asset reorganizations of the transferred corporation*. Except to the extent provided in paragraph (f)(1) or (f)(2) of this section, the exchanges made pursuant to a triangular asset reorganization of the transferred corporation will not be triggering events in paragraph (d)(1) or (d)(2) of this section, and the original gain recognition agreement shall terminate without further effect, if the following conditions are satisfied:

(A) The U.S. transferor or common parent, as applicable, enters into a new gain recognition agreement pursuant to which the U.S. transferor agrees to recognize gain (during the remaining term of the original gain recognition agreement), in accordance with the rules of paragraph (b) of this section, with respect to the initial transfer, and in which the U.S. transferor agrees to—

(*1*) Treat a disposition of the stock of the acquiring parent as a triggering event;

(*2*) If the reorganization is a triangular C reorganization or a reorganization de-

scribed in section 368(a)(2)(D), treat a disposition of the stock of the foreign acquiring subsidiary as a triggering event; and

(*3*) If the reorganization is described in section 368(a)(2)(E) and the merged corporation is the transferred corporation, treat a disposition of the stock of the surviving corporation as a triggering event.

(B) The U.S. transferor provides with its next annual certification (described in paragraph (b)(5) of this section) the new gain recognition agreement and a notice of the transfer setting forth a full description of the transfer (including the date of such transfer) and the name, address, and taxpayer identification number (if any) for the parent corporation of the foreign acquiring subsidiary.

(5) *Compulsory transfers*. A compulsory transfer under §1.367(a)–4T(f)(2) that is not reasonably foreseeable by the U.S. transferor is not a triggering event under paragraphs (d)(1) through (d)(3) of this section.

(6) *Certain liquidations and upstream reorganizations of the transferred corporation into the transferee foreign corporation*—(i) *General rule*. A transfer of assets by the transferred corporation to the transferee foreign corporation pursuant to a liquidation described in section 332, where the transferee foreign corporation is described in section 332(b)(1), or pursuant to a reorganization described in section 368(a), and related exchanges of stock or securities of the transferred corporation will not be triggering events under paragraph (d)(1) or (d)(2) of this section. The description of this exception that is required to be filed with the annual certification under paragraph (b)(5) of this section must include a description of the transaction. In such a case, the original gain recognition agreement shall continue to apply during the remainder of its term. If, however, in connection with a liquidation described in section 332, the transferred corporation recognizes gain under section 336 with respect to a portion of its assets, such assets shall be treated as disposed of for purposes of paragraph (d)(2) of this section.

(ii) *Example*. The principles of this paragraph (e)(6) are illustrated by the following example:

Example. (i) *Facts*. UST, a domestic corporation, owns 100 percent of the stock of TFD, a foreign corporation. UST transfers all of the TFD stock to newly-formed TFC, a foreign corporation, in an exchange to which section 351 applies. In the exchange, UST receives 100 percent of the voting stock of TFC. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). All of the requirements of §1.367(a)–3(b)(1) are satisfied, and UST enters into a gain recognition agreement to qualify for nonrecognition treatment and does not make the election described in paragraph (b)(1)(vii) of this section. UST also complies with the notice requirement under §1.367(b)–1(c). Two years after the initial transfer, TFD liquidates into TFC in a transaction described in sections 332 and 337, and UST complies with the requirements of this paragraph (e)(6). Four years after the initial transfer, TFC disposes of substantially all of the assets previously held by TFD.

(ii) *Result*. Because paragraph (d)(2) of this section provides that a disposition of substantially all of the transferred corporation's assets by any person is a triggering event, TFC's disposition of substantially all of the assets previously held by TFD is a triggering event. Under the terms of the gain recognition agreement, UST must amend its return for the year of the initial transfer and include in income the gain realized, but not recognized, on the initial transfer of the stock of TFD to TFC, and pay any interest charge.

(7) *Death of an individual U.S. transferor*. If the U.S. transferor is an individual and such individual dies, the individual's death will not be a triggering event under paragraph (d)(7) of this section, if—

(i) The person winding up the affairs of the U.S. transferor retains, for the duration of the waiver of the statute of limitations relating to the gain recognition agreement, assets to meet any possible liability of the U.S. transferor under the duration of the gain recognition agreement;

(ii) The person winding up the affairs of the U.S. transferor provides security as provided under paragraph (c) of this section for any possible liability of the U.S. transferor under the gain recognition agreement; or

(iii) The person winding up the affairs of the U.S. transferor obtains a ruling from the Internal Revenue Service providing for successors to the U.S. transferor under the gain recognition agreement.

(8) *Deconsolidation*. A deconsolidation described in paragraph (d)(4) of this section will not be a triggering event, and the original gain recognition agreement shall terminate without further effect, if the following conditions are satisfied:

(i) The U.S. transferor enters into a new gain recognition agreement pursuant to which the U.S. transferor agrees to recognize gain (during the remaining term of the original gain recognition agreement) with respect to the initial transfer and makes the election described in paragraph (b)(1)(vii) of this section.

(ii) The U.S. transferor provides with its next annual certification (described in paragraph (b)(5) of this section) notice of the deconsolidation.

(9) *Consolidation*. A consolidation described in paragraph (d)(5) of this section will not be a triggering event, and the original gain recognition agreement shall terminate without further effect, if the following conditions are satisfied:

(i) The common parent of the consolidated group that includes the U.S. transferor immediately after the consolidation enters into a new gain recognition agreement pursuant to which the U.S. transferor agrees to recognize gain (during the remaining term of the original gain recognition agreement) with respect to the initial transfer and in which it makes the election described in paragraph (b)(1)(vii) of this section.

(ii) The U.S. transferor provides with its next annual certification (described in paragraph (b)(5) of this section) a notice of the consolidation.

(10) *Reasonable cause exception for failure to comply*—(i) *Request for relief*. A failure to comply described in paragraph (d)(8) of this section will not be a triggering event, and the timeliness requirement with respect to a gain recognition agreement shall be considered satisfied notwithstanding a failure to file the agreement in a timely manner, if the person required to file the gain recognition agreement, annual certification, or Form 8838 is able to demonstrate to the Area Director, Field Examination, Small Business/Self Employed or the Director of Field Operations, Large and Mid-Size Business (Director) having jurisdiction of the taxpayer's tax return for the taxable year, that such failure was due to reasonable cause and not willful neglect. In determining whether the person has reasonable cause, the Director shall consider whether the person acted reasonably and in good faith. Whether the person acted reasonably and in good faith will be determined after considering all the facts and circumstances. The Director shall notify the person in writing within 120 days of the filing if it is determined that the failure to comply was not due to reasonable cause, or if additional time will be needed to make such determination. For this pur-

pose, the 120-day period shall begin to run on the date the Service notifies the person in writing that the request has been received and assigned for review. Once such period commences, if the person is not again notified within 120 days, then the person shall be deemed to have established reasonable cause. The reasonable cause exception of this paragraph (e)(10) shall apply only if, once the person becomes aware of the failure to file or comply with the agreement, the person complies with the requirements of paragraph (e)(10)(ii) of this section.

(ii) *Requirements for reasonable cause relief*—(A) *Time of submission*. Requests for reasonable cause relief will only be considered if once the person becomes aware of the failure to file or comply with the agreement, the person attaches all the documents that should have been filed, as well as a complete written statement setting forth the reasons for the failure to timely comply, to an amended return that amends the return to which the documents should have been attached pursuant to the rules of section 367(a) and the regulations under that paragraph.

(B) *Notice requirement*. In addition to the requirement of paragraph (e)(10)(ii)(A) of this section, the person must provide a copy of the amended return and all required attachments to the Director as follows:

(*1*) If the taxpayer is under examination for any taxable year when the person requests relief, the taxpayer must provide a copy of the amended return and attachments to the personnel conducting the examination.

(*2*) If the taxpayer is not under examination for any taxable year when the person requests relief, the taxpayer must provide a copy of the amended return and attachments to the Director having jurisdiction over the taxpayer's return.

(f) *Gain recognized in connection with certain nonrecognition transactions*—(1) *Dispositions of transferred stock or securities*—(i) *General rule*. If a disposition of the transferred stock or securities occurs in connection with a nonrecognition transaction described in paragraph (e)(1)(ii), (e)(2)(i), (e)(3)(ii), (e)(3)(iii), or (e)(4) of this section and gain is recognized by the transferee foreign corporation in connection with the transaction (for example, under sections 351(b) or 356(a)(1)), the U.S. transferor must recognize gain pursuant to the gain recognition agreement as determined under paragraph (f)(1)(ii) of this section. This paragraph (f)(1)(i) shall not apply to the extent that the gain recognized is treated as a dividend under section 356(a)(2).

(ii) *Method for determining amount of gain to be recognized*. The portion of the gain recognition agreement that must be recognized under paragraph (f)(1)(i) of this section, if any, is the gain that would be recognized by the transferee foreign corporation on such disposition (but not in excess of the amount of the gain recognition agreement). For purposes of this paragraph (f)(1)(ii), the gain that would be recognized in the nonrecognition transactions listed in paragraph (f)(1)(i) of this section by the transferee foreign corporation shall be calculated before taking into account any basis increase that may apply under paragraph (b)(3)(iv) of this section as a result of the gain that the U.S. transferor is required to recognize. If the amount of gain that the transferee foreign corporation would be required to recognize is less than the amount of the gain subject to the gain recognition agreement, then the new gain recognition agreement filed pursuant to paragraph (e)(1)(ii), (e)(2)(i), (e)(3)(ii), (e)(3)(iii), or (e)(4) of this section shall provide that the U.S. transferor shall recognize the remaining portion of the gain that was realized, but not recognized, on the initial transfer if a subsequent triggering event occurs.

(iii) *Example*. The rule of this paragraph (f)(1) is illustrated by the following example:

Example. (i) *Facts*. UST, a domestic corporation owning 100% of the stock of TFD, a foreign corporation, transfers all of the TFD stock to newly-formed TFC, a foreign corporation, in an exchange to which section 351 applies. In the exchange, UST receives 100% of the stock of TFC. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). All of the requirements of §1.367(a)–3(b)(1) are satisfied, and UST enters into a gain recognition agreement to qualify for nonrecognition treatment and does not make the election contained in paragraph (b)(1)(vii) of this section. UST also complies with the notice requirement under §1.367(b)–1(c). At the time of the initial transfer, UST has a basis of $50 in the stock of TFD, which has a fair market value of $100. Thus, the amount of gain subject to the gain recognition agreement is $50. Two years after the initial transfer, TFC and X, an unrelated domestic corporation, form CFC, a foreign corporation. TFC transfers the stock of TFD to CFC in an exchange to which section 351 applies. UST also complies with the notice requirement under §1.367(b)–1(c). At the time of the transfer, TFC's basis in the TFD stock equals $50 and the fair market value remains $100. In the exchange, TFC receives 25% of the stock of CFC and $35 of cash. Before taking into account adjustments made under paragraph (b)(3)(iv) of this section, TFC would recognize $35 of gain under section 351(b). X transfers property to CFC in exchange for the remaining 75% of the CFC stock. Under paragraph (d)(1) of this section, TFC's disposition of the TFD stock is a triggering event. However, UST complies with the requirements of paragraph (e)(1)(ii) of this section providing for an exception to the triggering event.

(ii) *Result*. Under paragraph (f)(1)(ii) of this section, pursuant to the terms of the gain recognition agreement, UST must recognize $35 of the $50 gain realized, but not recognized, on the initial transfer. The new gain recognition agreement that UST files pursuant to paragraph (e)(1)(ii)(C) of this section will reflect the $15 that remains of the gain realized, but not recognized, on the initial transfer. Under paragraph (b)(3)(iv)(A) of this section, TFC's basis in the TFD stock is increased (as of the date of the initial transfer) by $35 to $85. Under paragraph (b)(3)(iv)(B) of this section, UST's basis in the TFC stock is also increased by $35. Finally, after taking account of adjustments under paragraph (b)(3)(iv) of this section, TFC must recognize $15 of gain under section 351(b).

(2) *Dispositions of substantially all of the transferred corporation's assets*. If a disposition of substantially all of the assets of the transferred corporation occurs in connection with a nonrecognition transaction described in paragraph (e)(1)(iii), (e)(3)(iii), or (e)(4)(ii) of this section and gain is recognized on such disposition (for example, under section 351(b) or 356(a)(1)), the U.S. transferor must recognize gain pursuant to the gain recognition agreement to the extent of such gain recognized (but not in excess of the gain realized, but not recognized, on the initial transfer). This paragraph (f)(2) shall not apply to the extent that recognized gain is treated as a dividend under section 356(a)(2).

(g) *Transactions that terminate the gain recognition agreement or reduce the amount of gain required to be recognized pursuant to a gain recognition agreement*. Notwithstanding paragraph (d) of this section, the following events shall not constitute triggering events and instead shall either terminate the gain recognition agreement, or reduce the amount of gain required to be recognized pursuant to a gain recognition agreement:

(1) *Taxable disposition of stock of the transferee foreign corporation by U.S. transferor*—(i) *General rule*. If the U.S.

transferor disposes of all the stock of the transferee foreign corporation that is received (or deemed received) in the initial transfer, then the gain recognition agreement shall terminate without further effect if—

(A) Immediately before the disposition, the aggregate basis of the transferee foreign corporation stock disposed of does not exceed the sum of the aggregate basis of the transferred stock or securities immediately before the initial transfer plus any increase in the basis of such stock or securities as a result of the recognition of gain on the initial transfer. For purposes of this paragraph (g)(1)(i)(A), an increase in basis of the stock disposed of as a result of an income inclusion with respect to such stock (for example, pursuant to section 961) shall not be taken into account; and

(B) All realized gain (if any) in the stock disposed of is recognized currently and included in taxable income as a result of the disposition.

(ii) *Partial dispositions*—(A) *General rule*. If the U.S. transferor disposes of a portion of the stock of the transferee foreign corporation that is received (or deemed received) in the initial transfer in a transaction that satisfies the conditions described in paragraphs (g)(1)(i)(A) and (B) of this section, such disposition will not be a triggering event and the gain recognition shall remain in effect. For purposes of determining whether the condition described in paragraph (g)(1)(i)(A) of this section is satisfied, however, the aggregate basis of the stock of the transferee foreign corporation disposed of is compared to the aggregate basis of the transferred stock or securities exchanged for such stock at the time of the initial transfer.

(B) *Subsequent triggering event*. If the gain recognition agreement is triggered after a disposition described in paragraph (g)(1)(ii)(A) of this section, the U.S. transferor shall be required to recognize only a proportionate amount of the gain subject to the gain recognition agreement that otherwise would be required to be recognized on a subsequent triggering event. Except as provided in paragraph (g)(1)(iv) of this section, the proportion required to be recognized shall be determined by reference to the percentage of stock (based on relative fair market value) of the transferee foreign corporation received (or deemed received) in the initial transfer that is retained by the U.S. transferor.

(iii) The rule of paragraph (g)(1)(ii) of this section is illustrated by the following example:

Example. (i) *Facts*. A, a United States citizen, owns 100% of the outstanding stock of foreign corporation X. In a transaction to which section 351 applies, A exchanges his stock in X (and other assets) for 100% of the outstanding stock of foreign corporation Y. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). A enters into a gain recognition agreement, makes the election contained in paragraph (b)(1)(vii) of this section, and also complies with the notice requirement under §1.367(b)–1(c). In the second year following the initial transfer, A disposes of 60% of the fair market value of the stock of Y, and the requirements of paragraphs (g)(1)(i)(A) and (B) are met with respect to such disposition. In the fourth year following the initial transfer, Y disposes of 50% of the fair market value of the stock of X.

(ii) *Result*. The disposition of 60% of the stock of Y is not a triggering event, and the gain recognition agreement continues in effect. The disposition of X stock, however, is a triggering event under paragraph (d)(1)(i) of this section. As a result of the subsequent disposition of 50% of the stock of X, under paragraphs (d)(1)(iii) and (g)(1)(ii)(B) of this section, A is required to include in income in the year of such disposition 20% (40% of the fair market value of Y multiplied by 50% of the fair market value of X) of the gain that A realized but did not recognize on the initial transfer of the X stock to Y, and pay any applicable interest.

(iv) *Certain nonrecognition transactions*. The rules described in these paragraphs (g)(1)(iv)(A) through (C) apply if the U.S. transferor disposes of all or a portion of the stock of the transferee foreign corporation received (or deemed received) in the initial transfer pursuant to a nonrecognition transaction described in paragraph (e)(1)(i), (e)(2)(ii), (e)(3)(i), or (e)(3)(ii) of this section, the condition described in paragraph (g)(1)(i)(A) of this section is satisfied with respect to such disposition, and gain is recognized in connection with the disposition (for example, under sections 351(b), 356(a)(1), or 336). If, however, only a portion of the stock of the transferee corporation stock is disposed of pursuant to this paragraph (g)(1)(iv), then for purposes of determining whether the condition described in paragraph (g)(1)(i)(A) of this section is satisfied, the aggregate basis of the stock disposed of is compared to the aggregate basis of the transferred stock or securities exchanged for such stock at the time of the initial transfer.

(A) *U.S. transferor files new gain recognition agreement*. This paragraph (g)(1)(iv)(A) applies if the U.S. transferor (or successor U.S. transferor, as applicable) enters into a new gain recognition agreement as provided in paragraph (e)(1)(i), (e)(3)(i), or (e)(3)(ii) of this section, as applicable. In such a case, the amount of gain subject to the new gain recognition agreement shall equal the amount of gain realized, but not recognized, on the initial transfer, less any gain recognized by the U.S. transferor in connection with the nonrecognition transaction. If the amount of gain recognized on the transfer is equal to or greater than the amount of gain realized, but not recognized, on the initial transfer, then the original gain recognition agreement shall terminate without further effect.

(B) *U.S. transferor does not file a new gain recognition agreement*. This paragraph (g)(1)(iv)(B) applies if the U.S. transferor (or successor U.S. transferor, as applicable) fails to enter into a new gain recognition agreement as provided in paragraph (e)(1)(i), (e)(3)(i), or (e)(3)(ii) of this section, as applicable. In such a case, the amount required to be recognized by the U.S. transferor pursuant to the gain recognition agreement shall be the amount of gain realized, but not recognized, on the initial transfer, less any gain recognized by the U.S. transferor in connection with the nonrecognition transaction.

(C) *Special rule for recapitalizations*. Because paragraph (e)(2)(ii) of this section does not require the U.S. transferor to enter into a new gain recognition agreement, the amount of gain subject to the gain recognition agreement shall equal the amount of gain realized, but not recognized, on the initial transfer, less any gain recognized by the U.S. transferor in connection with the nonrecognition transaction described in paragraph (e)(2)(ii) of this section.

(v) *Election to reduce basis*—(A) *General rule*. For purposes of paragraphs (g)(1)(i), (ii) and (iv) of this section, the U.S. transferor may elect to reduce its aggregate basis in the stock disposed of effective immediately before the disposition such that the condition described in paragraph (g)(1)(i)(A) is satisfied. If an election is made pursuant to this paragraph (g)(1)(v), the U.S. transferor may increase its basis in other stock of the transferee foreign corporation it holds, if any, by a

corresponding amount but not above the fair market value of such stock.

(B) *Election*. The election pursuant to this paragraph (g)(1)(v) is made by filing with the U.S. transferor's income tax return for the taxable year in which the disposition of the transferee foreign corporation stock occurs, a statement setting forth the following information, with the heading "Election to Reduce Stock Basis Under §1.367(a)–8T(g)(1)(v)":

(*1*) A description of the transferee foreign corporation stock that the U.S. transferor has disposed of.

(*2*) An estimate of the fair market value of the stock as of the date of the disposition.

(*3*) A comparison of the basis of the transferee foreign corporation stock before and after the election that is made pursuant to this paragraph (g)(1)(v).

(*4*) The date on which the transferee foreign corporation stock was disposed of by the U.S. transferor.

(vi) The rules of paragraph (g)(1) of this section are illustrated by the following examples:

Example 1. (i) *Facts*. USP, a domestic corporation, owns 100% of the stock of two foreign corporations, FC1 and FC2. The basis and fair market value of the FC1 stock is $100 and $90, respectively. The basis and fair market value of the FC2 stock is $0 and $100, respectively. USP also owns land that has a basis and fair market value of $10. In year 1, USP transfers 100% of the stock of FC1 and FC2 and the land to FC3, a newly formed foreign corporation, in exchange for 20 shares of FC3 stock. The transfer of the stock of FC1 and FC2 qualifies under section 351 and section 368(a)(1)(B). The transfer of the land qualifies under section 351. The transfer of the FC2 stock is subject to both section 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). Pursuant to §1.367(a)–3(b)(1)(ii) and this section, USP enters into a gain recognition agreement with respect to the $100 of gain in the FC2 stock and complies with the notice requirement under §1.367(b)–1(c). USP takes the position that its basis in each of the 20 shares of FC3 stock received in the transfer equals $5.5 (($100+$0+10)/20). In year 3, USP sells 100% of its FC3 stock to an unrelated person for cash.

(ii) *Result*. The disposition of the FC3 stock is a triggering event described in paragraph (d)(3) of this section. The disposition does not terminate the gain recognition agreement pursuant to paragraph (g)(1)(i) of this section because USP takes the position that the basis of each of the 10 shares of FC3 stock it received in exchange for the FC2 stock in the initial transfer equals $5.5. Thus, the total basis in the 10 shares received for the FC2 stock equals $55, which exceeds the $0 basis USP had in the FC2 stock it transferred to FC3 in the initial transfer. As a result, the condition described in paragraph (g)(1)(i)(A) of this section is not satisfied. USP may, however, elect to reduce its basis in 10 of the FC3 shares it disposes of from $5.5 to $0, and increase its basis in its remaining 10 shares of FC2 stock by $5.5, pursuant to paragraph (g)(1)(v) of this section. As a result, the condition described in paragraph (g)(1)(i)(A) of this section would be satisfied, the disposition would not be a triggering event, and the gain recognition would terminate without further effect.

Example 2. (i) *Facts*. USP, a domestic corporation, owns 100% of the stock of FC1, a foreign corporation. The basis and fair market value of the FC1 stock is $0 and $80, respectively. In year 1, USP transfers 100% of the stock of FC1 to FC2, a newly formed foreign corporation, in exchange for 20 shares of FC2 stock. The transfer of the stock of FC1 qualifies under section 351 and section 368(a)(1)(B). The transfer of the FC1 stock is subject to both section 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). Pursuant to §1.367(a)–3(b)(1)(ii) and this section, USP enters into a gain recognition agreement with respect to the $80 of gain in the FC1 stock and complies with the notice requirement under §1.367(b)–1(c). USP's basis and fair market value in the FC2 stock it receives at the time of the transfer is $0 and $80, respectively. In year 3, when the fair market value of the FC2 stock continues to equal $80, USP transfers land that has a basis and fair market value of $20 to FC2 in a transfer that qualifies under section 351, but does not receive additional shares of FC2 in connection with such transfer. In year 5, USP sells 100% of its FC2 stock to an unrelated person for cash.

(ii) *Result*. The disposition of the FC3 stock is a triggering event described in paragraph (d)(3) of this section. The disposition would not terminate the gain recognition agreement pursuant to paragraph (g)(1)(i) of this section if the basis in each of the 20 FC2 shares that USP sells equals $1 ($20/20 shares) because immediately before the disposition the basis in the FC2 shares received for the FC1 shares exceeds the basis of the FC1 shares at the time of the initial transfer. As a result, the condition described in paragraph (g)(1)(i)(A) of this section would not be satisfied. USP may, however, elect to adjust its basis in its FC2 shares such that 16 of the shares have zero basis (reflecting the basis of the FC1 stock) and 4 of the shares have $20 of basis (reflecting the basis of the land). In such a case, the condition described in paragraph (g)(1)(i)(A) of this section would be satisfied, the disposition would not be a triggering event, and the gain recognition agreement would terminate without further effect.

(2) *Certain dispositions by a domestic transferred corporation of substantially all of its assets*. If, immediately before the initial transfer, the U.S. transferor owned an amount of stock in the transferred corporation described in section 1504(a)(2), and the transferred corporation is domestic, then the gain recognition agreement shall terminate without further effect if the transferred corporation disposes of substantially all of its assets in a transaction in which all realized gain is recognized currently. If an indirect stock transfer necessitated the filing of the gain recognition agreement, such agreement shall terminate if, immediately before the indirect transfer, the U.S. transferor owned an amount of stock in the acquired corporation described in section 1504(a)(2) (or, in the case of a section 368(a)(1)(A) and (a)(2)(E) reorganization described in §1.367(a)–3(d)(1)(ii), the U.S. transferor owned an amount of stock in the acquiring corporation described in section 1504(a)(2)) and the transferred corporation disposes of substantially all of its assets (taking into account §1.367(a)–3(d)(2)(v)) in a transaction in which all realized gain is recognized currently.

(3) *Distribution or transfer by transferee foreign corporation of stock or securities of transferred corporation under section 337, 355 or 361*—(i) *Scope*. This paragraph (g)(3) applies if the transferee foreign corporation distributes or transfers the stock or securities that initially necessitated the filing of the gain recognition agreement (and any additional stock received after the initial transfer) pursuant to any of the following transactions:

(A) A liquidating distribution to the U.S. transferor or a domestic corporation that is a member of the same consolidated group of which the U.S. transferor is then a member and that qualifies under sections 332 and 337, if such domestic distributee corporation is described in section 332(b)(1).

(B) A distribution to the U.S. transferor, a domestic corporation that is a member of the same consolidated group of which the U.S. transferor is a member, or an individual that is a United States person, that qualifies under section 355.

(C) A transfer to the U.S. transferor or a domestic corporation that is a member of the same consolidated group of which the U.S. transferor is then a member and to which section 361 applies (but, if in connection with a reorganization described in section 368(a)(1)(D) or (G), only if the requirements of section 354(b)(1)(A) and (B) are met).

(ii) *General rule*. If a distribution or transfer is described in paragraph (g)(3)(i) of this section, the gain recognition agreement shall terminate without further effect, provided that immediately after such distribution or transfer the basis in the transferred stock or securities in the hands of the domestic corporation or individual, as applicable, does not exceed the basis that

the U.S. transferor had in the transferred stock or securities immediately before the initial transfer. For purposes of this paragraph (g)(3)(ii), only the basis in the stock or securities transferred shall be taken into account, and increases to stock basis as a result of income inclusions with respect to stock (for example, pursuant to section 961) shall not be taken into account. In the case of a transaction described in paragraph (g)(3)(i)(B) of this section, any reductions or redistributions of stock basis under §1.367(b)–5(c)(2) or (4), respectively, shall be made before applying the rules of this paragraph (g)(3)(ii).

(iii) *Election to reduce basis in stock or securities of transferred corporation*. For purposes of paragraph (g)(3)(ii) of this section, the domestic corporation or individual, as applicable, may elect to reduce the basis in the stock or securities transferred to equal the basis the U.S. transferor had in the corresponding transferred stock or securities immediately before the initial transfer, such that the gain recognition agreement shall terminate without further effect. If such an election is made, the domestic corporation or individual may increase its basis in other stock of the transferred corporation it holds, if any, by a corresponding amount but not above the fair market value of such stock.

(iv) *Election*. The election pursuant to paragraph (g)(3)(iii) of this section is made by filing with the domestic corporation's or individual's income tax return for the taxable year in which the distribution or transfer occurs, a statement setting forth the following information, with the heading "Election to Reduce Stock Basis Under §1.367(a)–8T(g)(3)(iii)":

(*1*) A description of the stock or securities received.

(*2*) An estimate of the fair market value of the stock or securities as of the date of their receipt.

(*3*) A statement comparing the basis of the stock or securities before and after the election.

(*4*) The date on which the stock or securities were received.

(v) *Examples*. The rules of paragraph (g)(3) of this section are illustrated by the following examples:

Example 1. (i) *Facts*. USP, a domestic corporation, owns 100% of the stock of two foreign corporations, FC1 and FC2. FC1 has 10 shares of stock issued and outstanding. In year 1, when the basis and fair market value of the FC1 stock is $0 and $90, respectively, USP transfers its 10 shares of FC1 stock to FC2 in an exchange to which section 351 applies. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). Pursuant to §1.367(a)–3(b)(1)(ii) and this section, USP enters into a gain recognition agreement with respect to such transfer. USP also complies with the notice requirement under §1.367(b)–1(c). In year 2, FC2 transfers land with a basis and fair market value of $10 to FC1 in exchange for one newly issued share of FC1 stock. In year 4, FC2 distributes all of its FC1 stock to USP in a liquidating distribution that qualifies under sections 332 and 337.

(ii) *Result*. In determining whether the gain recognition agreement entered into by USP is terminated under paragraph (g)(3) of this section, or in the alternative triggered under paragraph (d)(1) of this section, only the stock of FC1 transferred by USP to FC2 in year 1 is considered. Thus, the basis in the one share of FC1 stock issued to FC2 in year 2 in exchange for land is not taken into account. If instead of FC1 actually issuing another share of stock to FC2 in exchange for the land, FC1 was deemed to issue stock to FC2 in such exchange, then the gain recognition agreement would terminate only if USP elects to adjust the basis in its FC1 shares such that nine of the shares have zero basis and one of the shares has $10 of basis.

Example 2. (i) *Facts*. USP, a domestic corporation, owns 100% of the stock of two foreign corporations, FC and FD. In year 1, USP transfers 100% of the stock of FC to FD in an exchange to which section 351 applies. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). At the time of the initial transfer, USP has a basis of $80 in its stock of FC; the stock of FC has a fair market value of $100. USP's basis in its stock of FD, and the fair market value of the FD stock, are both $100. Pursuant to §1.367(a)–3(b)(1)(ii) and this section, USP enters into a gain recognition agreement with respect to the initial transfer. USP also complies with the notice requirement under §1.367(b)–1(c). In year 4, FD distributes all of the stock of FC to USP in a *pro rata* distribution to which section 355 applies. At the time of the distribution, the fair market value of the FC stock has increased to $200, while the fair market value of the FD stock has remained $100. Under section 358, USP allocates its $180 predistribution basis in its FD stock between the FD stock and FC stock according to the stock blocks' relative fair market values, yielding a $60 basis in the FD stock and a $120 basis in the FC stock. Immediately before the distribution, USP's section 1248 amount with respect to FC and FD is zero.

(ii) *Result*. The distribution of FC stock is a triggering event under paragraph (d)(1) of this section. The distribution does not terminate the gain recognition agreement under paragraph (g)(3) of this section because after the distribution, USP's basis of $120 in the FC stock exceeds the $80 basis that USP had in the FC stock at the time of the initial transfer. If, however, USP elects to reduce its basis in the FC stock it receives to $80, then the condition described in paragraph (g)(3) of this section will be satisfied, and the gain recognition agreement will terminate without further effect. In addition, the $40 of basis that USP elected to reduce is redistributed to the stock of FD, the result of which is that USP has a basis of $100 in its FD stock.

(h) *Effective date*—(1) *General rule*—(i) *Gain recognition agreements filed for transfers on or after effective date*. With the exception of paragraph (f) of this section, the rules of this section apply to gain recognition agreements filed with respect to transfers of stock or securities under Treas. Reg. §§1.367(a)–3(b) through (d) and 1.367(a)–3T(e) occurring on or after March 7, 2007. The rules of paragraph (f) of this section apply to gain recognition agreements filed with respect to transfers of stock or securities under Treas. Reg. §§1.367(a)–3(b) through (d) and 1.367(a)–3T(e) occurring on or after August 6, 2007. However, the rules of this section do not apply to gain recognition agreements filed with respect to such a transfer of stock or securities occurring on or after March 7, 2007, if such transfer was entered into pursuant to a written agreement which was (subject to customary conditions) binding before February 5, 2007, and at all times thereafter. Solely for purposes of this paragraph (h), a transfer described in the preceding sentence shall be deemed to be a transfer occurring before March 7, 2007 to which the rules of §1.367(a)–8 (see 26 CFR part 1, revised April 1, 2006) apply. See paragraph (h)(2)(iii) of this section for the ability to apply the rules of this section with respect to gain recognition agreements filed before March 7, 2007.

(ii) *Gain recognition agreements filed for transfers before effective date*. For matters covered in this section for periods before March 7, 2007 but on or after July 20, 1998, the corresponding rules of §1.367(a)–8 (see 26 CFR part 1, revised April 1, 2006) apply. For matters covered in this section for periods before July 20, 1998, the corresponding rules of §1.367(a)–3T(g) (see 26 CFR part 1, revised April 1, 1998) and Notice 87–85, 1987–2 C.B. 395; (see §601.601(d)(2)(ii) of this chapter) apply. In addition, if a U.S. transferor entered into a gain recognition agreement for transfers before July 20, 1998, then the rules of §1.367(a)–3T(g) (see 26 CFR part 1, revised April 1, 1998) continue to apply in lieu of this section in the event of any direct or indirect nonrecognition transfer of the same property. See also, §1.367(a)–3(h).

(2) *Applicability to gain recognition agreements filed before effective date*—(i) *General rule*. This paragraph (h)(2)(i) applies only to rules in this regulation §1.367(a)–8T that were not already effective under the rules of §1.367(a)–8 (see 26 CFR part 1, revised April 1, 2006). Taxpayers may apply all or part of these regulations to gain recognition agreements filed with respect to transfers of stock or securities, for all open years, on or after July 20, 1998. If a taxpayer failed to file a gain recognition agreement with respect to a transfer of stock or securities on or after July 20, 1998 and before March 7, 2007, the taxpayer must first obtain reasonable cause relief under §1.367(a)–8(c)(2) to file the gain recognition agreement before the taxpayer may apply this paragraph (h)(2)(i).

(ii) *Special filing rule for tax year ending before effective date*. This paragraph (h)(2)(ii) provides the time and manner in which taxpayers may apply paragraph (h)(2)(i) of this section. Notwithstanding the rules provided in §1.367(a)–8T(a)(2), all agreements, certifications, or other information related to such gain recognition agreement that should have been filed on or before March 7, 2007 shall be treated as having been timely filed, provided they are attached to a Federal income tax return amending the taxpayer's Federal income tax return for the taxable year in which they should have been attached. The amended return described in the preceding sentence must be filed before August 6, 2007. A taxpayer that wishes to apply paragraph (h)(2)(i) of this section but that fails to meet the filing requirement described in the preceding sentence must request reasonable cause relief as provided in paragraph (e)(10) of this section.

(iii) *Tax year ending after effective date*. A taxpayer that entered into a gain recognition agreement to which §1.367(a)–8 (see 26 CFR part 1, revised April 1, 2006) applies may apply the rules of this section in a tax year ending on or after March 7, 2007 by attaching the agreement, certification, or other information related to such gain recognition agreement that the rules of this section require in accordance with the rules of this section and with the time and manner rules provided in §1.367(a)–8T(a)(2).

(iv) *Examples*. The rules of paragraph (h)(2) of this section are illustrated by the following examples:

Example 1. (i) *Facts*. USP, a domestic corporation, owns 100% of the stock of two foreign corporations, FC and FD. In 2003, USP transfers 100% of the stock of FC to FD in an exchange to which section 351 applies. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). Pursuant to §1.367(a)–3(b)(1)(ii) and this section, USP enters into a gain recognition agreement with respect to the initial transfer. USP also complies with the notice requirement under §1.367(b)–1(c). In 2005, FD distributes all of the stock of FC to USP in a *pro rata* distribution to which section 355 applies. Under section 358, USP's basis in its FC stock exceeds the basis that USP had in FC immediately before the initial transfer.

(ii) *Result*. Under paragraph (h)(1)(ii) of this section, the rules of §1.367(a)–8 apply because the gain recognition agreement was filed before March 7, 2007. As a result of the year 2005 transaction, under §1.367(a)–8(e)(1), USP is required to recognize all of the gain subject to the gain recognition agreement, and pay any applicable interest. The gain recognition agreement does not terminate under §1.367(a)–8(h)(3) because USP's basis in its FC stock immediately after the section 355 distribution exceeds the basis USP had in the FC stock immediately before the initial transfer. However, paragraph (g)(3)(iii) of this section provides a rule that would allow USP to elect to reduce its basis in the FC stock such that the conditions in paragraph (g)(3) of this section would be satisfied and the gain recognition agreement would terminate without further effect. Under paragraph (h)(2)(i) of this section, USP may apply paragraph (g)(3)(iii) of this section to the 2005 transaction, if 2005 is an open year, because the rule provided in paragraph (g)(3)(iii) of this section was not already effective under §1.367(a)–8. Under paragraph (h)(2)(ii) of this section, USP must submit the documents required under paragraph (g)(3)(iii) of this section to a Federal income tax return amending its 2005 Federal income tax return before August 6, 2007.

Example 2. (i) *Facts*. UST, a domestic corporation, owns 100% of the stock of two foreign corporations, TFC and TFD. In 2003, USP transfers 100% of the stock of TFD to TFC in an exchange to which section 351 applies. The transaction is subject to both sections 367(a) and (b). See §§1.367(a)–3(b) and 1.367(b)–1(a). All of the requirements of §1.367(a)–3(b)(1) are satisfied, and UST enters into a gain recognition agreement. UST also complies with the notice requirement under §1.367(b)–1(c). In 2005, TFC transfers its TFD stock to F1, also a foreign corporation, in an exchange to which section 351 applies. UST does not file a new gain recognition agreement under §1.367(a)–8(g)(2).

(ii) *Result*. Under paragraph (h)(1)(ii) of this section, the rules of §1.367(a)–8 apply because the gain recognition agreement was filed before March 7, 2007. Under §1.367(a)–8(e), UST must recognize the gain realized, but not recognized, on its initial transfer of TFD stock. Paragraph (h)(2)(i) of this section does not apply because the rule in paragraph (e)(1)(ii) of this section was already effective under §1.367(a)–8(g)(2). Therefore, UST's only recourse from recognizing the gain subject to the gain recognition agreement is the reasonable cause exception provided in §1.367(a)–8(c)(2).

(3) *Expiration*. The applicability of this section expires on or before February 1, 2010.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 7. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 8. In §602.101, paragraph (b) is revised by adding an entry for §1.367(a)–8T in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.367(a)–8T	1545–2056
* * * * *	

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved January 31, 2007.

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

(Filed by the Office of the Federal Register on February 1, 2007, 8:52 a.m., and published in the issue of the Federal Register for February 5, 2007, 72 F.R. 5174)

Section 807.—Rules for Certain Reserves

Insurance companies; interest rate tables. Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 2006 and 2007. Rev. Rul. 92–19 supplemented in part.

Rev. Rul. 2007–10

For purposes of § 807(d)(4) of the Internal Revenue Code, for taxable years beginning after December 31, 2005, this ruling supplements the schedules of prevailing state assumed interest rates set forth in Rev. Rul. 92–19, 1992–1 C.B. 227. This information is to be used by insurance companies in computing their reserves for (1) life insurance and supplementary total and permanent disability benefits, (2) individual annuities and pure endowments, and (3) group annuities and pure endowments. As § 807(d)(2)(B) requires that the interest rate used to compute these reserves be the greater of (1) the applicable federal interest rate, or (2) the prevailing state assumed interest rate, the table of applicable federal interest rates in Rev. Rul. 92–19 is also supplemented.

Following are supplements to schedules A, B, C, and D to Part III of Rev. Rul. 92–19, providing prevailing state assumed interest rates for insurance products with different features issued in 2006 and 2007, and a supplement to the table in Part IV of Rev. Rul. 92–19, providing the applicable federal interest rates under § 807(d) for 2006 and 2007. This ruling does not supplement Parts I and II of Rev. Rul. 92–19.

This is the fifteenth supplement to the interest rates provided in Rev. Rul. 92–19. Earlier supplements were published in Rev. Rul. 93–58, 1993–2 C.B. 241 (interest rates for insurance products issued in 1992 and 1993); Rev. Rul. 94–11, 1994–1 C.B. 196 (1993 and 1994); Rev. Rul. 95–4, 1995–1 C.B. 141 (1994 and 1995); Rev. Rul. 96–2, 1996–1 C.B. 141 (1995 and 1996); Rev. Rul. 97–2, 1997–1 C.B. 134 (1996 and 1997); Rev. Rul. 98–2, 1998–2 C.B. 259 (1997 and 1998); Rev. Rul. 99–10, 1999–1 C.B. 671 (1998 and 1999); Rev. Rul. 2000–17, 2000–1 C.B. 842 (1999 and 2000); Rev. Rul. 2001–11, 2001–1 C.B. 780 (2000 and 2001); Rev. Rul. 2002–12, 2002–1 C.B. 624 (2001 and 2002); Rev. Rul. 2003–24, 2003–1 C.B. 557 (2002 and 2003); Rev. Rul. 2004–14, 2004–1 C.B. 511 (2003 and 2004); Rev. Rul. 2005–29, 2005–1 C.B. 1080 (2004 and 2005); and Rev. Rul. 2006–25, 2006–20 I.R.B. 882 (May 15, 2006) (2005 and 2006).

Part III. Prevailing State Assumed Interest Rates — Products Issued in Years After 1982.*

Schedule A

STATUTORY VALUATION INTEREST RATES
BASED ON THE 1980 AMENDMENTS TO THE
NAIC STANDARD VALUATION LAW

A. Life insurance valuation:

Guarantee Duration (years)	Calendar Year of Issue 2007
10 or fewer	4.50**
More than 10 but not more than 20	4.25**
More than 20	4.00**

Source: Rates calculated from the monthly averages, ending June 30, 2006, of Moody's Composite Yield on Seasoned Corporate Bonds.

* The terms used in the schedules in this ruling and in Part III of Rev. Rul. 92–19 are those used in the Standard Valuation Law; the terms are defined in Rev. Rul. 92–19.

** As these rates exceed the applicable federal interest rate for 2007 of 3.97 percent, the valuation interest rate to be used for this product under § 807 is the applicable rate specified in this table.

Part III, Schedule B

STATUTORY VALUATION INTEREST RATES
BASED ON THE 1980 AMENDMENTS TO THE
NAIC STANDARD VALUATION LAW

B. Single premium immediate annuities and annuity benefits involving life contingencies arising from other annuities with cash settlement options and from guaranteed interest contracts with cash settlement options:

Calendar Year of Issue	Valuation Interest Rate
2006	5.25*

Source: Rates calculated from the monthly averages, ending June 30, 2006, of Moody's Composite Yield on Seasoned Corporate Bonds (formerly known as Moody's Corporate Bond Yield Average — Monthly Average Corporates). The terms used in this schedule are those used in the Standard Valuation Law as defined in Rev. Rul. 92–19.

*As this prevailing state assumed interest exceeds the applicable federal interest rate for 2006 of 3.98 percent, the valuation interest rate of 5.25 percent is to be used for this product under § 807.

STATUTORY VALUATION INTEREST RATES
BASED ON NAIC STANDARD VALUATION LAW
FOR **2006** CALENDAR YEAR BUSINESS
GOVERNED BY THE 1980 AMENDMENTS

C. Valuation interest rates for other annuities and guaranteed interest contracts that are valued on an issue year basis:

Cash Settlement Options?	Future Interest Guarantee?	Guarantee Duration (years)	Valuation Interest Rate (%) For Plan Type		
			A	B	C
Yes	Yes	5 or fewer	5.25	4.75	4.50
		More than 5, but not more than 10	5.25	4.75	4.50
		More than 10, but not more than 20	4.75	4.50	4.25*
		More than 20	4.25*	4.00*	4.00*
Yes	No	5 or fewer	5.50	4.75	4.50
		More than 5, but not more than 10	5.25	4.75	4.50
		More than 10, but not more than 20	5.00	4.50	4.50
		More than 20	4.50*	4.25*	4.25*
No	Yes or No	5 or fewer	5.25		
		More than 5, but not more than 10	5.25	NOT APPLICABLE	
		More than 10, but not more than 20	4.75		
		More than 20	4.25*		

Source: Rates calculated from the monthly averages, ending June 30, 2006, of Moody's Composite Yield on Seasoned Corporate Bonds.

*As these rates exceed the applicable federal interest rate for 2006 of 3.98 percent, the valuation interest rate to be used for this product under § 807 is the applicable rate specified in the above table.

Part III, Schedule D24 — 2006

STATUTORY VALUATION INTEREST RATES
BASED ON NAIC STANDARD VALUATION LAW
FOR **2006** CALENDAR YEAR BUSINESS
GOVERNED BY THE 1980 AMENDMENTS

D. Valuation interest rates for other annuities and guaranteed interest contracts that are contracts with cash settlement options and that are valued on a change in fund basis:

Cash Settlement Options?	Future Interest Guarantee?	Guarantee Duration (years)	Valuation Interest Rate For Plan Type		
			A	B	C
Yes	Yes	5 or fewer	5.75	5.50	4.50
		More than 5, but not more than 10	5.50	5.50	4.50
		More than 10, but not more than 20	5.25	5.25	4.50
		More than 20	4.75	4.75	4.25*
Yes	No	5 or fewer	5.75	5.50	4.75
		More than 5, but not more than 10	5.75	5.50	4.75
		More than 10, but not more than 20	5.50	5.25	4.50
		More than 20	4.75	4.75	4.25*

Source: Rates calculated from the monthly averages, ending June 30, 2006, of Moody's Composite Yield on Seasoned Corporate Bonds.

*As the applicable federal interest rate for 2006 of 3.98 percent is less than the prevailing state assumed interest rate, the valuation interest rate to be used for this product under § 807 is the applicable rate specified in the above table.

Part IV. Applicable Federal Interest Rates

TABLE OF
APPLICABLE FEDERAL INTEREST RATES
FOR PURPOSES OF § 807

Year	Interest Rate
2006	3.98
2007	3.97

Sources: Rev. Rul. 2004–106, 2004–2 C.B. 893, for the 2005 rate; Rev. Rul. 2005–77, 2005–2 C.B. 1071, for the 2006 rate; and Rev. Rul. 2006–61, 2006–49 I.R.B. 1028 (Dec. 11, 2006) for the 2007 rate.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 92–19 is supplemented by the addition to Part III of that ruling of prevailing state assumed interest rates under § 807 for certain insurance products issued in 2006 and 2007 and is further supplemented by an addition to the table in Part IV of Rev. Rul. 92–19 listing applicable federal interest rates. Parts I and II of Rev. Rul. 92–19 are not affected by this ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Josephine H. Firehock of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact her at (202) 622–3970 (not a toll-free call).

Section 1441.—Withholding of Tax on Nonresident Aliens

A revenue procedure provides administrative guidance permitting the use of a “Net Consideration Method” of accounting for certain patent cross licensing arrangements. Under the method, only cash and other non-patent-right consideration are taken into account for withholding and capitalization purposes. See Rev. Proc. 2007-23, page 675.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions and Other Related Items

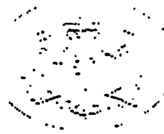
U.S.-Island of Jersey Reciprocal Exemption Agreement

Announcement 2007–23

The United States and the United Kingdom of Great Britain and Northern Ireland (on behalf of the Bailiwick of Jersey) have exchanged diplomatic notes evidencing a reciprocal exemption agreement for income from the international operation of ships for taxable years beginning on or after January 1, 1997. The diplomatic notes reproduced herein contain the terms of the reciprocal exemptions.

The principal author of this announcement is Patricia Bray of the Office of Associate Chief Counsel (International). For further information regarding this announcement, contact Patricia Bray at (202) 622–3880 (not a toll-free call).

The text of the agreement is as follows.

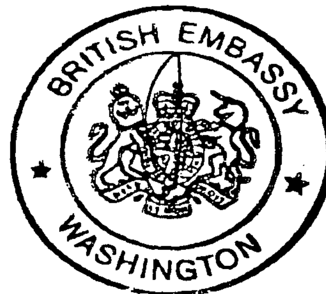


Note No : 195/97

Her Britannic Majesty's Embassy presents its compliments to the Department of State and has the honour to refer to the United States' Diplomatic Note dated 15 July 1997 concerning the proposed agreement with the Government of the United Kingdom of Great Britain and Northern Ireland, (on behalf of the Bailiwick of Jersey), to exempt from income tax, on a reciprocal basis, income derived by residents of Jersey and the United States of America from the international operation of ships.

The British Embassy, on behalf of the Government of the United Kingdom of Great Britain and Northern Ireland, hereby confirms that the proposals set out by the Department of State are acceptable. This Note, together with the Department of State's Note of 15 July 1997, shall therefore constitute an agreement between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland which will enter into force on 12 November 1997, and shall have effect with respect to taxable years beginning on or after 1 January 1997.

British Embassy
Washington DC
12 November 1997



The Department of State wishes to propose to the British Embassy that the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland, on behalf of the Balliwick of Jersey, conclude an agreement to exempt from income tax, on a reciprocal basis, income derived by residents of Jersey and the United States from the international operation of ships. The terms of the agreement are as follows:

1. The Government of the United States of America, in accordance with sections 872(b)(1) and 883(a)(i) of the Internal Revenue Code, agrees to exempt from tax gross income derived from the international operation of ships by Jersey residents and corporations organized in Jersey. This exemption is granted on the basis of equivalent exemptions granted by Jersey to United States residents and to corporations organized in the United States.

2. In the case of a corporation, the exemption shall apply only if the corporation meets either of the following conditions:

(a) the corporation's stock is primarily and regularly traded on an established securities market in Jersey, another country which grants an equivalent exemption to United States corporations, or the United States; or

(b) more than 50 percent of the value of the corporation's stock is owned, directly or indirectly, by individuals who are residents of

Jersey, or of a country which grants an equivalent exemption to United States corporations or by acorporation organized in a country which grants an equivalent exemption to U.S. corporations and whose stock is primarily and regularly traded on an established securities market in that country, another country which grants an equivalent exemption to U.S. corporations, or the United States.

3. For purposes of subparagraph (b) of paragraph 2, the States of Jersey shall be treated as an individual resident of Jersey. For the purposes of the exemption from United States tax, subparagraphs (a) and (b) of paragraph 2 shall be considered to be satisfied if the corporation is a "controlled foreign corporation" under the Internal Revenue Code.

4. In this agreement, the expression "corporation organized in Jersey" means a corporation registered in Jersey.

5. Gross income includes all income derived from the international operation or chartering of ships, including income from the rental of ships on a full (time or voyage) basis and income from the rental of containers and related equipment which is incidental to the international operation of ships. It also includes income from the rental on a bareboat basis of ships used for international transport and income from the disposition of ships which is incidental to income from the international operation of ships.

6. Either Government may terminate this agreement by giving written notice of termination through diplomatic channels.

If the proposals set out above are acceptable to the British Embassy, the Department of State proposes that the present Note together with the British Embassy's reply in

that sense shall constitute an agreement between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland which shall enter into force on the date of the British Embassy's reply, and shall have effect with respect to taxable years beginning on or after January 1, 1997.

Department of State,
Washington. JUL 15 1997

Part III. Administrative, Procedural, and Miscellaneous

Health Savings Accounts

Notice 2007–22

This notice provides guidance on rollovers from health Flexible Spending Arrangements (health FSAs) and Health Reimbursement Arrangements (HRAs) to Health Savings Accounts (HSAs) under amendments to the Internal Revenue Code by section 302 of the Health Opportunity Patient Empowerment Act of 2006 (the Act) included in the Tax Relief and Health Care Act of 2006, enacted December 20, 2006, Pub. L. No. 109–432. The guidance also provides special transition relief for rollovers completed before March 15, 2007. It is anticipated that additional guidance will be published later under this provision.

As discussed in detail below, the new rules provide, in limited circumstances, for certain amounts in a health FSA or HRA to be rolled over into an HSA and for the rollover to receive favorable tax treatment. Generally, under the new rules, all of the following conditions must be satisfied in order to receive the favorable tax treatment:

- By plan year end—
  - The plan must be amended
  - The employee must elect the rollover
  - The year-end balance must be frozen
- The funds must be transferred by the employer within two and a half months after the end of the plan year and result in a zero balance in the health FSA or HRA.

Under special transition relief provided in this notice for amounts remaining at the end of 2006, however:

- There is no requirement to freeze the year-end balance in the health FSA or HRA, and
- The amendment, election, and transfer must be completed by March 15, 2007.

BACKGROUND

Eligible individuals, as defined in § 223(c)(1) of the Code, may contribute to HSAs. In general, these are individuals who, as of the first day of the month, are covered by a high deductible health plan (HDHP) and by no other health plan that is not an HDHP (with the exception of certain disregarded coverage, including permitted insurance). An individual covered by a general purpose health FSA or general purpose HRA is not eligible to contribute to an HSA. See Rev. Rul. 2004–45, 2004–1 C.B. 971. If a general purpose health FSA allows reimbursements for expenses incurred during a grace period following the end of the plan year, an otherwise eligible individual participating in the health FSA is generally not eligible to make contributions to an HSA until the first day of the first month following the end of the grace period. The maximum duration of a grace period is until the fifteenth day of the third month following the end of a plan year. See Notice 2005–42, 2005–1 C.B. 1204. Prior to the Act, this rule applied even if the individual's health FSA had no unused benefits as of the end of the prior year (*i.e.*, the balance in the health FSA was zero as of the last day of the plan year). Notice 2005–86, 2005–2 C.B. 1075. However, coverage by an HSA-compatible health FSA or HRA (limited-purpose health FSA or HRA, post-deductible health FSA or HRA, retirement HRA, or suspended HRA), does not affect an employee's eligibility to contribute to an HSA, including coverage during a health FSA grace period. See Rev. Rul. 2004–45.

HEALTH OPPORTUNITY PATIENT EMPOWERMENT ACT OF 2006 — GENERAL RULES

Section 302(a) of the Act provides for "qualified HSA distributions" before January 1, 2012. A qualified HSA distribution is a direct distribution of an amount from a health FSA or HRA to an HSA. The distribution (rollover to an HSA) must not exceed the lesser of the balance in the health FSA or HRA (1) on September 21, 2006, or (2) as of the date of the distribution. Thus, an individual who was not covered by a health FSA or HRA on September 21, 2006 may not elect a qualified HSA distribution. Similarly, an individual who participated in a health FSA with one employer on September 21, 2006, and participates in a health FSA with a second employer after that date, may not elect a qualified HSA distribution with respect to the second employer's health FSA.

A qualified HSA distribution must be contributed directly to the HSA trustee by the employer. Qualified HSA distributions may be made from general purpose health FSAs and HRAs, as well as from HSA-compatible health FSAs and HRAs. Only one qualified HSA distribution is allowed with respect to each health FSA or HRA of an individual. Qualified HSA distributions are not taken into account in applying the annual limit for HSA contributions. Qualified HSA distributions are treated as rollovers and thus, are not deductible.

If the individual fails to remain HSA-eligible during the testing period following the distribution, the amount of the rollover is included in gross income and is subject to an additional 10 percent tax. For this purpose, the testing period is defined as the period beginning with the month in which the qualified HSA distribution is contributed to the HSA and ending on the last day of the 12th month following that month. It is not required that an employee be an eligible individual with HDHP coverage in order to have a qualified HSA distribution made on the employee's behalf. However, if an employee is not an eligible individual immediately following the qualified HSA distribution, the amount of the distribution is included in the employee's income and subject to an additional 10 percent tax.

Section 302(b) of the Act provides that only certain health FSA coverage during a grace period is treated as disregarded coverage for the purpose of determining an individual's eligibility to contribute to an HSA. Under new § 223(c)(1)(B)(iii) of the Code, coverage during a grace period by a general purpose health FSA is disregarded if (1) the balance in the health FSA at the end of the prior plan year is zero or (2) the individual makes a qualified HSA distribu-

tion of any balance remaining at the end of the plan year to an HSA.

Section 302(b) of the Act only applies to health FSA coverage during a grace period following a plan year. Thus, health FSA coverage during the plan year is not disregarded, regardless of whether the health FSA balance is reduced to zero during the plan year by a qualified HSA distribution or otherwise.

QUALIFIED HSA DISTRIBUTIONS

If an employer wants to provide qualified HSA distributions, the employer must amend the health FSA or HRA written plan. In order to comply with the comparability rules in § 4980G of the Code, the amended plan must offer qualified HSA distributions to any otherwise eligible individual covered by the employer's HDHP. See new § 106(e)(5)(B) of the Code. However, there is no requirement that the health FSA or HRA be terminated in order to provide a qualified HSA distribution. Health FSAs and HRAs must satisfy the nondiscrimination requirements in § 105(h) of the Code.

A qualified HSA distribution may be made at any time prior to January 1, 2012. However, even if the qualified HSA distribution reduces the balance of an FSA or HRA to zero, the health FSA or HRA coverage does not end. If the FSA or HRA is not HSA-compatible, employees can become eligible individuals only after transfers at the end of the plan year of the FSA or HRA that result in either disregarded coverage under 302(b) of the Act, or the termination of the HRA coverage at the end of the plan year. Consequently, qualified HSA distributions from health FSAs or HRAs that are not HSA-compatible and that take place at any time other than the end of a plan year, generally result in the inclusion of the distribution in income and the imposition of an additional 10 percent tax.

The amendments in the Act do not change the requirement that unused amounts remaining at the end of a health FSA's plan year must be forfeited in the absence of a grace period. Notice 2005–42. Thus, if a health FSA does not have a grace period, unused amounts remaining at the end of the plan year are forfeited and generally cannot be transferred through a qualified HSA distribution to an HSA after the end of the plan year. Although the unused amounts can be distributed to an HSA before the end of the plan year, because the health FSA coverage continues until the end of the plan year, an individual covered by the health FSA is not an eligible individual immediately after the qualified HSA distribution, and thus any such qualified HSA distribution is included in income and subject to an additional 10 percent tax. Similarly, an individual without HDHP coverage after a distribution is not an eligible individual after the distribution and thus the qualified HSA distribution is included in income and subject to an additional 10 percent tax. Unless a participant has a change in status as provided in Treas. Reg. § 1.125–4(a), health FSA elections may not be changed during a plan year. Prop. Treas. Reg. § 1.125–1, Q & A–15.

BALANCES DETERMINED ON CASH BASIS

For all purposes, balances are determined on a cash basis. Cash basis means the balance as of any date, without taking into account expenses incurred that have not been reimbursed as of that date. Thus, pending claims, claims submitted, claims received or claims under review that have not been paid as of a date are not taken into account for purposes of determining the account balance as of that date. In addition, the balance as of any date of a health FSA is determined by applying the uniform coverage rule (*i.e.*, maximum reimbursement available for the plan year reduced for prior reimbursements paid as of the date for the same plan year). See Prop. Treas. Reg. § 1.125–2, Q&A–7(b)(2).

HDHP COVERAGE BEGINNING AFTER 1ST DAY OF THE MONTH

An employee who begins HDHP coverage after the first day of the month is not an eligible individual until the first day of the next month. If a qualified HSA distribution is made on behalf of such an employee before the first day of the next month, the employee is not an eligible individual as of the date of the qualified HSA distribution and the amount of the distribution is included in the employee's income and subject to an additional 10 percent tax. Thus, if an employee begins HDHP coverage after the first day of the month, any qualified HSA distribution on behalf of the individual made on or after the first day of the next month avoids immediate inclusion in income.

CONSEQUENCES OF FAILING TO ROLL OVER ENTIRE BALANCE OF GENERAL PURPOSE HEALTH FSA OR GENERAL PURPOSE HRA

An employee with a balance in a health FSA with a grace period or HRA at the end of a plan year is not treated as an eligible individual for HSA purposes on the first day of the immediately following plan year if a qualified HSA distribution does not result in a zero balance in the health FSA or HRA. Because the employee is covered under a health plan that is not an HDHP during the testing period, the amount of the qualified HSA distribution is included in the employee's gross income in the year of the distribution and is subject to a 10 percent additional tax. However, an employee with a balance in an HSA-compatible health FSA or HRA at the end of a plan year remains an eligible individual, if otherwise eligible, regardless of whether a qualified HSA distribution is made.

ADDITIONAL TAX FOR FAILURE TO REMAIN AN ELIGIBLE INDIVIDUAL

If an individual ceases to be an eligible individual during the testing period, the amount of the qualified HSA distribution is included in the gross income of the individual and subject to an additional 10 percent tax. Failing to remain an eligible individual does not require the withdrawal of the qualified HSA distribution, and the amount is not an excess contribution. However, any HSA withdrawal not used for qualified medical expenses is included in income and subject to an additional 10 percent tax (with certain exceptions), regardless of whether the HSA received a qualified HSA distribution that was previously included in the account beneficiary's income and subject to the additional tax. See § 223(f)(4)(B).

PERMANENT RULE — INDIVIDUALS WITH A ZERO BALANCE IN GENERAL PURPOSE HEALTH FSA ON THE LAST DAY OF PLAN YEAR

Under the Act, if an individual has a zero balance in a general purpose health

FSA, as determined on a cash basis, on the last day of the health FSA plan year, the individual does not fail to be an eligible individual as of the first day of the immediately following health FSA plan year because of coverage during a health FSA grace period.

PERMANENT RULE — INDIVIDUALS WITH A ZERO BALANCE IN GENERAL PURPOSE HRA ON THE LAST DAY OF PLAN YEAR

An individual with a zero balance in a general purpose HRA, determined on a cash basis, on the last day of the HRA plan year, does not fail to be an eligible individual on the first day of the immediately following HRA plan year, so long as (1) effective on the first day of the immediately following HRA plan year, the employee elects to waive participation in the HRA, or (2) effective on or before the first day of the following HRA plan year, the employer terminates the general purpose HRA with respect to all employees, or (3) effective on or before the first day of the following HRA plan year, with respect to all employees, the employer converts the general purpose HRA to an HSA-compatible HRA, as described in Rev. Rul. 2004–45.

PERMANENT RULE — PLAN-YEAR-END ROLLOVERS FROM GENERAL PURPOSE HEALTH FSA OR GENERAL PURPOSE HRA TO HSA

An employee with a balance in a general purpose health FSA with a grace period or general purpose HRA at the end of a health FSA or HRA plan year (plan year) is treated as an eligible individual for HSA purposes as of the first day of the first month in the immediately following plan year that the individual has HDHP coverage on the first day of the month if:

(1) the employer amends the health FSA or HRA written plan effective by the last day of the plan year to allow a qualified HSA distribution,

(2) a qualified HSA distribution from the health FSA or HRA has not been previously made on behalf of the employee with respect to that particular health FSA or HRA,

(3) the employee has HDHP coverage as of the first day of the month during which the qualified HSA distribution occurs, and is otherwise an eligible individual,

(4) the employee elects by the last day of the plan year to have the employer make a qualified HSA distribution from the health FSA or HRA to the HSA of the employee,

(5) the health FSA or HRA makes no reimbursements to the employee after the last day of the plan year,

(6) the employer makes the qualified HSA distribution directly to the HSA trustee by the fifteenth day of the third calendar month following the end of the immediately preceding plan year, but after the employee becomes HSA-eligible,

(7) the qualified HSA distribution from the health FSA or HRA does not exceed the lesser of the balance of the health FSA or HRA on (a) September 21, 2006, or (b) the date of the distribution, and

(8)(a) after the qualified HSA distribution there is a zero balance in the health FSA or HRA, and the employee is no longer a participant in any non-HSA compatible health plan or (b) effective on or before the date of the first qualified HSA distribution the general purpose health FSA or general purpose HRA written plan is converted to an HSA-compatible health FSA or HRA, as described in Rev. Rul. 2004–45, for all participants.

TRANSITION RULE — QUALIFIED HSA DISTRIBUTIONS FROM GENERAL PURPOSE HEALTH FSA AND GENERAL PURPOSE HRA BEFORE MARCH 15, 2007

An employee with a balance in a general purpose health FSA with a grace period or general purpose HRA after December 31, 2006 is treated as an eligible individual for HSA purposes as of the first day of the first month in 2007 that the employee has HDHP coverage on the first day of the month if:

(1) the employer amends the health FSA or HRA written plan effective on or before March 15, 2007, to allow a qualified HSA distribution,

(2) a qualified HSA distribution from the health FSA or HRA has not been previously made on behalf of the employee with respect to that particular health FSA or HRA,

(3) the employee has HDHP coverage as of the first day of the month during which the qualified HSA distribution occurs, and is otherwise an eligible individual,

(4) the employee elects on or before March 15, 2007, to have the employer make a qualified HSA distribution from the health FSA or HRA to the HSA of the employee,

(5) the qualified HSA distribution from the health FSA or HRA does not exceed the lesser of the balance of the respective health FSA or HRA on (a) September 21, 2006, or (b) the date of the distribution,

(6) the employer makes the qualified HSA distribution directly to the HSA trustee by March 15, 2007, but after the employee becomes HSA-eligible, and

(7)(a) after the qualified HSA distribution there is a zero balance in the health FSA or HRA, and the employee is no longer a participant in any non-HSA compatible health plan or (b) effective on or before the date of the first qualified HSA distribution, the general purpose health FSA or general purpose HRA written plan is converted to an HSA-compatible health FSA or HRA, as described in Rev. Rul. 2004–45, for all participants.

EXAMPLES

The following examples illustrate these rules. All references to balances in the following examples are determined on a cash basis. All grace periods satisfy the requirements of Notice 2005–42. It is assumed in the examples that, for purposes of § 106(e)(3)(B) and § 223(f)(4)(B), no employees are disabled.

Permanent Rule Examples

Example 1. For 2007, Employer Z has a calendar year general purpose health FSA with a grace period ending March 15, 2008. For 2007, Employee A timely elects salary reduction of $500 for the general purpose health FSA. Employer Z offers employees the option of electing HDHP coverage for the plan year beginning January 1, 2008. On or before December 31, 2007, A elects HDHP coverage beginning January 1, 2008. On December 31, 2007, A has a zero balance in the health FSA. A is otherwise an eligible individual on January 1, 2008.

A does not fail to be an eligible individual on January 1, 2008 merely because of the health FSA grace period.

Example 2. For 2007, Employer Y has a calendar year general purpose health FSA with a grace period ending on March 15, 2008. Employer Y offers employees the option of electing HDHP coverage for the plan year beginning January 1, 2008.

Before January 1, 2008, Employer Y amends the health FSA to allow for qualified HSA distributions. The amended plan allows an employee electing HDHP coverage to also elect to have any health FSA balance at year-end, determined on a cash basis, contributed directly to an HSA trustee for the employee. For this purpose, the year-end balance is the balance of the health FSA without regard to any expenses incurred but not paid. Under the amendment, if an employee elects the qualified HSA distribution, the employee cannot submit any additional claims after December 31, 2007, regardless of when the underlying expense was incurred nor are any claims paid after December 31, 2007 even if submitted prior to December 31, 2007.

Employee B has a balance of $950 in the health FSA on September 21, 2006, and a balance of $700 on December 31, 2007. On or before December 31, 2007, B elects HDHP coverage beginning January 1, 2008. B also elects to have a qualified HSA distribution of the $700 remaining in the health FSA on December 31, 2007. Employer Y contributes $700 to an HSA on behalf of B on or before March 15, 2008. B is otherwise an eligible individual as of January 1, 2008.

Employee C has a balance of $850 on December 31, 2007. On or before December 31, 2007, C elects HDHP coverage for 2008. C does not elect to have a qualified HSA distribution of the $850 remaining in the health FSA on December 31, 2007. C is otherwise an eligible individual.

B does not fail to be an eligible individual as of January 1, 2008 because after the qualified HSA distribution B has a zero balance in the health FSA. C is an eligible individual on April 1, 2008.

Example 3. For 2007, Employer W has a calendar year general purpose HRA. Employer W offers employees the option of electing HDHP coverage for the plan year beginning January 1, 2008.

Before January 1, 2008, Employer W amends the HRA to allow for qualified HSA distributions. The amended HRA allows an employee electing HDHP coverage for the plan year to also elect to have the lesser of the balance in the HRA on September 21, 2006 or the HRA balance at year-end, determined on a cash basis, contributed directly to an HSA trustee for the employee. For this purpose, the year-end balance is the balance of the HRA without regard to any expenses incurred but not paid. Under the amendment, if an employee elects the qualified HSA distribution, the employee cannot submit any additional claims after December 31, 2007, regardless of when the underlying expense was incurred, nor will the HRA reimburse any claim submitted but unpaid as of December 31, 2007. The amendment also provides that an employee who elects a qualified HSA distribution may also elect to waive participation in the HRA.

Employee D has a balance of $300 in the HRA on September 21, 2006, and a balance of $175 on December 31, 2007. On or before December 31, 2007, D elects HDHP coverage for 2008. D also elects to have a qualified HSA distribution of the $175 remaining in the HRA on December 31, 2007, and to waive participation in the HRA effective after December 31, 2007. Employer W contributes $175 to an HSA on behalf of D on or before March 15, 2008. D is otherwise an eligible individual as of January 1, 2008.

Employee E has a balance of $300 in the HRA on September 21, 2006, and a balance of $550 on December 31, 2007. On or before December 31, 2007, E elects HDHP coverage for 2008. E also elects to have a qualified HSA distribution of the $300 that was in the HRA on September 21, 2006. Employer W contributes $300 to an HSA on behalf of E on March 15, 2008. E is otherwise an eligible individual as of January 1, 2008.

Employee F has a balance of $400 in the HRA on September 21, 2006. On or before December 31, 2007, F elects HDHP coverage for 2008. On June 15, 2008, F has a balance of $275 in the HRA, and elects to have a qualified HSA distribution of the $275. Employer W contributes $275 to an HSA on behalf of F on August 20, 2008. F is otherwise an eligible individual as of January 1, 2008.

D does not fail to be an eligible individual as of January 1, 2008 because after the qualified HSA distribution D has a zero balance in the HRA and does not participate in any non-HSA compatible HRA. E fails to be an eligible individual after the qualified HSA distribution, because E has a balance exceeding zero in the HRA after the distribution. E must include $300 in gross income in 2008, as well as pay an additional 10 percent tax. F fails to be an eligible individual after the qualified HSA distribution, because F remains a participant in an HRA that is not HSA-compatible until the end of the HRA plan year. The result is the same regardless of whether F waived participation in the HRA after June 15, 2008. Thus, F must include $275 in gross income in 2008, as well as pay an additional 10 percent tax.

Example 4. The same facts as *Example 3*, except Employer W converted the general purpose HRA to an HSA-compatible retirement HRA for all employees effective January 1, 2008.

Employee G has a balance of $275 in the HRA on September 21, 2006, and a balance of $700 on December 31, 2007. On or before December 31, 2007, G elects HDHP coverage beginning January 1, 2008. G is otherwise an eligible individual as of January 1, 2008. G also elects to have a qualified HSA distribution of the $275 that was in the HRA on September 21, 2006. Employer W contributes $275 to an HSA on behalf of G on or before March 15, 2008. G has a balance of $425 in a retirement HRA and remains an active employee.

G is an eligible individual as of January 1, 2008, because the HRA G participates in is HSA-compatible.

Example 5. Employer V has a fiscal year general purpose health FSA with a grace period. The fiscal year of the health FSA is October 1 — September 30. The grace period ends on December 15. For the plan year beginning October 1, 2007, Employer V offers employees the option of electing HDHP coverage.

In December 2006, Employer V amends the health FSA to allow for qualified HSA distributions. The amended plan allows an employee electing HDHP coverage for the plan year to also elect to have any health FSA balance at the end of the plan year, determined on a cash basis, contributed directly to an HSA trustee for the employee. For this purpose, the plan-year-end balance is the balance of the health FSA without regard to any expenses incurred but not paid. If an employee elects the qualified HSA distribution, the employee cannot submit any additional claims after September 30, 2007, regardless of when the underlying expense was incurred. The health FSA does not reimburse claims submitted but unpaid as of September 30, 2007.

Employee H has a balance of $600 in the health FSA on September 21, 2006, and a balance of $500 on September 30, 2007. On or before September 30, 2007, H elects HDHP coverage for the plan year beginning October 1, 2007. H also elects to have a qualified HSA distribution of the $500 remaining in the health FSA on September 30, 2007. Employer V contributes $500 to an HSA on behalf of H on or before December 15, 2007. H is otherwise an eligible individual as of October 1, 2007.

H does not fail to be an eligible individual as of October 1, 2007 because after the qualified HSA distribution H has a zero balance in the health FSA.

Example 6. The same facts as *Example 5*, except Employer V has a limited purpose health FSA.

Employee I has a balance of $2,000 in the limited purpose health FSA on September 21, 2006, and a balance of $3,000 on September 30, 2007. On or before September 30, 2007, I elects HDHP coverage for the plan year beginning October 1, 2007. I also elects to have a qualified HSA distribution of $2,000 that was in the health FSA on September 21, 2006. Employer V contributes $2,000 to an HSA on behalf of I on or before December 15, 2007. I has a balance of $1,000 in a limited purpose health FSA. I is otherwise an eligible individual as of October 1, 2007.

I does not fail to be an eligible individual because I participates in an HSA-compatible health FSA.

Example 7. For 2007, Employer U has a calendar year general purpose health FSA with a grace period ending on March 15, 2008. Employer U has a fiscal year health plan that begins July 1, 2007. For the plan year beginning July 1, 2007, Employer U offers employees the option of electing HDHP coverage.

Before January 1, 2008, Employer U amends the health FSA to allow for qualified HSA distributions. The amended plan allows an employee electing HDHP coverage to also elect to have any health FSA balance at year-end, determined on a cash basis, contributed directly to an HSA trustee for the employee. For this purpose, the year-end balance is the balance of the health FSA without regard to any expenses incurred but not paid. Under the amendment, if an employee elects the qualified HSA distribution, the employee cannot submit any additional claims after December 31, 2007, regardless of when the underlying expense was incurred. The health FSA does not pay claims submitted but unpaid as of December 31, 2007.

Employee J has a balance of $500 in the health FSA on September 21, 2006, and a balance of $400 on June 30, 2007. On or before June 30, 2007, J elects HDHP coverage for the immediately following health plan year. J also elects to have a qualified HSA distribution of $400 that was in the health FSA on June 30, 2007. Employer U contributes $400 to an HSA on behalf of J on or before September 15, 2007. J is an otherwise eligible individual as of July 1, 2007.

J fails to be an eligible individual after the distribution because J's participation in a health FSA is not disregarded coverage until January 1, 2008, even though the qualified HSA distribution reduces the balance of the health FSA to zero. J must include $400 in his gross income for 2007, and pay an additional 10 percent tax. J is an eligible individual on January 1, 2008.

Example 8. For 2007, Employer T has a calendar year general purpose health FSA with a grace period ending on March 15, 2008. Employer T offers employees the option of electing HDHP coverage for the plan year beginning January 15, 2008.

Before January 1, 2008, Employer T amends the health FSA to allow for qualified HSA distributions. The amended plan allows an employee electing HDHP coverage to also elect to have any health FSA balance at year-end, determined on a cash basis, contributed directly to an HSA trustee for the employee. For this purpose, the year-end balance is the balance of the health FSA without regard to any expenses incurred but not paid. Under the amendment, if an employee elects the qualified HSA distribution, the employee cannot submit any additional claims after December 31, 2007, regardless of when the underlying expense was incurred. The health FSA does not pay claims submitted but unpaid as of December 31, 2007.

Employee K has a balance of $1,000 in the health FSA on September 21, 2006, and a balance of $700 on December 31, 2007. On or before December 31, 2007, K elects HDHP coverage for the plan year beginning January 15, 2008. K also elects to have a qualified HSA distribution of the $700 remaining in the health FSA on December 31, 2007. Employer T contributes $700 to an HSA on behalf of K after February 1, 2008, but before March 15, 2008. K is otherwise an eligible individual as of January 15, 2008.

Employee L has a balance of $175 in the health FSA on September 21, 2006, and a balance of $150 on December 31, 2007. On or before December 31, 2007, L elects HDHP coverage for the plan year beginning January 15, 2008. L also elects to have a qualified HSA distribution of the $150 remaining in the health FSA on December 31, 2007. Employer T contributes $150 to an HSA on behalf of L on January 25, 2008.

K does not fail to be an eligible individual because K has a zero balance in the health FSA after the qualified HSA distribution. K is eligible to contribute to the HSA as of February 1, 2008. L is not an eligible individual at the time of the distribution because L does not have HDHP coverage on the first day of January. L must include $150 in gross income in 2008, and pay an additional 10 percent tax. As of February 1, 2008, L is an eligible individual because L has HDHP coverage and no other health plan coverage that is not an HDHP, is not enrolled in Medicare, and cannot be claimed as a dependent on another person's tax return.

Transition Rule Examples

Example 9. For 2006, Employer S has a calendar year general purpose health FSA with a grace period ending on March 15, 2007. Employer S offers employees the option of electing HDHP coverage for the plan year beginning January 1, 2007.

Employer S amends the health FSA to allow for qualified HSA distributions. The amended plan allows an employee electing HDHP coverage to also elect to have any health FSA balance at year-end, determined on a cash basis, contributed directly to an HSA trustee for the employee. For this purpose, the year-end balance is the balance of the health FSA without regard to any expenses incurred but not paid. During the period from January 1, 2007 to March 15, 2007, an employee electing HDHP coverage for 2007 may elect a qualified HSA distribution of the health FSA balance. The amount of the qualified HSA distribution is determined on a cash basis on the date of the distribution.

Employee M has a balance of $850 on December 31, 2006. On or before December 31, 2006, M elects HDHP coverage beginning January 1, 2007. M does not elect to have a qualified HSA distribution of the $850 remaining in the health FSA on December 31, 2006. M incurred $850 of § 213(d) expenses after January 1 and the health FSA reimbursed M for that amount. M's health FSA balance is zero on January 22, 2007. M is otherwise an eligible individual as of January 1, 2007.

Employee N has a balance of $800 in the health FSA on September 21, 2006, and a balance of $200 on December 31, 2006. On or before December 31, 2006, N elects HDHP coverage beginning January 1, 2007. During January 2007, the health FSA reimburses N for $50 in § 213(d) medical expenses. On February 12, 2007, N elects to have a qualified HSA distribution of the remaining health FSA balance of $150. Employer S contributes $150 to an HSA on behalf of N on or before March 15, 2007. N is otherwise an eligible individual as of January 1, 2007.

Employee O has a balance of $300 in the health FSA on September 21, 2006, and a balance of $175 on December 31, 2006. On or before December 31, 2006, O elects HDHP coverage for 2007. On or before March 15, 2007, O also elects to have a qualified HSA distribution of the $175 remaining in the health FSA on December 31, 2006. Employer S contributes $175 to an HSA on behalf of O on or before March 15, 2007. O is otherwise an eligible individual as of January 1, 2007.

M has disqualifying coverage by the health FSA until April 1, 2007 because M neither had a zero balance in the FSA on December 31, 2006 nor did M have a zero balance following a qualified HSA distribution on or before March 15, 2007. N is an eligible individual as of January 1, 2007 because after the qualified HSA distribution N has a zero balance in a health FSA. O is an eligible individual as of January 1, 2007, because after the qualified HSA distribution O has a zero balance in a health FSA.

Example 10. The same facts as *Example 9*, except M and N incurred their respective $850 and $50 in § 213(d) medical expenses in December 2006. M and N submitted the expenses and were reimbursed from the health FSA for the expenses after January 1, 2007 and before February 1, 2007. On February 12, 2007, N elects to have a qualified HSA distribution of the remaining health FSA balance of $150. Employer S contributes $150 to an HSA on behalf of N on or before March 15, 2007. N is otherwise an eligible individual as of January 1, 2007.

M has disqualifying coverage by the health FSA until April 1, 2007, because M neither has a zero balance in the FSA on December 31, 2006 nor did M have a zero balance following a qualified HSA distribution on or before March 15, 2007. N is an eligible individual as of January 1, 2007 because after the qualified HSA distribution N has a zero balance in a health FSA.

Examples of Additional 10 Percent Tax

Example 11. Employee P, who is 32 years old, has HDHP coverage as of January 1, 2008. P elects to have a qualified HSA distribution on or before December 31, 2007. On or before March 15, 2008, P's employer contributes $250 from a general purpose health FSA to an HSA on behalf of P in a qualified HSA distribution meeting the requirements of section 302 of the Act and this notice. Following the qualified HSA distribution, P has a balance of zero in the general purpose health FSA.

In July 2008, P terminates employment with Employer R, and begins employment with Employer Q. Employer Q does not offer an HDHP. P obtains health coverage under a low deductible health plan, and ceases to be an eligible individual for HSA purposes. P must include the $250 qualified HSA distribution in his gross income for 2008, and pay an additional 10 percent tax under § 106(e)(3) of the Code. P does not have to withdraw the $250 from his HSA, and the amounts in the HSA may grow tax-free.

Example 12. The same facts as *Example 11*, except in February 2009, P uses $200 from his HSA for a nonqualified medical expense. The $200 is included in P's gross income for 2009 and is subject to an additional 10 percent tax under § 223(f)(4) of the Code.

Example 13. The same facts as *Example 12*, except P uses $200 from his HSA for a qualified medical expense. The $200 is not included in P's gross income, and there is no additional tax.

NO EFFECT ON HSA ESTABLISHMENT DATE

Qualified medical expenses for HSA purposes are only expenses incurred after the HSA is established. Notice 2004–2, 2004–1 C.B. 269, Q&A–26. While this notice provides that certain individuals are treated as eligible individuals as of the first day of the plan year, those rules do not treat an HSA as established before the actual establishment of the HSA.

State trust law determines when an HSA is established. Most state trust laws require that for a trust to exist, an asset must be held in trust; thus, most state trust laws require that a trust must be funded to be established.

REPORTING

Amounts transferred through a qualified HSA distribution are not reported in box 12 of Form W–2. Employers are not responsible for reporting whether an employee receiving a qualified HSA distribution remains an eligible individual during the testing period. However, employers must report qualified HSA distributions as rollover contributions to the HSA trustee,

and the HSA trustee must report the qualified HSA distribution as a rollover contribution on Form 5498–SA.

EFFECTIVE DATE

The provision in the Act allowing qualified HSA distributions from health FSAs and HRAs is effective on or after December 20, 2006, and before January 1, 2012.

EFFECT ON OTHER DOCUMENTS

Published guidance under § 105(b) states that if any person has the right to receive cash or any other taxable or nontaxable benefit under a health FSA or HRA, other than the reimbursement of § 213(d) medical expenses of the employee, employee's spouse or employee's dependents, then all distributions made from the arrangement are included in the employee's gross income, even amounts paid to reimburse medical care. See Rev. Rul. 2006–36, 2006–36 I.R.B. 353; Rev. Rul. 2005–24, 2005–1 C.B. 892; Rev. Rul. 2003–102, 2003–2 C.B. 559; Notice 2002–45, 2002–2 C.B. 93; Rev. Rul. 2002–41, 2002–2 C.B. 75; Rev. Rul. 69–141, 1969–1 C.B. 48. New § 106(e) provides that a health FSA or HRA will not fail to satisfy the requirements of §§ 105 or 106 merely because the plan provides for a qualified HSA distribution. Amounts rolled into an HSA may be used for purposes other than reimbursing the § 213(d) medical expenses of the employee, spouse or dependents. Accordingly, Rev. Rul. 2006–36, Rev. Rul. 2005–24, Rev. Rul. 2003–102, Notice 2002–45, Rev. Rul. 2002–41, and Rev. Rul. 69–141 are modified with respect to qualified HSA distributions described in § 106(e). In addition, Notice 2005–86, 2005–2 C.B. 1075, is modified effective as of December 20, 2006.

DRAFTING INFORMATION

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

---

26 CFR 601.702: Publication, public inspection, and specific requests for records.
(Also: Part l, Section 6103(p)(2).)

Rev. Proc. 2007–22

SECTION 1. PURPOSE

This revenue procedure modifies the payment procedures for user fees applicable to the processing of Form 8802, *Application for United States Residency Certification*, to allow for the electronic payment of such fees effective April 2, 2007.

SECTION 2. BACKGROUND

Form 8802 is used to request Form 6166, a letter that the applicant may use as proof of the applicant's status as a resident of the United States to claim benefits under an income tax treaty or an exemption from a value added tax (VAT) imposed by a foreign country.

Rev. Proc. 2006–35, 2006–37 I.R.B. 434, announced that a new user fee charge will apply to process all requests for residency certification on Form 8802. Section 3.01 of the revenue procedure describes the fee schedule, and section 3.02 provides that the fee must be paid by check or money order to the United States Treasury in U.S. dollars.

Notice 2006–90, 2006–42 I.R.B. 688, modified Rev. Proc. 2006–35, by delaying the effective date of the user fee charge for processing Form 8802 until November 1, 2006.

Recognizing the administrative advantages to both taxpayers and the IRS of alternative payment methods, the IRS is making arrangements to allow for the electronic payment of these fees.

SECTION 3. PROCEDURES

Effective for Forms 8802 submitted on or after April 2, 2007, payment of user fees for Form 8802 may be made electronically to the IRS. The specific instructions for making payments electronically will be included in the next version of Form 8802 and its accompanying instructions, to be issued in March 2007. All further changes and modifications to these payment procedures will be reflected in Form 8802 and its accompanying instructions.

SECTION 4. INQUIRIES

For information regarding processing of Form 8802 and the user fees, contact Mr. Robert Hergenhan of Wage and Investment, Customer Account Service, Accounts Management at (215) 516–6685 (not a toll-free call).

SECTION 5. EFFECT ON OTHER DOCUMENTS

Effective February 9, 2007, Rev. Proc. 2006–35, as modified by Notice 2006–90, is further modified.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective February 9, 2007.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Ms. Quyen P. Huynh of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Quyen P. Huynh at (202) 622–3880 (not a toll-free call).

---

26 CFR 1.1441–1: Requirement for deduction and withholding of tax on payments to foreign persons.
(Also: Part I, §§ 263, 263A.)

Rev. Proc. 2007–23

SECTION 1. PURPOSE

This revenue procedure provides administrable tax rules under domestic and international provisions of the Internal Revenue Code for certain patent cross licensing arrangements. This revenue procedure is issued in response to comments and requests for guidance in connection with Notice 2006–34, 2006–14 I.R.B. 705. In general, and as described below, this revenue procedure provides rules permitting taxpayers to change to, or continue to use, the Net Consideration Method described in section 5 of this revenue procedure for a qualified patent cross licensing arrangement (QPCLA) described in section 4 of this revenue procedure. This revenue procedure does not provide rules

concerning the treatment of cross licensing arrangements that are not QPCLAs.

SECTION 2. DEFINITIONS

.01 *Application*. The definitions contained in this section 2 apply only for purposes of this revenue procedure.

.02 *Cross Licensing Arrangement*. A "cross licensing arrangement" is a contractual arrangement between two or more parties that own intellectual property under which each party grants to the other a license of specified intellectual property that is properly characterized as a license under applicable U.S. tax law principles.

.03 *Consideration*. The term "consideration" means, with respect to a cross licensing arrangement, any license rights, cash, or other consideration paid or received pursuant to the arrangement.

.04 *Controlled*. The term "controlled" has the same meaning as in § 1.482–1(i)(4) of the Income Tax Regulations.

SECTION 3 . BACKGROUND

.01 *Request for Comments*. Notice 2006–34 requested comments, information, and documents on cross licensing arrangements, including the: (i) business circumstances in which the arrangements arise; (ii) legal and factual means for distinguishing between different types of, or uses for, the arrangements; (iii) means for sourcing income from the arrangements; (iv) means for valuing cross-licensed rights; (v) financial accounting treatment of the arrangements; and (vi) foreign tax treatment of the arrangements.

.02 *Comments*. In response to the requests for information contained in Notice 2006–34, several commentators stated that many cross licensing arrangements are entered into primarily to provide each party with unfettered use of its own patents. In this way, the parties seek "freedom to operate" or the freedom to use their own intellectual property without threat of costly patent litigation from the potentially competing patent claims of the other party. These arrangements may be worded to insure "patent exhaustion" (that is, they are worded to confer rights to make, have made, import, sell, lease, use, or otherwise dispose of patented products). Commentators also stated that the use of cross licensing arrangements in this context would not typically include the transfer of other technology, such as know-how, copyright, or trademark rights. Commentators also indicated that these arrangements may or may not involve cash payments. These arrangements generally are nonexclusive.

Commentators indicated that parties to a cross licensing arrangement entered into to avoid patent litigation typically do not attempt to value the underlying patents prior to entering into the arrangement beyond a broad relative judgment that is reflected in the amount of cash payments, if any, between the parties.

Commentators pointed to the particular circumstances of patent law. Reports offered by the U.S. Patent and Trademark Office (USPTO) indicate drastic increases in the numbers of patents applied for and granted over the last 50 years. For instance, in 1950 the USPTO received 74,108 patent applications and granted 47,847 patents; by 2000, the USPTO received 315,015 patent applications and granted 175,455 patents. United States Patent and Trademark Office, *Table of Annual U.S. Patent Activity Since 1790, available at http://www.uspto.gov/web/offices/ac/ido/oeip/taf/h_counts.pdf*. At the same time, commentators indicated that a large number of patent infringement suits are filed each year with large associated costs. Commentators indicated that businesses, when faced with a potential "patent thicket," often choose to negotiate and enter into cross licensing arrangements rather than face uncertain results and expenses that might accompany patent litigation.

Commentators also described other technology sharing business arrangements that may involve a shared business purpose and the sharing of intellectual property beyond patent rights. In addition to providing information regarding the different uses for cross licensing and other technology sharing arrangements, commentators stated their view that, under established tax law principles, the execution of a cross licensing arrangement without any cash payment is not an income recognition event that would trigger withholding tax.

Commentators also indicated that attempting to value any rights granted under a cross licensing arrangement, or to source any income arising therefrom, would be extremely difficult, likely incorporating all of the uncertainties of both patent law and tax law. Commentators indicated that, under U.S. generally accepted accounting principles, profit or loss is generally reported with respect to cross licenses and similar arrangements only to the extent of any cash payments. Commentators said that several policy objectives, including maintaining U.S. competitiveness in the global marketplace in light of foreign taxation rules, would be hindered if an amount in excess of any cash received under a cross licensing arrangement were subject to withholding.

For all these reasons, commentators urged that only cash received under a cross licensing arrangement should be subject to withholding.

.03 *Applicable Law*.

Section 61(a) of the Internal Revenue Code provides the general rule that, except as otherwise provided by law, gross income includes all income from whatever source derived.

Section 162 permits a taxpayer to deduct all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 263(a) provides that no deduction shall be allowed for any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

Section 263A provides that in the case of any property to which § 263A applies, the direct costs of such property and such property's proper share of those indirect costs (including taxes), part or all of which are allocable to such property shall, in the case of property which is inventory in the hands of the taxpayer, be included in inventory costs and, in the case of any other property, shall be capitalized. With certain exceptions, § 263A applies to real or tangible personal property produced by the taxpayer and real or personal property described in § 1221(a)(1) which is acquired by the taxpayer for resale.

In relevant part, §§ 871(a) and 881(a) impose a 30-percent tax on U.S. source fixed or determinable annual or periodical gains, profits, and income (FDAP) received by nonresident aliens and foreign corporations to the extent such FDAP is not effectively connected with the conduct of a trade or business within the United States. Royalties, whether paid in one lump sum or periodically, constitute

FDAP. *Commissioner v. Wodehouse*, 337 U.S. 369, 392 (1949); see also §§ 1.871–7(b)(1) and 1.1441–2(b).

Section 1441(a) provides the general rule that all payors having the control, receipt, custody, disposal or payment of items described in § 1441(b) must deduct and withhold a tax equal to 30 percent on payments of certain items of income to nonresident aliens to the extent that such items constitute gross income from sources within the United States. Section 1441(b) provides that these items of income include interest, dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations and emoluments or other fixed or determinable annual or periodical gains, profits, and income. Section 1442(a) provides that, in the case of foreign corporations subject to taxation under subtitle A of the Code, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in § 1441 a tax equal to 30 percent thereof.

Section 861(a)(4) provides that rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States patents, copyrights, secret processes and formulas, good will, trade marks, trade brands, franchises, and other like property, shall be treated as income from sources within the United States.

Section 862(a)(4) provides that rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States patents, copyrights, secret processes and formulas, good will, trade marks, trade brands, franchises, and other like property, shall be treated as income from sources without the United States.

Section 863(a) provides that items of gross income, expenses, losses, and deductions, other than those specified in §§ 861(a) and 862(a), shall be allocated or apportioned to sources within or without the United States, under regulations prescribed by the Secretary.

Section 863(b) provides that, in the case of gross income derived from sources partly within and partly without the Unites States, the taxable income may first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The section further provides that the portion of such taxable income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Secretary.

Sections 871(b) and 882 provide that when a nonresident alien individual or a foreign corporation is engaged in a trade or business within the United States, the individual or corporation is taxable at U.S. graduated tax rates on taxable income which is effectively connected with the conduct of a trade or business within the United States (ECI). Section 864(c) provides specific rules for determining the income, gain, or loss treated as ECI.

Section 1031(a)(1) provides generally that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment. For § 1031 to apply, a taxpayer must have realized gain or loss from a disposition of property, as described in § 1001. While a sale or other disposition of a patent generally gives rise to a gain or loss under § 1001, the mere grant of a patent license does not because it is not a sale or other disposition of property within the meaning of § 1001(a). Similarly, gain or loss under § 1001 does not arise in the case of mutual grants of licenses. Thus, § 1031 has no application to a QPCLA addressed in this revenue procedure.

In general, the foregoing rules regarding inclusion, deduction, sourcing, and withholding operate independently as to each item of gross income and expense.

.04 *Administrability Issues*. The Treasury Department (Treasury) and the Internal Revenue Service (IRS) recognize that QPCLAs entered into by uncontrolled parties to pursue their businesses free from potential patent infringement claims raise many difficult issues for both taxpayers and the IRS. In light of the large number of patent applications and grants, and the difficulty and cost of resolving patent infringement disputes, it is often very difficult to ascertain the validity and scope of patent rights without incurring significant expense, which may include the cost of litigation. Thus, this unique interaction of patent and tax law creates administrative challenges for the taxation of QPCLAs.

For instance, while valuation of intellectual property is always difficult, valuation of patent rights is exceedingly difficult where the parties enter into the cross licensing arrangement to avoid or settle patent infringement disputes. Uncertainty in the patent law increases the difficulties of reaching a valuation when the parties enter into a cross licensing arrangement to avoid the costs and risks of determining their ultimate patent rights by litigation.

Similarly, the sourcing of gross income from QPCLAs entered into to avoid or settle patent infringement disputes may present administrative problems. In those arrangements, the difficulty in tracing the location and use of intangibles to a particular jurisdiction in the absence of objective benchmarks (for example, if a QPCLA did not provide for per-unit cash royalties based on sales of products) may make it difficult to allocate income to a particular source.

For these reasons, Treasury and the IRS have determined that, in the interest of sound tax administration, taxpayers are not required to take into account amounts other than the "net consideration" as defined in section 5.02 of this revenue procedure for QPCLAs described in section 4 of this revenue procedure.

SECTION 4. QUALIFIED PATENT CROSS LICENSING ARRANGEMENT (QPCLA)

A QPCLA is a nonexclusive, nontransferable patent cross licensing arrangement among uncontrolled parties, the subject matter of which is limited to the parties' present or future patent rights, as specified in the arrangement. If the parties to an arrangement also engage in more than *de minimis* licensing or other transfer of other intangible property (including copyrights, trademarks, and know how) pursuant to the arrangement, the arrangement is not a QPCLA. The determination of whether the licensing or other transfer of other intangible property is *de minimis* is determined under all the facts and circumstances.

SECTION 5. NET CONSIDERATION METHOD

.01 *Scope*. The Net Consideration Method provided in this section 5 may be used for a QPCLA by any taxpayer without regard to whether the taxpayer has made a payment of income subject to withholding with respect to the QPCLA.

.02 *Net Consideration*. For purposes of this section, "net consideration" is defined as the amount of consideration other than license rights and *de minimis* other intangible property received in the taxable year by a party pursuant to the arrangement, reduced by the amount of consideration other than license rights and *de minimis* other intangible property paid in the taxable year by the party pursuant to the arrangement.

.03 *Financial Statement Conformity*. A taxpayer may not use the Net Consideration Method discussed in this section for a QPCLA unless the taxpayer takes into account only the "net consideration", as defined in subsection 5.02 of this revenue procedure, for such arrangement on its audited financial statements (if any), or similar statement in the case of a foreign corporation, for all years ending after February 14, 2007, that the net consideration method is used for tax purposes.

.04 *Use of Net Consideration Method*. A taxpayer choosing to use the Net Consideration Method must apply the Net Consideration Method as provided in sections 5.05 and 5.06 of this revenue procedure. The use of the Net Consideration Method will be presumed to clearly reflect a taxpayer's income.

.05 *Withholding*. Under the Net Consideration Method, only the net consideration transferred between the parties to a QPCLA during a taxable year will be taken into account for withholding purposes. The Net Consideration Method applies whether the QPCLA is entered into in advance of, during, or after a patent dispute.

.06 *Capitalization*. Under the Net Consideration Method, only the net consideration transferred between the parties to a QPCLA during a taxable year will be taken into account for capitalization purposes under § 263(a) or § 263A of the Code.

.07 *Example*. X, a domestic corporation, and Y, a foreign corporation, each hold patents potentially implicated by the manufacture and sale of product P. In addition, each actively engages in the manufacture and sale of product P on a global basis. Y does not have income effectively connected with a U.S. trade or business. In 2007, X and Y enter into a QPCLA with respect to their respective patents. In accordance with the terms of the QPCLA, $20 million is paid by X to Y. The only consideration for the QPCLA taken into account on X's financial statements is the $20 million payment made by X to Y. X may use the Net Consideration Method to determine its withholding obligations and the amount subject to capitalization for federal income tax purposes.

Under the Net Consideration Method, only the $20 million payment made by X under the QPCLA is treated as income to Y for withholding purposes. Therefore, withholding under § 1442 will apply only with respect to the portion of the $20 million payment by X attributable to U.S. sources under § 861(a)(4). Further, only the $20 million payment by X is subject to capitalization under § 263(a) or § 263A.

SECTION 6. CHANGE IN ACCOUNTING METHOD

A change in the reporting of a QPCLA to the Net Consideration Method described in section 5 of this revenue procedure is a change in method of accounting within the meaning of §§ 446 and 481 and the regulations issued thereunder. Accordingly, a taxpayer that wishes to change its treatment for a QPCLA to the Net Consideration Method must obtain the consent of the Commissioner under §§ 446(e) and 1.446–1(e)(3).

SECTION 7. EFFECTIVE DATE

In general, the rules described in this revenue procedure apply to a QPCLA entered into on or after February 14, 2007.

SECTION 8. QPCLAS ENTERED INTO PRIOR TO THIS REVENUE PROCEDURE

Use of the Net Consideration Method described in section 5 of this revenue procedure for a QPCLA entered into prior to February 14, 2007 will not be raised as an issue by the IRS. If a taxpayer uses the Net Consideration Method described in section 5 of this revenue procedure for one or more QPCLAs entered into prior to February 14, 2007, and its use of that method is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002–9, 2002–1 C.B. 327, or its successor) in examination, in appeals, or before the U.S. Tax Court, that issue will not be further pursued by the IRS.

SECTION 9. COMMENTS

.01 *Comments Requested*. The Treasury and IRS request comments on the definition of a QPCLA and whether the Net Consideration Method also should extend to other types of cross licensing arrangements and, if so, under what conditions.

For example, comments are requested on the tax treatment of cross licensing arrangements for the joint development of intellectual property discussed in comments in response to Notice 2006–34. Such cross licensing arrangements are not within the definition of a QPCLA because the parties to such arrangements also engage in more than *de minimis* licensing or other transfer of other intangible property pursuant to the arrangements. The Treasury and IRS are considering, however, whether it may be appropriate to extend similar tax treatment to those arrangements. See § 1.482–7(g)(2) and (g)(8), Examples 4 and 5.

.02 *Submission of Comments*. Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: John E. Hinding (Revenue procedure 2007–23), CC:INTL:6, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to *revenue procedure.comments@irscounsel.treas.gov*. Please include "Revenue Procedure 2007–23" in the subject line of any electronic communications. Comments will be available for public inspection and copying.

SECTION 10. DRAFTING INFORMATION

The principal authors of this revenue procedure are John E. Hinding of the Office of Associate Chief Counsel (International) and Martin Scully, Jr. of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury participated in their development. For comments or questions regarding the international provisions applicable to cross licenses covered by this revenue procedure, contact John E. Hinding at 202–435–5265 (not a

toll-free call). For comments or questions regarding the domestic provisions applicable to cross licenses covered by this revenue procedure, contact Martin Scully, Jr. at 202–622–8066 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Certain Transfers of Stock or Securities by U.S. Persons to Foreign Corporations

REG–147144–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9311) under section 367(a) of the Internal Revenue Code (Code) regarding gain recognition agreements. These regulations are necessary to respond to comments requested in Notice 2005–74. The regulations primarily affect U.S. persons that transfer stock or securities to foreign corporations or corporations engaged in transactions that affect existing gain recognition agreements. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by May 7, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–147144–06), 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–147144–06), 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–147144–06).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Daniel McCall, (202) 622–3860; concerning submissions of comments, requests for a public hearing, and/or to be placed on the building access list to attend a hearing, contact Richard Hurst at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by May 7, 2007.

Comments are specifically requested concerning:

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

The accuracy of the estimated burden associated with the proposed collection of information;

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

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

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

The collections of information in this proposed regulation is in §1.367(a)–8(b)(3)(iii), (e)(1) through (e)(8), and (g). Responses to these collections of information are required to prevent triggering gain recognition agreements—for example, by submitting new gain recognition agreements or by submitting elections to reduce basis in certain stock. Responses are also required to facilitate electronic filing. These regulations include a rule requiring that gain or interest due under section 367(a) be included in a schedule that can be attached to a taxpayer's electronically-filed return. Response to these collections of information is mandatory. The likely respondents are large corporations.

Estimated total annual reporting burden: 240.

Estimated average annual burden hours per respondent: from 1 hour to 2 hours, depending on individual circumstances.

Estimated number of respondents: 170.

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 control number assigned by the Office of Management and Budget.

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

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to section 367(a) of the Internal Revenue Code (Code) and gain recognition agreements. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

It is hereby certified that the collections of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. These regulations primarily will affect United States persons that are large corporations engaged in cross-border corporate transactions. Thus, the number of affected small entities—in whichever of the three categories defined in the Regulatory Flexibility Act (small businesses, small organizations, and small governmental jurisdictions)—will not be substantial. The IRS and Treasury Department estimate that small organizations and small governmental jurisdictions are likely to be affected only insofar as they might hold a portfolio interest in stock or securities and in the unlikely event that they transfer such stock or securities to a foreign corporation. While a certain number of small entities may transfer stock or securities to a foreign corporation in connection with an acquisition or reorganization, the IRS and Treasury Department do not anticipate the number to be substantial. Furthermore, the IRS and Treasury Department estimate that those small entities that are affected by the regulations will likely face a burden of approximately two hours at an hourly rate of $200. Considering that the collections of information enable taxpayers to defer or avoid the recognition of potentially large amounts of gain that is subject to a gain recognition agreement, IRS and Treasury believe that $400 is not a significant economic impact. Comments about the accuracy of this certification may be submitted to the addresses provided in the preamble. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been 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 rules and how they can be made easier to understand. For additional requests for comments, see the section "Request for Comments," in the preamble to the cross-referenced temporary regulations of this issue of the Bulletin. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Daniel McCall of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the 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 new entries to read as follows:

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

Section 1.367(a)–3T(e) also issued under 367(a) and (b).* * *

Section 1.367(a)–8T also issued under 367(a) and (b).* * *

Par. 2. Section 1.367(a)–3 is amended by revising paragraphs (e) and (f) to read as follows:

§1.367(a)–3 Treatment of transfers of stock or securities to foreign corporations.

* * * * *

(e) [The text of this proposed amendment is the same as the text of §1.367(a)–3T(e) published elsewhere in this issue of the Bulletin].

(f) [The text of this proposed amendment is the same as the text of §1.367(a)–3T(f) published elsewhere in this issue of the Bulletin].

* * * * *

Par. 3. Section 1.367(a)–8 is revised to read as follows:

§1.367(a)–8 Gain recognition agreement requirements.

[The text of proposed §1.367(a)–8 is the same as the text of §1.367(a)–8T published elsewhere in this issue of the Bulletin.]

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on February 1, 2007, 10:34 a.m., and published in the issue of the Federal Register for February 5, 2007, 72 F.R. 5228)

Archer Medical Savings Accounts — Trustees' Reports on the Number of Archer MSAs Established Between January 1, 2005 and June 30, 2005 and Between January 1, 2006 and June 30, 2006

Announcement 2007–24

PURPOSE

The purpose of this announcement is to notify trustees and custodians that they must report to the Internal Revenue Service (IRS) the number of Archer MSAs established (1) between January 1, 2005 and June 30, 2005 and (2) between January 1, 2006 and June 30, 2006. Trustees must report this information to IRS on separate Forms 8851 for 2005 and 2006, no later than March 20, 2007. Form 8851 (revised 2007) is currently available at *www.irs.gov*.

Archer Medical Savings Accounts (Archer MSAs)

Archer MSAs are authorized by section 220 of the Internal Revenue Code. The Tax Relief and Health Care Act of 2006 § 117, Pub. Law. No. 109–432, amends sections 220(j)(4), (5) of the Code to require that trustees of Archer MSAs report the number of Archer MSAs established (1) between January 1, 2005 and June 30, 2005 and (2) between January 1, 2006 and June 30, 2006. Trustees must report this information to IRS by March 20, 2007. Archer MSAs will terminate if the number

of individuals establishing Archer MSAs exceeds certain numerical limits. If these limitations are exceeded in 2005 or 2006, April 19, 2007 will be a "cut-off date" after which, in general, no new Archer MSAs can be established. IRS will publish no later than April 19, 2007 the number of Archer MSAs established and whether April 19, 2007 is a "cut-off date."

Questions regarding this announcement may be directed to Shoshanna Tanner in the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622–6080 (not a toll-free number).

Corporate Reorganizations; Distributions Under Sections 368(a)(1)(D) and 354(b)(1)(B)

Announcement 2007–25

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations; correction notice.

SUMMARY: This document contains corrections to temporary regulations (T.D. 9303, 2007–5 I.R.B. 379) that was published in the **Federal Register** on Tuesday, December 19, 2006 (71 FR 75879) regarding the qualification of certain transactions as reorganizations described in section 368(a)(1)(D).

DATES: These corrections are effective December 19, 2006.

FOR FURTHER INFORMATION CONTACT: Bruce A. Decker at (202) 622–7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations (T.D. 9303) that is the subject of these corrections are under sections 368 and 354 of the Internal Revenue Code.

Need for Correction

As published, the temporary regulations (T.D. 9303) contain errors that may prove to be misleading and are in need of correction.

Correction of Publication

Accordingly, the temporary regulations (T.D. 9303) that was the subject of FR Doc. E6–21565, is corrected as follows:

1. On page 75879, column 1, in the preamble, under the caption "SUMMARY:", line 9, the language "securities of the acquiring corporation is" is corrected to read "securities of the acquiring corporation are."

2. On page 75880, column 1, in the preamble, under the paragraph heading "Background", first full paragraph of the column, line 5, the language "its operating assets to Y for $34x dollars," is corrected to read "its operating assets to Y for $34x,."

3. On page 75880, column 1, in the preamble, under the paragraph heading "Background", second full paragraph of the column, line 7, the language "requirements of section 354 and 356, is corrected to read "requirements of sections 354 and 356,."

4. On page 75881, column 1, in the preamble, under the paragraph heading "Special Analyses", line 7 from the bottom of the paragraph, the language "published elsewhere in this **Federal**" is corrected to read "published elsewhere in this issue of the **Federal**."

* * * * *

PART 1—INCOME TAXES

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

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

§ 1.368–2T [Corrected]

Par. 2. Section 1.368–2T is amended by revising paragraph (l)(1) to read as follows:

§ 1.368–2T Definition of terms (temporary).

* * * * *

(l) * * *

1) *General rule*. In order to qualify as a reorganization under section 368(a)(1)(D), a corporation (transferor corporation) must transfer all or part of its assets to another corporation (transferee corporation) and immediately after the transfer the transferor corporation, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, must be in control of the transferee corporation; but only if, in pursuance of the plan, stock or securities of the transferee corporation are distributed in a transaction which qualifies under section 354, 355, or 356.

* * * * *

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Office of Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on January 23, 2007, 8:45 a.m., and published in the issue of the Federal Register for January 24, 2007, 72 F.R. 3057)

Corporate Reorganizations; Distributions Under Sections 368(a)(1)(D) and 354(b)(1)(B); Correction Notice

Announcement 2007–26

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations; Correction notice.

SUMMARY: This document contains corrections to notice of proposed rulemaking by cross-reference to temporary regulations (REG–125632–06, 2007–5 I.R.B. 415) that was published in the **Federal Register** on Tuesday, December 19, 2006 (71 FR 75898) providing guidance regarding the qualification of certain transactions as reorganizations described in section 368(a)(1)(D) where no stock and/or securities of the acquiring corporation are issued and distributed in the transaction.

FOR FURTHER INFORMATION CONTACT: Bruce A. Decker at (202) 622–7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking by cross-reference to temporary regulations (REG–125632–06) that is the subject of

these corrections are under sections 368 and 354 of the Internal Revenue Code.

Need for Correction

As published, notice of proposed rulemaking by cross-reference to temporary regulations (REG–125632–06) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking by cross-reference to temporary regulations (REG–125632–06) that was the subject of FR Doc. E6–21572, is corrected as follows:

On page 75898, column 3, in the preamble, under the caption "SUMMARY:", line 9, the language "acquiring corporation is issued and" is corrected to read "acquiring corporation are issued and."

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Office of Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on January 23, 2007, 8:45 a.m., and published in the issue of the Federal Register for January 24, 2007, 72 F.R. 3087)

Extension of Deadline for Settlement Offered to Certain Foreign Embassy Staff

Announcement 2007–28

Following is a copy of the News Release issued by the Office of Deputy Commissioner, International on February 13, 2007 (IR–2007–34).

IRS Extends Deadline for Settlement Offered to Certain Foreign Embassy Staff

IR–2007–34, Feb. 13, 2007

WASHINGTON — The Internal Revenue Service will extend until March 30 the deadline for current and former U.S.-based employees of foreign embassies, consular offices and missions and international organizations to participate in a one-time settlement initiative to resolve outstanding tax matters related to their employment.

The deadline for participating in the offer, first announced November 17, had originally been February 20. Following requests from several embassies, the date is being extended to make certain those wishing to participate in the initiative have the opportunity to do so.

The offer is open to employees of those organizations who are U.S. citizens, green-card holders and foreign employees who have U.S. tax obligations. Accredited diplomatic personnel are generally exempt from income taxes on their wages under international treaties or agreements.

The IRS estimates that as many as half of these employees subject to U.S. tax either fail to report their wages, claim deductions they are not entitled to, incorrectly establish SEP/IRA retirement plans, fail to pay self-employment tax or fail to file tax returns at all.

To participate, employees must submit amended or original tax returns, which properly reflect their income and expenses, for tax years 2003, 2004 and 2005.

Failure to act now could mean facing a costly audit process in the future. Foreign embassy, consular office or international organization employees who fail to come forward may be subject to IRS audits and penalties which could cover more than just three years.

Additional guidance on the extension will be announced soon and will be posted on *IRS.gov*.

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]

Bulletins 2007–1 through 2007–10

Announcements:

2007-1, 2007-1 I.R.B. *243*
2007-2, 2007-2 I.R.B. *263*
2007-3, 2007-4 I.R.B. *376*
2007-4, 2007-7 I.R.B. *518*
2007-5, 2007-4 I.R.B. *376*
2007-6, 2007-4 I.R.B. *376*
2007-7, 2007-4 I.R.B. *377*
2007-8, 2007-5 I.R.B. *416*
2007-9, 2007-5 I.R.B. *417*
2007-10, 2007-6 I.R.B. *464*
2007-11, 2007-6 I.R.B. *464*
2007-12, 2007-6 I.R.B. *465*
2007-13, 2007-7 I.R.B. *519*
2007-14, 2007-7 I.R.B. *519*
2007-15, 2007-8 I.R.B. *596*
2007-16, 2007-8 I.R.B. *597*
2007-17, 2007-8 I.R.B. *597*
2007-18, 2007-9 I.R.B. *625*
2007-19, 2007-7 I.R.B. *521*
2007-20, 2007-8 I.R.B. *599*
2007-21, 2007-9 I.R.B. *630*
2007-22, 2007-9 I.R.B. *631*
2007-23, 2007-10 I.R.B. *665*
2007-24, 2007-10 I.R.B. *681*
2007-25, 2007-10 I.R.B. *682*
2007-26, 2007-10 I.R.B. *682*
2007-28, 2007-10 I.R.B. *683*

Notices:

2007-1, 2007-2 I.R.B. *254*
2007-2, 2007-2 I.R.B. *254*
2007-3, 2007-2 I.R.B. *255*
2007-4, 2007-2 I.R.B. *260*
2007-5, 2007-3 I.R.B. *269*
2007-6, 2007-3 I.R.B. *272*
2007-7, 2007-5 I.R.B. *395*
2007-8, 2007-3 I.R.B. *276*
2007-9, 2007-5 I.R.B. *401*
2007-10, 2007-4 I.R.B. *354*
2007-11, 2007-5 I.R.B. *405*
2007-12, 2007-5 I.R.B. *409*
2007-13, 2007-5 I.R.B. *410*
2007-14, 2007-7 I.R.B. *501*
2007-15, 2007-7 I.R.B. *503*
2007-16, 2007-8 I.R.B. *536*
2007-18, 2007-9 I.R.B. *608*
2007-20, 2007-9 I.R.B. *610*
2007-21, 2007-9 I.R.B. *611*
2007-22, 2007-10 I.R.B. *670*

Proposed Regulations:

REG-157711-02, 2007-8 I.R.B. *537*
REG-159444-04, 2007-9 I.R.B. *618*
REG-152043-05, 2007-2 I.R.B. *263*
REG-161919-05, 2007-6 I.R.B. *463*
REG-125632-06, 2007-5 I.R.B. *415*
REG-147144-06, 2007-10 I.R.B. *680*

Revenue Procedures:

2007-1, 2007-1 I.R.B. *1*
2007-2, 2007-1 I.R.B. *88*
2007-3, 2007-1 I.R.B. *108*
2007-4, 2007-1 I.R.B. *118*
2007-5, 2007-1 I.R.B. *161*
2007-6, 2007-1 I.R.B. *189*
2007-7, 2007-1 I.R.B. *227*
2007-8, 2007-1 I.R.B. *230*
2007-9, 2007-3 I.R.B. *278*
2007-10, 2007-3 I.R.B. *289*
2007-11, 2007-2 I.R.B. *261*
2007-12, 2007-4 I.R.B. *354*
2007-13, 2007-3 I.R.B. *295*
2007-14, 2007-4 I.R.B. *357*
2007-15, 2007-3 I.R.B. *300*
2007-16, 2007-4 I.R.B. *358*
2007-17, 2007-4 I.R.B. *368*
2007-18, 2007-5 I.R.B. *413*
2007-19, 2007-7 I.R.B. *515*
2007-20, 2007-7 I.R.B. *517*
2007-21, 2007-9 I.R.B. *613*
2007-22, 2007-10 I.R.B. *675*
2007-23, 2007-10 I.R.B. *675*

Revenue Rulings:

2007-1, 2007-3 I.R.B. *265*
2007-2, 2007-3 I.R.B. *266*
2007-3, 2007-4 I.R.B. *350*
2007-4, 2007-4 I.R.B. *351*
2007-5, 2007-5 I.R.B. *378*
2007-6, 2007-5 I.R.B. *393*
2007-7, 2007-7 I.R.B. *468*
2007-8, 2007-7 I.R.B. *469*
2007-9, 2007-6 I.R.B. *422*
2007-10, 2007-10 I.R.B. *660*
2007-11, 2007-9 I.R.B. *606*

Tax Conventions:

2007-23, 2007-10 I.R.B. *665*

Treasury Decisions:

9298, 2007-6 I.R.B. *434*
9299, 2007-6 I.R.B. *460*
9300, 2007-2 I.R.B. *246*
9301, 2007-2 I.R.B. *244*
9302, 2007-5 I.R.B. *382*

Treasury Decisions— Continued:

9303, 2007-5 I.R.B. *379*
9304, 2007-6 I.R.B. *423*
9305, 2007-7 I.R.B. *479*
9306, 2007-6 I.R.B. *420*
9307, 2007-7 I.R.B. *470*
9308, 2007-8 I.R.B. *523*
9309, 2007-7 I.R.B. *497*
9310, 2007-9 I.R.B. *601*
9311, 2007-10 I.R.B. *635*

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2006–27 through 2006–52 is in Internal Revenue Bulletin 2006–52, dated December 26, 2006.

Finding List of Current Actions on Previously Published Items[1]

Bulletins 2007–1 through 2007–10

Notices:

2002-45
Modified by
Notice 2007-22, 2007-10 I.R.B. *670*

2005-29
Modified and superseded by
Notice 2007-4, 2007-2 I.R.B. *260*

2005-86
Modified by
Notice 2007-22, 2007-10 I.R.B. *670*

2006-2
Modified and superseded by
Notice 2007-4, 2007-2 I.R.B. *260*

2006-50
Amplified, clarified, and modified by
Notice 2007-11, 2007-5 I.R.B. *405*

Proposed Regulations:

REG-208270-86
Corrected by
Ann. 2007-4, 2007-7 I.R.B. *518*

REG-121509-00
Corrected by
Ann. 2007-17, 2007-8 I.R.B. *597*

REG-141901-05
Corrected by
Ann. 2007-7, 2007-4 I.R.B. *377*

REG-142270-05
Corrected by
Ann. 2007-2, 2007-2 I.R.B. *263*

REG-125632-06
Corrected by
Ann. 2007-26, 2007-10 I.R.B. *682*

REG-127819-06
Corrected by
Ann. 2007-5, 2007-4 I.R.B. *376*

REG-136806-06
Corrected by
Ann. 2007-6, 2007-4 I.R.B. *376*
Hearing cancelled by
Ann. 2007-19, 2007-7 I.R.B. *521*

Revenue Procedures:

98-20
Superseded by
Rev. Proc. 2007-12, 2007-4 I.R.B. *354*

Revenue Procedures— Continued:

2000-38
Modified by
Rev. Proc. 2007-16, 2007-4 I.R.B. *358*

2000-50
Modified by
Rev. Proc. 2007-16, 2007-4 I.R.B. *358*

2001-42
Modified and amplified by
Rev. Proc. 2007-19, 2007-7 I.R.B. *515*

2002-9
Modified and amplified by
Rev. Proc. 2007-14, 2007-4 I.R.B. *357*
Modified by
Rev. Proc. 2007-16, 2007-4 I.R.B. *358*

2004-11
Superseded by
Rev. Proc. 2007-16, 2007-4 I.R.B. *358*

2004-65
Modified and superseded by
Rev. Proc. 2007-20, 2007-7 I.R.B. *517*

2005-12
Superseded by
Rev. Proc. 2007-17, 2007-4 I.R.B. *368*

2005-69
Superseded by
Rev. Proc. 2007-15, 2007-3 I.R.B. *300*

2006-1
Superseded by
Rev. Proc. 2007-1, 2007-1 I.R.B. *1*

2006-2
Superseded by
Rev. Proc. 2007-2, 2007-1 I.R.B. *88*

2006-3
Superseded by
Rev. Proc. 2007-3, 2007-1 I.R.B. *108*

2006-4
Superseded by
Rev. Proc. 2007-4, 2007-1 I.R.B. *118*

2006-5
Superseded by
Rev. Proc. 2007-5, 2007-1 I.R.B. *161*

2006-6
Superseded by
Rev. Proc. 2007-6, 2007-1 I.R.B. *189*

2006-7
Superseded by
Rev. Proc. 2007-7, 2007-1 I.R.B. *227*

2006-8
Superseded by
Rev. Proc. 2007-8, 2007-1 I.R.B. *230*

Revenue Procedures— Continued:

2006-35
Modified by
Rev. Proc. 2007-22, 2007-10 I.R.B. *675*

Revenue Rulings:

69-141
Modified by
Notice 2007-22, 2007-10 I.R.B. *670*

75-161
Obsoleted by
Rev. Rul. 2007-8, 2007-7 I.R.B. *469*

76-188
Obsoleted by
Rev. Rul. 2007-8, 2007-7 I.R.B. *469*

78-330
Modified by
Rev. Rul. 2007-8, 2007-7 I.R.B. *469*

81-225
Clarified and amplified by
Rev. Rul. 2007-7, 2007-7 I.R.B. *468*

92-19
Supplemented in part by
Rev. Rul. 2007-10, 2007-10 I.R.B. *660*

2002-41
Modified by
Notice 2007-22, 2007-10 I.R.B. *670*

2003-43
Modified by
Notice 2007-2, 2007-2 I.R.B. *254*

2003-92
Clarified and amplified by
Rev. Rul. 2007-7, 2007-7 I.R.B. *468*

2003-102
Modified by
Notice 2007-22, 2007-10 I.R.B. *670*

2005-24
Modified by
Notice 2007-22, 2007-10 I.R.B. *670*

2005-76
Supplemented and superseded by
Rev. Rul. 2007-4, 2007-4 I.R.B. *351*

2006-36
Modified by
Notice 2007-22, 2007-10 I.R.B. *670*

Treasury Decisions:

9263
Corrected by
Ann. 2007-22, 2007-9 I.R.B. *631*

[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2006–27 through 2006–52 is in Internal Revenue Bulletin 2006–52, dated December 26, 2006.

Treasury Decisions— Continued:

9276

Corrected by

Ann. 2007-20, 2007-8 I.R.B. *599*
Ann. 2007-21, 2007-9 I.R.B. *630*

9278

Corrected by

Ann. 2007-9, 2007-5 I.R.B. *417*
Ann. 2007-10, 2007-6 I.R.B. *464*

9286

Corrected by

Ann. 2007-8, 2007-5 I.R.B. *416*

9303

Corrected by

Ann. 2007-25, 2007-10 I.R.B. *682*

GPO U.S. GOVERNMENT PRINTING OFFICE
KEEPING AMERICA INFORMED

Order Processing Code:
3465

Easy Secure Internet:
bookstore.gpo.gov

Internal Revenue Cumulative Bulletins Publications and Subscription Order Form

Toll Free: 866 512-1800
DC Area: 202 512-2800
Fax: 202 512-2250

Mail: Superintendent of Documents
P.O. Box 371954
Pittsburgh, PA 15250-7954

Publications

Qty.	Stock Number	Title	Price Each	Total Price
	048-004-02467-5	Cum. Bulletin 1999-3	20.40	
	048-004-02462-4	Cum. Bulletin 2001-2 (Jul-Dec)	24.00	
	048-004-02480-2	Cum. Bulletin 2001-3	71.00	
	048-004-02470-5	Cum. Bulletin 2002-2 (Jul-Dec)	28.80	
	048-004-02486-1	Cum. Bulletin 2002-3	54.00	
	048-004-02483-7	Cum. Bulletin 2004-2 (July-Dec)	54.00	
	048-004-02488-8	Cum. Bulletin 2005-2	56.00	
			Total for Publications	

Subscriptions

Qty.	List ID	Title	Price Each	Total Price
	IRS	Internal Revenue Bulletin	$247	
		Optional – Add $50 to open Deposit Account		
		Total for Subscriptions		
		Total for Publications and Subscriptions		

NOTE: Price includes regular shipping and handling and is subject to change. International customers please add 40 percent.

Standing Order Service*

To automatically receive future editions of *Internal Revenue Cumulative Bulletins* without having to initiate a new purchase order, sign below for Standing Order Service.

Qty.	Standing Order	Title
	ZIRSC	Internal Revenue Cumulative Bulletins

Authorization

I hereby authorize the Superintendent of Documents to charge my account for Standing Order Service:
(enter account information at right)

❑ VISA ❑ MasterCard ❑ Discover/NOVUS ❑ American Express

❑ Superintendent of Documents (SOD) Deposit Account

Authorizing signature (Standing orders not valid unless signed.)

Please print or type your name.

Daytime phone number (_______) ____________________

SuDocs Deposit Account

A Deposit Account will enable you to use Standing Order Service to receive subsequent volumes quickly and automatically. For an initial deposit of $50 you can establish your Superintendent of Documents Deposit Account.

❑ **YES!** Open a SOD Deposit Account for me so I can order future publications quickly and easily.
I am enclosing the $50 initial deposit.

VISA MasterCard DISCOVER NOVUS AMERICAN EXPRESS

Check method of payment:

❑ Check payable to Superintendent of Documents

❑ SOD Deposit Account ☐☐☐☐☐☐☐ – ☐

❑ VISA ❑ MasterCard ❑ Discover/Novus ❑ American Express

☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐

☐☐☐☐ (expiration date)

Thank you for your Order!

Authorizing signature 06/06

Company or personal name (Please type or print)

Additional address/attention line

Street address

City, State, Zip Code

E-mail address

Daytime phone including area code

Purchase order number (optional)

*Standing Order Service
Just sign the authorization above to charge selected items to your existing Deposit Account, VISA or MasterCard, Discover/NOVUS, or American Express account. Or open a Deposit Account with an initial deposit of $50 or more. Your account will be charged only as each volume is issued and mailed. Sufficient money must be kept in your account to insure that items are shipped. Service begins with the next issue released of each item you select.

You will receive written acknowledgement for each item you choose to receive by Standing Order Service.
If you wish to cancel your Standing Order Service, please notify the Superintendent of Documents in writing (telephone cancellations are accepted, but must be followed up with a written cancellation within 10 days).

Important: Please include this completed order form with your payment.

INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletin is sold on a yearly subscription basis by the Superintendent of Documents. Current subscribers are notified by the Superintendent of Documents when their subscriptions must be renewed.

CUMULATIVE BULLETINS

The contents of this weekly Bulletin are consolidated semiannually into a permanent, indexed, Cumulative Bulletin. These are sold on a single copy basis and *are not* included as part of the subscription to the Internal Revenue Bulletin. Subscribers to the weekly Bulletin are notified when copies of the Cumulative Bulletin are available. Certain issues of Cumulative Bulletins are out of print and are not available. Persons desiring available Cumulative Bulletins, which are listed on the reverse, may purchase them from the Superintendent of Documents.

ACCESS THE INTERNAL REVENUE BULLETIN ON THE INTERNET

You may view the Internal Revenue Bulletin on the Internet at www.irs.gov. Under information for: select Businesses. Under related topics, select More Topics. Then select Internal Revenue Bulletins.

INTERNAL REVENUE BULLETINS ON CD-ROM

Internal Revenue Bulletins are available annually as part of Publication 1796 (Tax Products CD-ROM). The CD-ROM can be purchased from National Technical Information Service (NTIS) on the Internet at www.irs.gov/cdorders (discount for online orders) or by calling 1-877-233-6767. The first release is available in mid-December and the final release is available in late January.

HOW TO ORDER

Check the publications and/or subscription(s) desired on the reverse, complete the order blank, enclose the proper remittance, detach entire page, and mail to the Superintendent of Documents, P.O. Box 371954, Pittsburgh PA, 15250–7954. Please allow two to six weeks, plus mailing time, for delivery.

WE WELCOME COMMENTS ABOUT THE INTERNAL REVENUE BULLETIN

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can e-mail us your suggestions or comments through the IRS Internet Home Page (www.irs.gov) or write to the IRS Bulletin Unit, SE:W:CAR:MP:T:T:SP, Washington, DC 20224

Internal Revenue Service
Washington, DC 20224

Official Business
Penalty for Private Use, $300