

## **HIGHLIGHTS OF THIS ISSUE**

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

### **INCOME TAX**

#### **Rev. Rul. 2004-94, page 491.**

**Dealers in securities futures contracts.** This ruling holds that Tier 1, Tier 2, and Tier 3 NQLX LLC Market Makers that satisfy the market maker requirements described in the ruling perform functions similar to the functions performed by options dealers (as defined in section 1256(g)(8)(A) of the Code) and that these NQLX LLC Market Makers are therefore dealers in securities futures contracts within the meaning of section 1256(g)(9)(B).

#### **Rev. Rul. 2004-95, page 492.**

**Dealers in securities futures contracts.** This ruling holds that Category 1 and Category 2 OneChicago LLC Market Makers that satisfy the Market Maker requirements described in the ruling and satisfy the section 1256 Dealer Qualification quotation requirements described in the ruling perform functions similar to the functions performed by options dealers (as defined in section 1256(g)(8)(A) of the Code) and that these OneChicago LLC Market Makers are therefore dealers in securities futures contracts within the meaning of section 1256(g)(9)(B).

#### **T.D. 9151, page 489.**

#### **REG-116265-04, page 505.**

Final, temporary, and proposed regulations under section 1031 of the Code replace the Standard Industrial Classification (SIC) system of codes with the North American Industry Classification System (NAICS) for purposes of determining what depreciable tangible personal property is like-kind to other property. For transfers of property on or before the date of publication of final regulations, taxpayers may treat properties within the same SIC product class or the same NAICS product class as property of a like class and of like-kind.

#### **REG-106889-04, page 501.**

Proposed regulations under section 368 of the Code provide guidance regarding the requirements necessary for a transaction to qualify as a mere change in identity, form, or place of organization of one corporation under section 368(a)(1)(F).

#### **REG-131264-04, page 506.**

Proposed regulations under section 1502 of the Code provide rules for taking into account items of income, gain, deduction, and loss of members from transactions between members of a consolidated group. Section 1.1502-13(c)(7)(ii), *Example 13*, illustrates how the matching rules of the intercompany transaction regulations treat manufacturer incentive payments from one member of a group to another. These regulations supplement the fact pattern in this example to provide further guidance regarding the proper treatment of certain of these manufacturer incentive payment transactions under the intercompany transaction regulations.

### **EXCISE TAX**

#### **T.D. 9149, page 494.**

#### **REG-163909-02, page 499.**

Final, temporary, and proposed regulations under section 4251 of the Code provide guidance for collectors of communications excise taxes and excise taxes on amounts paid for taxable transportation under sections 4261 and 4271. These regulations state the time by which collectors must report refusals to pay or other failures to collect these excise taxes.

**(Continued on the next page)**

Finding Lists begin on page ii.



## **ADMINISTRATIVE**

### **T.D. 9139, page 495.**

### **REG-131786-03, page 500.**

Final, temporary, and proposed regulations under section 7701 of the Code provide that an eligible entity that makes a timely and valid election to be classified as an S corporation will be deemed to have elected to be classified as an association taxable as a corporation.

### **Rev. Proc. 2004-57, page 498.**

This procedure allows taxpayers additional time to file the written statement required by Rev. Proc. 2004-23, 2004-16 I.R.B. 785, relating to changes in methods of accounting for costs to acquire or create intangible assets. Rev. Proc. 2004-23 modified.

### **Announcement 2004-68, page 508.**

This document contains corrections to proposed regulations (REG-150562-03, 2004-32 I.R.B. 175) relating to the application of section 1045 of the Code to partnerships and their partners.

# The IRS Mission

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

applying the tax law with integrity and fairness to all.

## Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

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

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

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

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

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

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

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

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

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

## Section 1031.—Exchange of Property Held for Productive Use or Investment

26 CFR 1.1031(a)–2: Additional rules for exchanges of personal property.

T.D. 9151

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

#### Additional Rules for Exchanges of Personal Property Under Section 1031(a)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

**SUMMARY:** This document contains final and temporary regulations replacing the use of the Standard Industrial Classification (SIC) system with the North American Industry Classification System (NAICS) for determining what properties are of a like class for purposes of section 1031 of the Internal Revenue Code (Code). The text of these temporary regulations also serves as the text of the proposed regulations (REG–116265–04) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin. The final regulations consist of technical revisions to reflect the issuance of the temporary regulations.

**DATES:** *Effective Date:* These final and temporary regulations are effective August 12, 2004.

*Applicability Date:* For date of applicability, see §1.1031(a)–2T(d).

FOR FURTHER INFORMATION CONTACT: J. Peter Baumgarten, (202) 622–4920 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document contains amendments to 26 CFR Part 1 under section 1031(a) relating to the exchange of items of personal property that are within the same product class. Section 1031(a)(1) generally provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of like kind to be held either for productive use in a trade or business or for investment. Thus, for a transaction to qualify as an exchange under section 1031, the transaction must constitute an exchange, the property relinquished and the property received in the exchange must be held for use in a trade or business or for investment, and the exchanged properties must be of like kind.

Section 1.1031(a)–2(a) provides that personal properties of a like class are to be considered of like kind for purposes of section 1031. Under §1.1031(a)–2(b), depreciable tangible personal property is of a like class to other depreciable tangible personal property if the exchanged properties are either within the same *general asset class* or within the same *product class*. The general asset classes are derived from Rev. Proc. 87–56, 1987–2 C.B. 674, (dealing with depreciation of personal property). Section 1.1031(a)–2(b)(2) adopts certain of those general asset classes to determine what property is of like kind for purposes of exchanging depreciable tangible personal property under section 1031, and identifies the types of personal property included in each general asset class listed.

Section 1.1031(a)–2(b)(3) provides, in part, that property within a product class consists of depreciable tangible personal property that is listed in a 4-digit product class (or “code”) within Division D (pertaining to the manufacturing sector of the economy) of Executive Office of the President, Office of Management and Budget, *Standard Industrial Classification Manual* (1987) (SIC Manual). Section 1.1031(a)–2(b)(4) states that the SIC Manual generally is modified every

5 years and that the product classes for section 1031 purposes will follow the modifications of product classes in the SIC Manual.

Effective January 1, 1997, the Department of Commerce discontinued the SIC system set forth in the SIC Manual and adopted NAICS as set forth in Executive Office of the President, Office of Management and Budget, *North American Industry Classification System, United States, 1997* (NAICS Manual). The NAICS Manual was updated in 2002. Copies of the NAICS Manual may be obtained from the National Technical Information Service of the Department of Commerce and may be accessed, with a more complete listing of manufactured products and manufacturing industries, on the internet at <http://www.census.gov/naics>.

##### Explanation of Provisions

As a result of the replacement of the SIC system with NAICS, these temporary regulations discontinue the use of SIC codes and adopt Sectors 31 through 33 of NAICS (pertaining to manufacturing) as the system for defining the product classes for purposes of like-kind exchanges of depreciable tangible personal property. Within NAICS, product classes are designated using 6-digit codes rather than the 4-digit codes assigned to product classes under the SIC system. However, properties within the same product class under the 4-digit SIC system generally will be of the same product class under the 6-digit NAICS. For example, under the SIC codes, dairy equipment and haying machinery are within the same product class (SIC code 3523). Under NAICS, milking machines and haying machines are also within the same product class (NAICS code 333111).

The temporary regulations generally incorporate the provisions of §1.1031(a)–2(b)(3) relating to the use of product classes but substitute NAICS codes for SIC codes. For example, §1.1031(a)–2(b)(3) provides that, under the 4-digit SIC system, any 4-digit product class ending in 9 (a miscellaneous category) is not property within a product class. Similarly, the temporary regulations

provide that any NAICS 6-digit product class ending in 9 is not property within a product class. Accordingly, such property, and property that is not listed in a 6-digit product class, cannot be of a like class to other property based on the 6-digit NAICS Manual classification. Taxpayers, however, may still demonstrate that these properties are of a like kind.

Comments are specifically requested regarding the continued utility of SIC codes and any potential problems in adopting the 6-digit NAICS codes in lieu of the 4-digit SIC codes, including specific examples of how a product class is narrowed if the 6-digit NAICS code is used and whether this would be a disadvantage to any class of taxpayers.

The temporary regulations incorporate the provisions of §1.1031(a)-2(b)(4) that permit taxpayers, in structuring like-kind exchanges, to rely on modifications to the product classes resulting from revisions to the NAICS Manual. The temporary regulations omit the provisions of §1.1031(a)-2(b)(4) that permit taxpayers to rely on modifications to the general asset classes in Rev. Proc. 87-56 for purposes of structuring like-kind exchanges. Under section 6253 of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647, 102 Stat. 3342), the Commissioner may not modify the asset classes in Rev. Proc. 87-56 for depreciation purposes. However, the temporary regulations provide that the Commissioner may, through published guidance of general applicability, supplement, modify, clarify and update the rules for the classification of properties. Therefore, the Commissioner may determine through published guidance not to follow a general asset class or product class for purposes of identifying property of like class or may determine that other properties not listed within the same or in any product class or general asset class nevertheless are of a like class.

#### Effective Date

In general, the temporary regulations apply to transfers of property made by taxpayers on or after August 12, 2004. However, taxpayers may apply the temporary regulations to transfers of property made by taxpayers on or after January 1, 1997, in taxable years for which the period of limi-

tation has not expired. The temporary regulations include a transition rule permitting taxpayers to treat properties within the same product classes under a 4-digit SIC code as properties of like class for transfers of property made by taxpayers on or before the date these temporary regulations are published as final regulations in the **Federal Register**. Comments are specifically requested on whether a longer transition period should be provided before the use of the SIC codes is discontinued.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Please refer to the cross-referenced notice of proposed rulemaking published elsewhere in this issue of the Bulletin for applicability of the Regulatory Flexibility Act (5 U.S.C. Chapter 6). Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### Drafting Information

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

#### Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### Part 1 — INCOME TAXES

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

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

Par. 2. In §1.1031(a)-2, paragraphs (b)(3) through (b)(6), paragraph (b)(7) *Example 3* and *Example 4*, are revised and a sentence is added at the end of paragraph (d) to read as follows:

*§1.1031(a)-2 Additional rules for exchanges of personal property.*

\* \* \* \* \*

(b)(3) through (b)(6) [Reserved]. For further guidance, see §1.1031(a)-2T(b)(3) through (b)(6).

(b)(7) \* \* \*

*Example 3.* [Reserved]. For further guidance, see §1.1031(a)-2T(b)(2), *Example 3*.

*Example 4.* [Reserved]. For further guidance, see §1.1031(a)-2T(b)(2), *Example 4*.

\* \* \* \* \*

(d) \* \* \* For transfers of property made by taxpayers on or after January 1, 1997, see §1.1031(a)-2T(d).

Par. 3. Section 1.1031(a)-2T is added to read as follows:

*§1.1031(a)-2T Additional rules for exchanges of personal property (temporary).*

(a) through (b)(2) [Reserved]. For further guidance, see §1.1031(a)-2(a) through (b)(2).

(3) *Product classes.* Except as provided in paragraphs (b)(4) and (b)(5) of this section, or as provided by the Commissioner in published guidance of general applicability, property within a product class consists of depreciable tangible personal property that is described in a 6-digit product class within Sectors 31, 32, and 33 (pertaining to manufacturing industries) of the North American Industry Classification System (NAICS), set forth in Executive Office of the President, Office of Management and Budget, *North American Industry Classification System*, United States, 2002 (NAICS Manual), as periodically updated. Copies of the NAICS Manual may be obtained from the National Technical Information Service, an agency of the U.S. Department of Commerce, and may be accessed on the internet. Sectors 31 through 33 of the NAICS Manual contain listings of specialized industries for the manufacture of described products and equipment. For this purpose, any 6-digit NAICS product class with a last digit of 9 (a miscellaneous category) is not a product class for purposes of this section. If a property is listed in more than one product class, the property is treated as listed in any one of those product classes. A prop-

erty's 6-digit product class is referred to as the property's NAICS code.

(4) *Modifications of NAICS product classes.* The product classes of the NAICS Manual may be updated or otherwise modified from time to time as the manual is updated, effective on or after the date of the modification. The NAICS Manual generally is modified every five years, in years ending in a 2 or 7 (such as 2002, 2007, and 2012). The applicability date of the modified NAICS Manual is announced in the **Federal Register** and generally is January 1 of the year the NAICS Manual is modified. Taxpayers may rely on these modifications as they become effective in structuring exchanges under this section. Taxpayers may rely on the previous NAICS Manual for transfers of property made by a taxpayer during the one-year period following the effective date of the modification. For transfers of property made by a taxpayer on or after January 1, 1997, and on or before January 1, 2003, the NAICS Manual of 1997 may be used for determining product classes of the exchanged property.

(5) *Administrative procedures for revising general asset classes and product classes.* The Commissioner may, through published guidance of general applicability, supplement, modify, clarify, or update the guidance relating to the classification of properties provided in this paragraph (b). (See §601.601(d)(2) of this chapter.) For example, the Commissioner may determine not to follow (in whole or in part) a general asset class for purposes of identifying property of like class, may determine not to follow (in whole or in part) any modification of product classes published in the NAICS Manual, or may determine that other properties not listed within the same or in any product class or general asset class nevertheless are of a like class. The Commissioner also may determine that two items of property that are listed in separate product classes or in product classes with a last digit of 9 are of a like class, or that an item of property that has a NAICS code is of a like class to an item of property that does not have a NAICS code.

(6) *No inference outside of section 1031.* The rules provided in this section concerning the use of general asset classes or product classes are limited to exchanges

under section 1031. No inference is intended with respect to the classification of property for other purposes, such as depreciation.

(7) *Examples.* The provisions of this paragraph (b) are illustrated by the following examples:

*Example 1 and Example 2* [Reserved]. For further guidance, see §1.1031(a)-2(b)(7), *Example 1 and Example 2*.

*Example 3.* Taxpayer E transfers a grader to F in exchange for a scraper. Neither property is within any of the general asset classes. However, both properties are within the same product class (NAICS code 333120). The grader and scraper are of a like class and deemed to be of a like kind for purposes of section 1031.

*Example 4.* Taxpayer G transfers a personal computer (asset class 00.12), an airplane (asset class 00.21) and a sanding machine (NAICS code 333210), to H in exchange for a printer (asset class 00.12), a heavy general purpose truck (asset class 00.242) and a lathe (NAICS code 333210). The personal computer and the printer are of a like class because they are within the same general asset class; the sanding machine and the lathe are of a like class because they are within the same product class (although neither property is within any of the general asset classes). The airplane and the heavy general purpose truck are neither within the same general asset class nor within the same product class, and are not of a like kind.

(8) *Transition rule.* Properties within the same product classes based on the 4-digit codes contained in Division D of the Executive Office of the President, Office of Management and Budget, Standard Industrial Classification Manual (1987), will be treated as property of a like class for transfers of property made by taxpayers on or before the date these regulations are published as final regulations in the **Federal Register**.

(c) [Reserved]. For further guidance, see §1.1031(a)-2(c).

(d) *Effective dates.* This section applies to transfers of property made by taxpayers on or after August 12, 2004. However, taxpayers may apply this section to transfers of property made by taxpayers on or after January 1, 1997, in taxable years for which the period of limitation for filing a claim for refund or credit under section 6511 has not expired. For all other exchanges occurring prior to August 12, 2004, see §1.1031(a)-2(d).

Linda M. Kroening,  
Acting Deputy Commissioner for  
Services and Enforcement.

Approved July 28, 2004.

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

(Filed by the Office of the Federal Register on August 12, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 13, 2004, 69 F.R. 50067)

## Section 1256.—Section 1256 Contracts Marked to Market

**Dealers in securities futures contracts.** This ruling holds that Tier 1, Tier 2, and Tier 3 NQLX LLC Market Makers that satisfy the market maker requirements described in the ruling perform functions similar to the functions performed by options dealers (as defined in section 1256(g)(8)(A) of the Code) and that these NQLX LLC Market Makers are therefore dealers in securities futures contracts within the meaning of section 1256(g)(9)(B).

### Rev. Rul. 2004-94

#### ISSUE

If a Tier 1, Tier 2, or Tier 3 NQLX LLC (NQLX) Market Maker satisfies the requirements described below, is it a dealer in securities futures contracts (SFCs) within the meaning of § 1256(g)(9)(B) of the Internal Revenue Code?

#### FACTS

NQLX has been designated by the Commodity Futures Trading Commission (CFTC) as a contract market that is permitted to list SFCs. As such, NQLX is a "qualified board or exchange" within the meaning of § 1256(g)(7). NQLX has a market maker program under which NQLX members may qualify as NQLX Market Makers. NQLX Market Makers are obligated to provide liquidity for their specifically assigned SFC products that trade on NQLX. For this purpose, an SFC product consists of contracts that may have varying maturities but that all relate to a particular underlying security or a particular narrow-based index of securities. NQLX Market Makers fall into one of three classes: Tier 1, Tier 2, and Tier 3. Tier 1 Market Makers are assigned at least 50, if not all, SFC products listed on NQLX. Tier 2 Market Makers are assigned

25 to 49 SFC products listed on NQLX. Tier 3 Market Makers are assigned fewer than 25 SFC products listed on NQLX. In each case, the SFC products assigned to a Market Maker in the aggregate must account for at least 20% of the total volume in all SFCs traded on NQLX for the preceding calendar quarter.

An NQLX Market Maker must meet all of the following requirements:

- (1) Be a member of NQLX;
- (2) Be registered as a floor trader or floor broker with the CFTC or as a dealer with the Securities Exchange Commission (SEC);
- (3) Maintain records sufficient to prove compliance with the NQLX Market Maker requirements, including, but not limited to, documents concerning personnel effecting relevant orders, relevant trade and cash blotters, relevant stock records, and documents concerning applicable internal system capacity and performance; and
- (4) Hold itself out as willing to buy and sell SFCs for its own account on a regular or continuous basis.

For an NQLX Market Maker to fulfill the regular or continuous requirement in paragraph (4) above, it must satisfy the following criteria for each of its assigned SFC products:

(i) Provide continuous two-sided quotations for the first two delivery months of each assigned SFC product throughout the trading day, except during unusual market conditions as determined by NQLX (such as a fast market in either the SFC product or the security underlying the SFC product) at which times the Market Maker must use its best efforts to quote continuously and competitively;

(ii) Quote for the first two delivery months, with (A) a Maximum Bid/Ask Spread of no more than the greater of \$0.10 or 150% of the bid/ask spread in the primary market for the security underlying the SFC product and (B) a Minimum Number of Contracts of no less than the lesser of 10 contracts or the corresponding contract size equivalent of the best bid and best offer for the security underlying the SFC product; and

(iii) Respond to requests for quotation in each assigned SFC product within 5 seconds for all delivery months other than the first two delivery months with a two-sided quotation that has (A) a Maximum Bid/Ask Spread of no more than the

greater of \$0.20 or 150% of the bid/ask spread in the primary market for the security underlying the SFC product and (B) a Minimum Number of Contracts of no less than the lesser of 5 contracts or the corresponding contract size equivalent of the best bid and best offer for the security underlying the SFC product.

Any NQLX Market Maker that fails to comply with the NQLX rules, CFTC rules, or SEC rules, as applicable, is subject to disciplinary action in accordance with NQLX rules.

#### LAW

Section 1256(g)(8)(A) defines the term "options dealer" to mean any person registered with an appropriate national securities exchange as a market maker or specialist in listed options. Section 1256(g)(9)(B) provides that a person shall be treated as a dealer in SFCs or options on such contracts if the Secretary determines that such person performs, with respect to such contracts or options, as the case may be, functions similar to the functions performed by an options dealer. Section 1256(g)(9)(B) further provides that such determination shall be made to the extent appropriate to carry out the purposes of that section.

The legislative history for § 1256(g)(9) states the following with respect to the determination process:

The determination of who is a dealer in securities futures contracts is to be made in a manner that is appropriate to carry out the purposes of the provision, which generally is to provide comparable tax treatment between dealers in securities futures contracts, on the one hand, and dealers in equity options, on the other. Although traders in securities futures contracts (and options on such contracts) may not have the same market-making obligations as market makers or specialists in equity options, many traders are expected to perform analogous functions to such market makers or specialists by providing market liquidity for securities futures contracts (and options) even in the absence of a legal obligation to do so. Accordingly, the absence of market-making obligations is not inconsistent with a determination that a class of traders are dealers in securities futures contracts (and options), if the

relevant factors, including providing market liquidity for such contracts (and options), indicate that the market functions of the traders is comparable to that of equity options dealers.

H.R. Conf. Rep. No. 106-1033, at 1036 (2000).

#### HOLDING

It is determined that Tier 1, Tier 2, and Tier 3 NQLX Market Makers that satisfy the requirements described above perform functions similar to the functions performed by options dealers (as defined in § 1256(g)(8)(A)) and that these NQLX Market Makers are therefore dealers in SFCs within the meaning of § 1256(g)(9)(B). This determination will cease to apply in the event of material changes in the NQLX Market Maker program affecting the Tier 1, Tier 2, or Tier 3 Market Makers described above. See § 601.601(d)(2)(v) of the Income Tax Regulations.

#### EFFECTIVE DATE

The effective date of this ruling is the date of publication in the Internal Revenue Bulletin. Because this ruling is prospective only, the holding applies to SFCs that are entered into by a dealer in SFCs on or after the effective date of this ruling.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is K. Scott Brown of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact K. Scott Brown at (202) 622-3920 (not a toll-free call).

**Dealers in securities futures contracts.** This ruling holds that Category 1 and Category 2 OneChicago LLC Market Makers that satisfy the Market Maker requirements described in the ruling and satisfy the section 1256 Dealer Qualification quotation requirements described in the ruling perform functions similar to the functions performed by options dealers (as defined in section 1256(g)(8)(A) of the Code) and that these OneChicago LLC Market Makers are therefore dealers

in securities futures contracts within the meaning of section 1256(g)(9)(B).

## Rev. Rul. 2004-95

### ISSUE

If a Category 1 or Category 2 OneChicago LLC (OneChicago) Market Maker satisfies the Market Maker requirements described below and satisfies the Section 1256 Dealer Qualification quotation requirements described below, is it a dealer in securities futures contracts (SFCs) within the meaning of § 1256(g)(9)(B) of the Internal Revenue Code?

### FACTS

OneChicago has been designated by the Commodity Futures Trading Commission (CFTC) as a contract market that is permitted to list SFCs. As such, OneChicago is a “qualified board or exchange” within the meaning of § 1256(g)(7). OneChicago has a market maker program under which OneChicago members may qualify as OneChicago Market Makers eligible for the market maker exclusion provided in OneChicago’s customer margin rules. OneChicago Market Makers are obligated to provide liquidity for their specifically assigned SFC products that trade on OneChicago. For this purpose, an SFC product consists of contracts that may have varying maturities but that all relate to a particular underlying security or a particular narrow-based index of securities.

A Category 1 or Category 2 OneChicago Market Maker must meet all of the following requirements:

- (1) Be a member of OneChicago;
- (2) Be registered as a floor trader or floor broker with the CFTC or as a dealer with the Securities and Exchange Commission (SEC);
- (3) Maintain records sufficient to prove compliance with OneChicago Market Maker requirements and the related regulations and rules of the CFTC or SEC, as applicable, including, without limitation, trading account statements and other financial records sufficient to detail activity; and
- (4) Hold itself out as willing to buy and sell SFCs for its own account on a regular or continuous basis.

For a OneChicago Market Maker to fulfill the regular or continuous requirement in paragraph (4) above, it must satisfy the following criteria, as applicable, for each of its assigned SFC products:

*Category 1 Market Maker* — The member provides continuous two-sided quotations throughout the trading day for all delivery months of all assigned SFC products (where such assigned SFC products represent in the aggregate at least a meaningful proportion of the total trading volume on OneChicago), except during unusual market conditions as determined by OneChicago (such as a fast market in either an SFC product or a security underlying an SFC product), at which time the member must use its best efforts to quote continuously and competitively; and, when the member provides quotations, it quotes for a minimum of one SFC with a Maximum Bid/Ask Spread of no more than the greater of \$0.20 or 150% of the bid/ask spread in the primary market for the security underlying each SFC product; or

*Category 2 Market Maker* — The member responds to at least 75% of the requests for quotation (RFQs) for all delivery months of all assigned SFC products (where such assigned SFC products represent in the aggregate at least a meaningful proportion of the total trading volume on OneChicago), except during unusual market conditions as determined by OneChicago (such as a fast market in either an SFC product or a security underlying an SFC product), at which times the member must use its best efforts to quote competitively; and, when the member responds to RFQs, it quotes within five seconds for a minimum of one SFC with a Maximum Bid/Ask Spread of no more than the greater of \$0.20 or 150% of the bid/ask spread in the primary market for the security underlying each SFC product.

For purposes of the preceding requirements for Category 1 and Category 2 Market Makers, a “meaningful proportion of the total trading volume on OneChicago” means a minimum of 20% of the trading volume of SFCs traded on OneChicago during the calendar quarter.

Any OneChicago Market Maker that fails to comply with the OneChicago rules, CFTC rules, or SEC rules, as applicable, is subject to disciplinary action in accordance with OneChicago rules.

*Section 1256 Dealer Qualification.* Category 1 and Category 2 Market Makers seeking to qualify as a § 1256(g)(9)(B) dealer under OneChicago’s market maker program must agree to meet minimum quotation size requirements for all of their assigned SFC products that are specified for purposes of the market maker exclusion provided in OneChicago’s margin rules. Category 1 and Category 2 Market Makers must provide continuous two-sided quotations or respond to requests for quotations in accordance with the applicable obligations set forth above by quoting:

(a) ten contracts for each product not covered by (b) or (c);

(b) five contracts for each product specified by the member to the extent such quotations are provided for delivery months other than the next two delivery months then trading; and

(c) one contract for any single stock futures contract where the average market price for the underlying stock was \$100 or higher for the preceding calendar month or for any narrow-based stock index futures contract, as defined by § 1a(25) of the Commodity Exchange Act.

### LAW

Section 1256(g)(8)(A) defines the term “options dealer” to mean any person registered with an appropriate national securities exchange as a market maker or specialist in listed options. Section 1256(g)(9)(B) provides that a person shall be treated as a dealer in SFCs or options on such contracts if the Secretary determines that such person performs, with respect to such contracts or options, as the case may be, functions similar to the functions performed by an options dealer. Section 1256(g)(9)(B) further provides that such determination shall be made to the extent appropriate to carry out the purposes of that section.

The legislative history for § 1256(g)(9) states the following with respect to the determination process:

The determination of who is a dealer in securities futures contracts is to be made in a manner that is appropriate to carry out the purposes of the provision, which generally is to provide comparable tax treatment between dealers in securities futures contracts, on the one hand, and dealers in equity options,



on the other. Although traders in securities futures contracts (and options on such contracts) may not have the same market-making obligations as market makers or specialists in equity options, many traders are expected to perform analogous functions to such market makers or specialists by providing market liquidity for securities futures contracts (and options) even in the absence of a legal obligation to do so. Accordingly, the absence of market-making obligations is not inconsistent with a determination that a class of traders are dealers in securities futures contracts (and options), if the relevant factors, including providing market liquidity for such contracts (and options), indicate that the market functions of the traders is comparable to that of equity options dealers.

H.R. Conf. Rep. No. 106-1033, at 1036 (2000).

#### HOLDING

It is determined that Category 1 and Category 2 OneChicago Market Makers that satisfy the Market Maker requirements described above and satisfy the Section 1256 Dealer Qualification quotation requirements described above perform functions similar to the functions performed by options dealers (as defined in § 1256(g)(8)(A)) and that these OneChicago Market Makers are therefore dealers in SFCs within the meaning of § 1256(g)(9)(B). This determination will cease to apply in the event of material changes in the OneChicago Market Maker program affecting the Category 1 or Category 2 Market Makers described above. See § 601.601(d)(2)(v) of the Income Tax Regulations.

#### EFFECTIVE DATE

The effective date of this ruling is the date of publication in the Internal Revenue Bulletin. Because this ruling is prospective only, the holding applies to SFCs that are entered into by a dealer in SFCs on or after the effective date of this ruling.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is K. Scott Brown of the Office of Associate Chief Counsel (Financial Institu-

tions & Products). For further information regarding this revenue ruling, contact K. Scott Brown at (202) 622-3920 (not a toll-free call).

### Section 4291.—Cases Where Persons Receiving Payment Must Collect Tax

26 CFR 49.4291-1: Persons receiving payment must collect tax.

#### T.D. 9149

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 40 and 49

### Collected Excise Taxes; Duties of Collector

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to the obligations of persons that receive payments for air transportation or communications services subject to excise tax when persons liable for tax refuse to pay the tax. These temporary regulations affect persons that receive payments subject to tax and persons liable for those taxes. The text of the temporary regulations also serves as the text of the proposed regulations (REG-163909-02) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective October 1, 2004.

*Applicability Date:* For dates of applicability, see §§40.6302(c)-3T(b)(2)(ii) and 49.4291-1T.

FOR FURTHER INFORMATION CONTACT: Taylor Cortright (202) 622-3130 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document contains amendments to the Excise Tax Procedural Regulations (26

CFR part 40) and the Facilities and Services Excise Tax Regulations (26 CFR part 49). Section 4251 of the Internal Revenue Code (Code) imposes an excise tax on amounts paid for certain communications services. Sections 4261(a) and (b) impose excise taxes on amounts paid for taxable transportation of persons by air. Section 4261(e)(3) provides that any amount paid to an air carrier or related party for the right to provide mileage awards for (or other reductions in the cost of) any transportation of persons by air is treated for purposes of section 4261(a) as an amount paid for taxable transportation and is therefore subject to tax. Section 4261(c) imposes an excise tax on any amount paid for the air transportation of persons that begins or ends in the United States. Section 4271 imposes an excise tax on amounts paid for taxable transportation of property by air. These taxes collectively are referred to as collected excise taxes.

For each of the collected excise taxes, the person liable for the tax is the person making the payment on which tax is imposed (the taxpayer). Under section 4291, the person receiving the payment on which tax is imposed (the collector) generally must collect the tax from the person making the payment and pay it over to the government.

If the taxpayer refuses to pay the tax the collector is required, under §49.4291-1, to report this refusal to the IRS. The IRS will then assert the tax against the taxpayer. Current regulations do not specify the time within which the collector must report this refusal to the IRS.

Collectors are responsible for filing returns with respect to the collected excise taxes and for making deposits of tax as required by section 6302. Section 40.6302(c)-3 provides an alternative method for computing the amount of deposits of collected excise taxes. Under the alternative method, collectors may compute the amount of tax to be deposited on the basis of amounts considered as collected instead of on the basis of actual collections of tax. A person may use the alternative method with respect to a tax only if the person separately accounts for the tax. The separate account must reflect for each month all items of tax that are included in amounts billed or tickets sold to customers during the month and items of adjustment (including bad debts and

errors) relating to the tax for prior months within the period of limitations for credits or refunds. When a collector using the alternative method determines that a taxpayer has refused to pay the tax, the collector adjusts the separate account to reflect that the tax was not collected. Current regulations do not specify the time for adjusting the separate account to reflect that refusal.

The temporary regulations provide that the collector must report the refusal to pay the tax to the IRS by the due date of the return on which the tax would have been reported but for the refusal to pay. In addition, the temporary regulations provide that, for a person using the alternative method, the separate account cannot be adjusted to reflect a refusal to pay tax for the month unless such refusal has been reported.

### Special Analyses

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

### Drafting Information

The principal author of these regulations is Patrick S. Kirwan, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 40 and 49 are amended as follows:

## PART 40—EXCISE TAX PROCEDURAL REGULATIONS

Paragraph 1. The authority citation for part 40 is amended by adding an entry in numerical order to read, in part, as follows:

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

Section 40.6302(c)–3T also issued under 26 U.S.C. 6302 \* \* \*

Par. 2. Paragraph (b)(2)(ii) of §40.6302(c)–3 is amended by:

a. Removing the language “and” at the end of paragraph (b)(2)(ii)(A).

b. Redesignating paragraph (b)(2)(ii)(B) as paragraph (b)(2)(ii)(C) and removing the language “Items” and adding “Other items” in its place.

c. Adding new paragraph (b)(2)(ii)(B) to read as follows:

*§40.6302(c)–3 Special rules for use of Government depositaries under chapter 33.*

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(B) [Reserved]. For further guidance, see §40.6302(c)–3T(b)(2)(ii)(B).

\* \* \* \* \*

Par. 3. Section 40.6302(c)–3T is added to read as follows:

*§40.6302(c)–3T Special rules for use of Government depositaries under chapter 33 (temporary).*

(a) through (b)(2)(ii)(A) [Reserved]. For further guidance, see §40.6302(c)–3(a) through (b)(2)(ii)(A).

(b)(2)(ii)(B) Applicable October 1, 2004, the account required under §40.6302(c)–3(b)(2)(i)(A) may not reflect an item of adjustment for any month during a quarter if the adjustment results from a refusal to pay or inability to collect the tax and the uncollected tax has not been reported under §49.4291–1 of this chapter on or before the due date of the return for that quarter; and

(b)(2)(ii)(C) through (g) [Reserved]. For further guidance, see §40.6302(c)–3(b)(2)(ii)(C) through (g).

## PART 49—FACILITIES AND SERVICES EXCISE TAXES

Par. 4. The authority citation for part 49 continues to read, in part, as follows:

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

Par. 5. Section 49.4291–1 is amended by adding a sentence after the third sentence to read as follows:

*§49.4291–1 Persons receiving payment must collect tax.*

\* \* \* For further guidance, see §49.4291–1T. \* \* \*

Par. 6. Section 49.4291–1T is added to read as follows:

*§49.4291–1T Persons receiving payment must collect tax (temporary).*

Applicable October 1, 2004, a person required to report uncollected tax under §49.4291–1 must make the report on or before the due date of the return on which the refusal to pay or inability to collect such tax is reflected (or could be reflected but for the limitation in §40.6302(c)–3T).

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

Approved June 21, 2004.

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

(Filed by the Office of the Federal Register on August 9, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 10, 2004, 69 F.R. 48393)

## Section 7701.—Definitions

*26 CFR 301.7701–3: Classification of certain business entities.*

### T.D. 9139

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

## Deemed Election To Be an Association Taxable as a Corporation for a Qualified Electing S Corporation

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains a temporary regulation that deems certain eligible entities that file timely S corporation elections to have elected to be classified as associations taxable as corporations. This regulation affects certain eligible entities filing timely elections to be S corporations on or after July 20, 2004. The text of this temporary regulation also serves as the text of the proposed regulations (REG-131786-03) set forth in a notice of proposed rulemaking on this subject published elsewhere in this issue of the Bulletin.

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

FOR FURTHER INFORMATION CONTACT: Rebekah A. Myers, (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### Background

Section 301.7701-3(a) provides that an eligible entity with two or more owners may elect to be classified as an association (and thus a corporation under §301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner may elect to be classified as an association or to be disregarded as an entity separate from its owner. Section 301.7701-3(b) provides that, unless the entity elects otherwise, a domestic eligible entity is a partnership if it has two or more owners or is disregarded as an entity separate from its owner if it has a single owner. Section 301.7701-3(c) describes the time and place for filing an entity classification election. Section 301.7701-3(c)(1)(i) provides that an eligible entity may elect to be classified as other than its default classification or to change its classification by filing Form 8832, “*Entity Classification Election*”,

with the service center designated on the form.

A taxpayer whose default classification is a partnership or a disregarded entity may seek to be classified as an S corporation. In these cases, the taxpayer must elect to be classified as an association under §301.7701-3(c)(1)(i) by filing Form 8832 and must elect to be an S corporation under section 1362(a) by filing Form 2553, “*Election by a Small Business Corporation*.” In some cases, an entity may timely file the Form 2553 but fail to file the Form 8832. The entity must then submit a letter ruling request for an extension of time under §301.9100 to file a late entity classification election. The temporary regulation provides relief for these entities. In other cases, the Form 2553 and the Form 8832 are filed late, and the entity must submit a ruling request under §301.9100 to file a late entity classification election and under section 1362(b)(5) to file a late S corporation election. Rev. Proc. 2004-48, 2004-32 I.R.B. 172, provides relief for these entities.

### Explanation of Provisions

Requiring eligible entities to file two elections in order to be classified as S corporations creates a burden on those entities and on the Internal Revenue Service (IRS). The temporary regulation simplifies these paperwork requirements by eliminating, in certain cases, the requirement that the entity elect to be classified as an association. Instead, an eligible entity that makes a timely and valid election to be classified as an S corporation will be deemed to have elected to be classified as an association taxable as a corporation.

The temporary regulation amends §301.7701-3(c)(1)(v) to provide that, if an eligible entity makes a timely and valid election to be an S corporation under section 1362(a)(1), it is treated as having made an election to be classified as an association under §301.7701-3. However, if the eligible entity’s election is not timely and valid, the default classification rules provided in §301.7701-3(b) will apply to the entity unless the Service provides late S corporation election relief or inadvertent invalid election relief. If the late or invalid election is not perfected, the default rules will maintain the passthrough taxation

treatment by classifying the entity as a partnership or a disregarded entity.

### Effective Date

The regulations apply to elections to be an S corporation filed on or after July 20, 2004. However, eligible entities that timely filed S elections July 20, 2004, may also rely on the provisions of the regulation.

### Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore a regulatory assessment is not required. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analysis section of the preamble to the notice of proposed rulemaking on this subject published elsewhere in this issue of the Bulletin.

### Drafting Information

The principal author of this regulation is Rebekah A. Myers, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.7701-3 is amended by adding paragraphs (c)(1)(v)(C) and (h)(3) to read as follows:

§301.7701-3 *Classification of certain business entities.*

\* \* \* \* \*

(c) \* \* \*

(1) \* \* \*

(v) \* \* \*

(C) *S corporations*. [Reserved]. For further guidance, see §301.7701-3T(c)(1)(v)(C).

\* \* \* \* \*

(h) \* \* \*

(3) *Deemed elections for S corporations*. [Reserved]. For further guidance, see §301.7701-3T(h)(3).

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

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

(a) through (c)(1)(v)(B) [Reserved]. For further guidance, see §301.7701-3(a) through (c)(1)(v)(B).

(c)(1)(v)(C) *S corporations*. An eligible entity that timely elects to be an S corporation under section 1362(a)(1) is

treated as having made an election under this section to be classified as an association, provided that (as of the effective date of the election under section 1362(a)(1)) the entity meets all other requirements to qualify as a small business corporation under section 1361(b). Subject to §301.7701-3(c)(1)(iv), the deemed election to be classified as an association will apply as of the effective date of the S corporation election and will remain in effect until the entity makes a valid election, under §301.7701-3(c)(1)(i), to be classified as other than an association.

(c)(2) through (h)(2)(iii) [Reserved]. For further guidance, see §301.7701-3(c)(2) through (h)(2)(iii).

(h) \* \* \*

(3) *Deemed elections for S corporations*. Paragraph (c)(1)(v)(C) of this sec-

tion applies to timely S corporation elections under section 1362(a) filed on or after July 20, 2004. Eligible entities that filed timely S elections before July 20, 2004, may also rely on the provisions of the regulation.

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

Approved July 6, 2004.

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

(Filed by the Office of the Federal Register on July 19, 2004, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2004, 69 F.R. 43317)

# Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.204: *Changes in accounting periods and in methods of accounting.*  
(Also, Part 1, §§ 162, 263, 446, 461, 481; 1.167(a)-3(b), 1.263(a)-4, 1.263(a)-5, 1.446-1, 1.461-4, 1.461-5, 1.481-1.)

## Rev. Proc. 2004-57

### SECTION 1. PURPOSE

This revenue procedure allows additional time for taxpayers to comply with the requirements of section 6.02 of Rev. Proc. 2004-23, 2004-16 I.R.B. 785. Section 6.02 of Rev. Proc. 2004-23 requires certain taxpayers that seek to change to a method of accounting provided in §§ 1.263(a)-4, 1.263(a)-5, and 1.167(a)-3(b) of the Income Tax Regulations to submit a written statement containing information necessary to obtain automatic consent for the change.

### SECTION 2. BACKGROUND

.01 On March 24, 2004, the Internal Revenue Service released Rev. Proc. 2004-23. Rev. Proc. 2004-23 provides procedures under which certain taxpayers may obtain automatic consent for the taxpayer's first taxable year ending on or after December 31, 2003, to change to a method of accounting provided in §§ 1.263(a)-4, 1.263(a)-5, and 1.167(a)-3(b) of the Income Tax Regulations. As a term and condition of obtaining this automatic consent, taxpayers must file Form 3115, *Application for Change in Accounting Method*, and provide therein certain information specifically required by Rev. Proc. 2004-23.

.02 Section 6.02 of Rev. Proc. 2004-23 provides transition rules applicable to certain taxpayers that filed Form 3115 prior to April 26, 2004, and did not include in the Form 3115 all of the information required by Rev. Proc. 2004-23. In lieu of preparing and filing a new Form 3115, these transition rules permit taxpayers to prepare and file a written statement that includes all of the necessary information that was not included in the original Form 3115. Section 6.02(2) of Rev.

Proc. 2004-23 requires taxpayers to submit the written statement, with an attached copy of page 1 of the original Form 3115 filed by the taxpayer, to the national office within the timely filing requirements of section 6.02(3)(a) (including the automatic extension period described in section 6.02(3)(b)(i)) of Rev. Proc. 2002-9, 2002-1 C.B. 327, as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432.

.03 Section 6.02(3) of Rev. Proc. 2004-23 requires taxpayers to attach the written statement and a copy of the original Form 3115 to the taxpayer's federal income tax return for the taxpayer's —

(i) first taxable year ending on or after December 31, 2003, or

(ii) second taxable year ending on or after December 31, 2003, if the taxpayer prior to April 26, 2004, has filed the taxpayer's federal income tax return for the taxpayer's first taxable year ending on or after December 31, 2003, that includes a Form 3115, a copy of which also has been filed with the national office, and the § 481(a) adjustment included on that return was computed correctly as described in section 5 of Rev. Proc. 2004-23.

### SECTION 3. ADDITIONAL TIME TO SUBMIT WRITTEN STATEMENT

.01 A taxpayer is treated as meeting the timely filing requirement of section 6.02(2) of Rev. Proc. 2004-23 if the taxpayer submits the written statement referred to in section 6.02(2) of Rev. Proc. 2004-23, along with the attached copy of page 1 of the original Form 3115 filed by the taxpayer, to the national office at the special address provided in section 4.01(3) of Rev. Proc. 2004-23 on or before the time that the taxpayer files the federal income tax return referred to in section 6.02(3)(i) or (ii) (whichever is applicable) of Rev. Proc. 2004-23.

.02 A taxpayer is treated as meeting the timely filing requirement of section 6.02(3)(ii) of Rev. Proc. 2004-23 by at-

taching the written statement and a copy of the original Form 3115 to the taxpayer's federal income tax return for the taxpayer's second taxable year ending on or after December 31, 2003, if the taxpayer prior to April 26, 2004, filed the taxpayer's federal income tax return for the taxpayer's first taxable year ending on or after December 31, 2003, that included a Form 3115, a copy of which also has been filed with the national office, whether or not the § 481(a) adjustment was computed correctly in the taxpayer's federal income tax return for the taxpayer's first taxable year ending on or after December 31, 2003, but only if computing the § 481(a) adjustment in accordance with section 5 of Rev. Proc. 2004-23 does not result in any change in the taxable income reported on that return.

.03 For purposes of section 3.01 of this revenue procedure, section 6.02(3)(ii) of Rev. Proc. 2004-23 is applied after taking into account section 3.02 of this revenue procedure.

.04 Sections 3.01 and 3.02 of this revenue procedure do not apply to a taxpayer described in section 4.03(2) of Rev. Proc. 2004-23 (relating to an unauthorized change in method of accounting or change in the treatment of an item).

### SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2004-23 is modified.

### SECTION 5. EFFECTIVE DATE

This revenue procedure is effective on September 1, 2004.

### SECTION 6. INQUIRIES

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

## Part IV. Items of General Interest

### Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

#### Collected Excise Taxes; Duties of Collector

##### REG-163909-02

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. 9149) relating to the obligations of persons that receive payments for air transportation or communications services subject to excise tax when persons liable for the tax refuse to pay the tax. The text of those temporary regulations also serves as the text of these proposed regulations. These proposed regulations affect persons liable for those taxes and persons that receive payments subject to tax.

DATES: Written and electronic comments and requests for a public hearing must be received by November 8, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-163909-02), room 5203, Internal Revenue Service, POB 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-163909-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at [www.irs.gov/reg](http://www.irs.gov/reg), or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG-163909-02).

FOR FURTHER INFORMATION CONTACT: Concerning submissions, the Publication and Regulations Unit, (202)

622-7180; concerning the regulations, Taylor Cortright, (202) 622-3130 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

These proposed regulations relate to the obligations of persons that receive payments for air transportation or communications services subject to excise tax when persons liable for the tax refuse to pay the tax. These proposed regulations would amend the Excise Tax Procedural Regulations (26 CFR part 40) and the Facilities and Services Excise Tax Regulations (26 CFR part 49). The text of temporary regulations published in this issue of the Bulletin also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary 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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the notice of proposed rulemaking does not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

##### Comments and Requests for a Public Hearing

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

and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing may 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 hearing will be published in the **Federal Register**.

##### Drafting Information

The principal author of these regulations is Patrick S. Kirwan, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

##### Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 40 and 49 are proposed to be amended as follows:

##### PART 40—EXCISE TAX PROCEDURAL REGULATIONS

Paragraph 1. The authority citation for part 40 continues to read, in part, as follows:

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

Par. 2. Section 40.6302(c)-3 is amended by revising paragraph (b)(2)(ii)(B) to read as follows:

*§40.6302(c)-3 Special rules for use of Government depositaries under chapter 33.*

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(B) [The text of this proposed paragraph is the same as the text of §40.6302(c)-3T(b)(2)(ii)(B) published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

##### PART 49—FACILITIES AND SERVICES EXCISE TAXES

Par. 3. The authority citation for part 49 continues to read in part as follows:

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

Par. 4. Section 49.4291-1 is amended by revising the fourth sentence to read as follows:

*§49.4291-1 Persons receiving payment must collect tax.*

\* \* \* [The text of this proposed sentence is the same as the text of §49.4291-1T published elsewhere in this issue of the Bulletin].\* \* \*

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

(Filed by the Office of the Federal Register on August 9, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 10, 2004, 69 F.R. 48432)

## Notice of Proposed Rulemaking by Cross Reference to Temporary Regulations

### Deemed Election To Be an Association Taxable as a Corporation for a Qualified Electing S Corporation

#### REG-131786-03

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. 9139) that deem certain eligible entities that file timely S corporation elections to have elected to be classified as associations taxable as corporations. The text of those temporary regulations also serves as the text of these proposed regulations. These regulations affect certain eligible entities filing timely elections to be S corporations on or after July 20, 2004.

DATES: A request for a public hearing and written or electronic comments must be received by October 18, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-131786-03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC, 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-131786-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at: [www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal E-Rulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS and REG-131786-03).

FOR FURTHER INFORMATION CONTACT: Rebekah A. Myers at (202) 622-3050 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

Temporary regulations published elsewhere in this issue of the Bulletin amend §301.7701-3T(c)(1)(v)(C) to provide that certain eligible entities that file timely S corporation elections are deemed to have elected to be classified as associations taxable as corporations. The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

##### Special Analysis

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 collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the purpose of the regulation is to decrease the number of entities required to file an entity classification election, Form 8832. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed regulation will be submitted to the Chief Counsel for Advocacy

of the Small Business Administration for comment on its impact on small business.

#### Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing 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 of the public hearing will be published in the **Federal Register**.

#### Drafting Information

The principal author of this regulation is Rebekah A. Myers, Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

#### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 301—PROCEDURE AND ADMINISTRATION

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

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

Para. 2. Section 301.7701-3 is amended by adding paragraphs (c)(1)(v)(C) and (h)(3) to read as follows:

*§301.7701-3 Classification of certain business entities.*

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

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

(Filed by the Office of the Federal Register on July 19, 2004, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2004, 69 F.R. 43369)

## Notice of Proposed Rulemaking

### Reorganizations Under Section 368(a)(1)(E) or (F)

#### REG-106889-04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the requirements for a transaction to qualify as a reorganization under section 368(a)(1)(E) or (F) of the Internal Revenue Code. The proposed regulations will affect corporations and their shareholders.

DATES: Written or electronic comments and requests for a public hearing must be received by November 10, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-106889-04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-106889-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Internal Revenue Service Internet site at [www.irs.gov/reg](http://www.irs.gov/reg) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS — REG-106889-04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Robert B. Gray, (202) 622-7550; concerning submissions of comments, Guy R. Traynor, (202) 622-7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background and Explanation of Provisions

In general, upon the exchange of property, gain or loss must be accounted for if the new property differs materially, in kind or extent, from the old property. See Internal Revenue Code (Code) §1001; §1.368-1(b). The purpose of the reorganization provisions of the Internal Revenue Code (the Code) is to except from the general rule certain specifically described exchanges that are required by business exigencies and effect only a readjustment of continuing interests in property under modified corporate forms. See §1.368-1(b).

Section 368(a)(1)(E) provides that the term reorganization includes a recapitalization (an E reorganization). A recapitalization has been defined as a “reshuffling of a capital structure within the framework of an existing corporation.” *Helvering v. Southwest Consolidated Corp.*, 315 U.S. 194 (1942).

Section 368(a)(1)(F) provides that the term reorganization includes a mere change in identity, form, or place of organization of one corporation, however effected (an F reorganization). One court has described the F reorganization as follows:

[The F reorganization] encompass[es] only the simplest and least significant of corporate changes. The (F)-type reorganization presumes that the surviving corporation is the same corporation as the predecessor in every respect, except for minor or technical differences. For instance, the (F) reorganization typically has been understood to comprehend only such insignificant modifications as the reincorporation of the same corporate business with the same assets and the same stockholders surviving under a new charter either in the same or in a different State, the renewal of a corporate charter having a limited life, or the conversion of a U.S.-chartered savings and loan association to a State-chartered institution.

*Berghash v. Commissioner*, 43 T.C. 743, 752 (1965) (citation and footnotes omitted), *aff'd*, 361 F.2d 257 (2<sup>nd</sup> Cir. 1966).

To qualify as a reorganization, a transaction must generally satisfy not only the

statutory requirements of the reorganization provisions but also certain nonstatutory requirements, including the continuity of interest and continuity of business enterprise requirements. See §1.368-1(b). The purpose of the continuity requirements is to ensure that reorganizations are limited to readjustments of continuing interests in property under modified corporate form and to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations. §1.368-1(d)(1) and (e)(1); see also *LeTulle v. Scofield*, 308 U.S. 415 (1940); *Helvering v. Minnesota Tea Co.*, 296 U.S. 378 (1935); *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U.S. 462 (1933).

Despite the general rule, the courts and the Service have taken the position that the continuity of interest and continuity of business enterprise requirements need not be satisfied for a transaction to qualify as an E reorganization. See *Hickok v. Commissioner*, 32 T.C. 80 (1959); Rev. Rul. 82-34, 1982-1 C.B. 59; Rev. Rul. 77-415, 1977-2 C.B. 311. In Revenue Rulings 77-415 and 82-34, the IRS reasoned that the continuity of interest and continuity of business enterprise requirements are necessary in an acquisitive reorganization to ensure that the transaction does not involve an otherwise taxable transfer of stock or assets, but that they are not necessary when the transaction involves only a single corporation.

Although an F reorganization may involve an actual or deemed transfer of assets from one corporation to another, such a transaction effectively involves only one corporation. In this way, an F reorganization is much like an E reorganization, which can only involve one corporation even in form. As a result, an F reorganization is treated for most purposes of the Code as if the reorganized corporation were the same entity as the corporation in existence before the reorganization. Consequently, the taxable year of the corporation does not end on the date of the transfer, and the losses of the reorganized corporation can be carried back to offset income of its predecessor. See §1.381(b)-1(a)(2). Nonetheless, courts have applied the continuity requirements in determining whether a transaction qualifies as an F reorganization. See, e.g., *Pridemark, Inc. v. Commissioner*, 345 F.2d 35 (4<sup>th</sup> Cir. 1965)



(stating that the application of the F reorganization statute is limited to cases where the corporate enterprise continues uninterrupted, except perhaps for a distribution of some of its liquid assets); *Yoc Heating Corp. v. Commissioner*, 61 T.C. 168 (1973) (holding that continuity of interest is required for an F reorganization).

The Service and the Treasury Department have considered whether continuity of interest and continuity of business enterprise should be requirements of an F reorganization. Because F reorganizations involve only the slightest change in a corporation and do not resemble sales, the Service and the Treasury Department have concluded that applying the continuity of interest and continuity of business enterprise requirements to transactions that would otherwise qualify as F reorganizations is not necessary to protect the policies underlying the reorganization provisions. Therefore, these proposed regulations provide that a continuity of interest and a continuity of business enterprise are not required for a transaction to qualify as an F reorganization. In addition, to reflect the IRS' position in Revenue Rulings 77-415 and 82-34, these proposed regulations provide that a continuity of interest and a continuity of business enterprise are not required for a transaction to qualify as an E reorganization.

In light of the proposed rules regarding the application of the continuity requirements to transactions that otherwise qualify as F reorganizations, the IRS and the Treasury Department believe it is desirable to provide guidance regarding the characteristics of F reorganizations. These regulations propose such criteria.

Consistent with section 368(a)(1)(F), the proposed regulations provide that, to qualify as an F reorganization, a transaction must result in a mere change in identity, form, or place of organization of one corporation. The proposed regulations further provide that a transaction that involves an actual or deemed transfer is a mere change only if four requirements are satisfied. First, all the stock of the resulting corporation, including stock issued before the transfer, must be issued in respect of stock of the transferring corporation. Second, there must be no change in the ownership of the corporation in the transaction, except a change that has no effect other than that of a redemption of

less than all the shares of the corporation. Third, the transferring corporation must completely liquidate in the transaction. Fourth, the resulting corporation must not hold any property or have any tax attributes (including those specified in section 381(c)) immediately before the transfer.

The first two requirements reflect the Supreme Court's holding in *Helvering v. Southwest Consolidated*, 315 U.S. 194 (1942), that a transaction that shifts the ownership of the proprietary interests in a corporation cannot be a mere change. These requirements prevent a transaction that involves the introduction of a new shareholder or new capital into the corporation from qualifying as an F reorganization. Such an introduction may occur, for example, when a new shareholder contributes assets to the resulting corporation in exchange for stock before a merger of the transferring corporation into the resulting corporation. Notwithstanding these requirements, the proposed regulations permit the resulting corporation's issuance of a nominal amount of stock not in respect of stock of the transferring corporation to facilitate the organization of the resulting corporation. This rule is designed to permit reincorporation in a jurisdiction that requires, for example, minimum capitalization, two or more shareholders, or ownership of shares by directors. It is also intended to permit a transfer of assets to certain pre-existing entities.

The second requirement allows changes of ownership that have no effect other than a redemption of less than all the shares of the corporation to reflect the case law holding that certain transactions qualify as F reorganizations even if shareholders are redeemed in the transaction. See *Reef Corp. v. U.S.*, 368 F.2d 125 (5<sup>th</sup> Cir. 1966) (holding that a redemption of 48 percent of the stock of a corporation that occurred during a change in place of incorporation did not cause the transaction to fail to qualify as an F reorganization); cf. *Casco Products Corp. v. Commissioner*, 49 T.C. 32 (1967) (holding that the surviving corporation in a merger was the continuation of the merging corporation for purposes of allowing a loss carryback, despite the forced redemption of nine percent of the stock of the merging corporation).

The third requirement (providing for the liquidation of the transferring corporation) and the fourth requirement (limiting the assets the resulting corporation may hold immediately before the transfer) reflect the statutory requirement that an F reorganization involve only one corporation. Although the proposed regulations generally require that the transferring corporation completely liquidate in the transaction, they do not require the transferring corporation to legally dissolve, thereby facilitating preservation of the value of the transferring corporation's charter. Further, to accommodate transactions in jurisdictions where it is customary to preserve pre-existing entities for future use rather than create new ones, the proposed regulations permit the retention of a nominal amount of assets for the sole purpose of preserving the transferring corporation's legal existence.

Although the proposed regulations generally require that the resulting corporation not hold any property or have any tax attributes immediately before the transfer, they do allow the resulting corporation to hold or to have held a nominal amount of assets to facilitate its organization or preserve its existence, and to have tax attributes related to these assets. In addition, to accommodate transactions involving the refinancing of debt or the leveraged redemption of shareholders, the proposed regulations provide that this requirement will not be violated if, before the transfer, the resulting corporation holds the proceeds of borrowings undertaken in connection with the transaction.

As described above, section 368(a)(1)(F) provides that an F reorganization includes a mere change in identity, form, or place of organization of one corporation, however effected. The IRS and the Treasury Department believe that the inclusion of the words "however effected" in the statutory definition of an F reorganization reflects a Congressional intent to treat as an F reorganization a series of transactions that together result in a mere change. The proposed regulations reflect this view by providing that a series of related transactions that together result in a mere change may qualify as an F reorganization.

The IRS and the Treasury Department also recognize that a reorganization qualifying under section 368(a)(1)(F) may be

a step in a larger transaction that effects more than a mere change. For example, in Revenue Ruling 96-29, 1996-1 C.B. 50, the IRS ruled that a reincorporation qualified as an F reorganization even though it was a step in a transaction in which the reincorporated entity issued common stock in a public offering and redeemed stock having a value of 40 percent of the aggregate value of its outstanding stock before the offering. In the same ruling, the IRS ruled that a reincorporation of a corporation in another state qualified as an F reorganization even though it was a step in a transaction in which the reincorporated entity acquired the business of another entity.

Consistent with Revenue Ruling 96-29, the proposed regulations provide that related events preceding or following the transaction or series of transactions that constitute a mere change do not cause that transaction or series of transactions to fail to qualify as an F reorganization. The proposed regulations further provide that the qualification of the mere change as an F reorganization does not alter the treatment of the larger transaction. For example, if a redemption of stock occurs in a transaction that qualifies as an F reorganization and the F reorganization is part of a plan that includes a subsequent merger, the step or series of steps constituting the F reorganization will not alter the tax consequences of the subsequent merger.

A number of commentators have questioned whether distributions of money or other property in an F reorganization are distributions to which section 356 applies. The IRS and the Treasury Department believe it is appropriate to treat such distributions as transactions separate from the F reorganization, even if they occur during the F reorganization. See, e.g., §1.301-1(l). Accordingly, these proposed regulations provide that if a shareholder receives money or other property (including in exchange for its shares) from the transferring or resulting corporation in a transaction that constitutes an F reorganization, the money or other property is treated as distributed by the transferring corporation immediately before the transaction. The tax treatment of such distributions is governed by sections 301 and 302, and section 356 does not apply to such distributions. The IRS and the Treasury Department believe that the same

rule should apply in the context of E reorganizations. Comments are requested on whether there are some E reorganizations to which this treatment should not apply.

These regulations are proposed to be effective for transactions that occur on or after the date these regulations are published as final regulations in the **Federal Register**.

#### Effect on Other Documents

Upon the issuance of these regulations as final regulations, Rev. Rul. 66-284, 1966-2 C.B. 115, Rev. Rul. 74-36, 1974-1 C.B. 85, Rev. Rul. 77-415, 1977-2 C.B. 311, Rev. Rul. 77-479, 1977-2 C.B. 119, Rev. Rul. 79-250, 1979-2 C.B. 156, Rev. Rul. 82-34, 1982-1 C.B. 59, and Rev. Rul. 96-29, 1996-1 C.B. 50, will be obsolete.

#### Special Analyses

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

#### Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the Service. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing 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 Robert B. Gray of the Office of Associate Chief Counsel (Corporate). However, other personnel from the Service and Treasury Department participated in their development.

\* \* \* \* \*

#### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

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

Par. 2. Section 1.368-1(b) is amended by adding a sentence after the third sentence to read as follows:

*§1.368-1 Purpose and scope of exception of reorganization exchanges.*

\* \* \* \* \*

(b) *Purpose.* \* \* \* Notwithstanding the previous sentence, for transactions on or after the date these regulations are published as final regulations in the **Federal Register**, a continuity of the business enterprise and a continuity of interest are not required for a transaction to qualify as a reorganization under section 368(a)(1)(E) or (F). \* \* \*

\* \* \* \* \*

Par. 3. Section 1.368-2 is amended by:

1. Adding and reserving new paragraph (l).
2. Adding new paragraph (m).  
The addition reads as follows:

*§1.368-2 Definition of terms.*

\* \* \* \* \*

(l) [Reserved].

(m) *Qualification as a reorganization under section 368(a)(1)(F)* — (1) *Mere change* — (i) *In general.* To qualify as a reorganization under section 368(a)(1)(F), a transaction must result in a mere change in identity, form, or place of organization of

one corporation (“mere change”). A transaction that involves an actual or deemed transfer is a mere change only if —

(A) All the stock of the resulting corporation, including stock issued before the transfer, is issued in respect of stock of the transferring corporation;

(B) There is no change in the ownership of the corporation in the transaction, except a change that has no effect other than that of a redemption of less than all the shares of the corporation;

(C) The transferring corporation completely liquidates in the transaction; and

(D) The resulting corporation does not hold any property or have any tax attributes (including those specified in section 381(c)) immediately before the transfer.

(ii) *Exceptions and special rules* — (A) *Transferring corporation.* Legal dissolution of the transferring corporation is not required, and the mere retention of a nominal amount of assets for the sole purpose of preserving the corporation’s legal existence will not disqualify the transaction as a mere change.

(B) *Resulting corporation.* A transaction will not fail to be a mere change solely because the resulting corporation, to facilitate its organization, issues a nominal amount of stock other than in respect of stock of the transferring corporation. At the time of or before the transfer, the resulting corporation may hold or have held a nominal amount of assets to facilitate its organization or preserve its existence as a corporation, and may have tax attributes related to holding such assets. Moreover, the resulting corporation may hold the proceeds of borrowings undertaken in connection with the transaction.

(2) *Non-application of continuity of interest and continuity of business enterprise requirements.* A continuity of the business enterprise and a continuity of interest are not required for a transaction to qualify as a reorganization under section 368(a)(1)(F). See §1.368-1(b).

(3) *Related transactions* — (i) *Series of transactions.* A series of related transactions that together result in a mere change may qualify as a reorganization under section 368(a)(1)(F).

(ii) *Mere change within a larger transaction.* A reorganization under section 368(a)(1)(F) may occur within a larger transaction that effects more than a mere

change. Related events that precede or follow the transaction or series of transactions that constitutes a mere change will not cause that transaction or series of transactions to fail to qualify as a reorganization under section 368(a)(1)(F). Qualification of the mere change as a reorganization under section 368(a)(1)(F) will not alter the treatment of the larger transaction.

(4) *Treatment of distributions.* If a shareholder receives money or other property (including in exchange for its shares) from the transferring or resulting corporation in a transaction that constitutes a reorganization under section 368(a)(1)(F), the money or other property is treated as distributed by the transferring corporation immediately before the transaction, and section 356(a) does not apply to such distribution. See, e.g., §1.301-1(l).

(5) *Examples.* The following examples illustrate the application of this paragraph (m). In all examples, assume that each transaction is entered into for a valid business purpose and that all corporations are domestic corporations, unless stated otherwise. The examples are as follows:

*Example 1.* C owns all of the stock of W, a State A corporation. The net value of W’s assets and liabilities is \$1,000,000. V, a State B corporation, seeks to acquire the assets of W. To effect the acquisition, V and W enter into an agreement under which V will contribute \$1,000,000 to U, a newly formed corporation of which V is the sole shareholder, and W will merge into U. In the merger, C surrenders his W stock in exchange for the \$1,000,000 V contributed to U. After the merger, U holds all of the assets and liabilities of W. However, the U stock is not issued in respect of the W stock as required by paragraph (m)(1)(i)(A) of this section, and the transaction results in a change in the ownership of W that has an effect other than that of a redemption of some of the W shares in violation of paragraph (m)(1)(i)(B) of this section. Therefore, the merger of W into U is not a mere change and does not qualify as a reorganization under section 368(a)(1)(F).

*Example 2.* A and B own 75 and 25 percent, respectively, of the stock of X, a State A corporation. The management of X determines that it would be in the best interest of X to reorganize under the laws of State B. Accordingly, X forms Y, a State B corporation, and X and Y enter into an agreement under which X will merge into Y. A does not wish to own stock in Y. In the merger, A surrenders her X stock in exchange for cash from X from X’s cash reserves, and B exchanges all of his X stock for all the stock of Y. Without regard to A’s surrender of her stock in X, the merger of X into Y is a mere change of X. The change in ownership caused by A’s surrender of her stock in X has no effect other than that of a redemption of less than all the X shares as described in paragraph (m)(1)(i)(B) of this section. Therefore, the

merger of X into Y is a mere change and qualifies as a reorganization under section 368(a)(1)(F).

*Example 3.* D owns all of the stock of S, a Country A corporation. The management of S determines that it would be in the best interest of S to reorganize under the laws of Country B. Under Country B law, a corporation must have at least two shareholders to enjoy limited liability. D is advised by a Country B attorney that the new corporation should issue one percent of its stock to a shareholder that is not D’s nominee to assure satisfaction of the two-shareholder requirement. As part of an integrated plan, E organizes T, a Country B corporation with 1,000 shares of common stock authorized, and contributes cash to T in exchange for ten of the common shares. S then merges into T under the laws of Country A and Country B. Pursuant to the plan of merger, D surrenders his shares of stock in S in exchange for 990 shares of T common stock. Without regard to the prior issuance of T stock to E, the merger of S into T is a mere change of S. The ten shares of stock issued to E not in respect of the S stock are nominal and used to facilitate the organization of T within the meaning of paragraph (m)(1)(ii)(B) of this section. Therefore, the issuance of this stock to a new shareholder does not cause the merger of S into T to fail to be a mere change. Accordingly, the merger is a reorganization under section 368(a)(1)(F).

*Example 4.* A owns all of the stock of H, a corporation that owns all of the stock of S, a corporation engaged in a manufacturing business. H has owned the stock of S for many years. H owns no assets other than the stock of S. A decides to eliminate the holding company structure by merging H into S. Because it operates a manufacturing business, the resulting corporation, S, holds property and has tax attributes immediately before the transfer. Therefore, under paragraph (m)(1)(i)(D) of this section, the merger of H into S is not a mere change and does not qualify as a reorganization under section 368(a)(1)(F). The same result would occur if, instead of H merging into S, S merged into H.

*Example 5.* Corporation P owns all of the stock of S1, a State X corporation. The management of P determines that it would be in the best interest of P to change its place of incorporation to State Y. Accordingly, under an integrated plan, P forms S2, a new State Y corporation, P contributes the S1 stock to S2, and S1 merges into S2 under the laws of State X and State Y. Under paragraph (m)(3)(i) of this section, a series of transactions that together result in a mere change of one corporation may qualify as a reorganization under section 368(a)(1)(F). The contribution of S1 stock to S2 and the merger of S1 into S2 together constitute a mere change of S1. Therefore, the transaction qualifies as a reorganization under section 368(a)(1)(F). S1 is treated as transferring its assets to S2 in exchange for the S2 stock and distributing the S2 stock to P in exchange for P’s S1 stock.

*Example 6.* Corporation P owns all of the stock of S, a State X corporation. The management of P determines that it would be in the best interest of P to change its place of incorporation to State Y. Accordingly, P forms New S, a State Y corporation. S then merges into New S under the laws of State X and State Y. As part of the same plan, P sells all of its stock in New S to an unrelated party. Without regard to the sale of New S stock, the merger of S into New S is a mere change within the meaning of paragraph (m)(1)

of this section. Under paragraph (m)(3)(ii) of this section, related events that precede or follow the transaction or series of transactions that constitute a mere change do not cause that transaction to fail to qualify as a reorganization under section 368(a)(1)(F). Therefore, the sale of the New S stock is disregarded in determining whether the merger of S into New S is a mere change. Accordingly, the merger of S into New S is a reorganization under section 368(a)(1)(F).

*Example 7.* A owns all of the stock of T and none of the stock of P. P owns all of the stock of S. T and S are State M corporations engaged in manufacturing businesses. The following transactions occur pursuant to a single plan. First, T merges into S with A receiving solely stock in P. Second, P changes its state of incorporation to State N by merging into newly organized New P under the laws of State M and State N. Third, P redeems all the stock issued to A in respect of his T stock for cash. Without regard to the other steps, the merger of T into S qualifies as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D). Without regard to the other steps, the merger of P into New P qualifies as a reorganization under section 368(a)(1)(F). Under paragraph (m)(3)(ii) of this section, related events that precede or follow the transaction or series of transactions that constitute a mere change do not cause that transaction to fail to qualify as a reorganization under section 368(a)(1)(F). Therefore, the merger of P into New P qualifies as a reorganization under section 368(a)(1)(F). However, under paragraph (m)(3)(ii) of this section, the qualification of the merger of P into New P as a reorganization under section 368(a)(1)(F) does not alter the tax treatment of the merger of T into S. Because the P shares received by A in respect of the T shares are redeemed for cash pursuant to the plan, the merger of T into S does not satisfy the continuity of interest requirement and does not qualify as a reorganization under section 368(a)(1)(A).

*Example 8.* Corporation P owns all of the stock of S, a State A corporation. The management of P determines that it would be in the best interest of S to change its form from a State A corporation to a State A limited partnership. Accordingly, P contributes one percent of the S stock to newly formed LLC, a limited liability company, in exchange for all of the membership interests in LLC. Under §301.7701-3 of this chapter, LLC is disregarded as an entity separate from its owner, P. Under a State A statute, S converts to a State A limited partnership. In the conversion, P's interest as a 99 percent shareholder of S is converted into a 99 percent limited partner interest, and LLC's interest as a one percent shareholder of S is converted into a one percent general partner interest. S then elects, under §301.7701-3(c), to be classified as a corporation for federal income tax purposes, effective on the date of the conversion. The conversion of S from a State A corporation to a State A limited partnership, together with the election to treat S as a corporation for federal tax purposes, constitutes a mere change and is a reorganization under section 368(a)(1)(F).

(6) *Effective Date.* This paragraph (m) applies to transactions occurring on or after the date these regulations are published as final regulations in the **Federal Register**.

Linda M. Kroening,  
*Acting Deputy Commissioner for  
Services and Enforcement.*

(Filed by the Office of the Federal Register on August 11, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 12, 2004, 69 F.R. 49836)

## Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

### Additional Rules for Exchanges of Personal Property Under Section 1031(a) Regulations

#### REG-116265-04

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 final and temporary regulations (T.D. 9151) replacing the use of the Standard Industrial Classification (SIC) system with the North American Industry Classification System (NAICS) for determining what properties are of a like class for purposes of section 1031 of the Internal Revenue Code (Code). The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by November 12, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-116265-04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-116265-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS internet site at <http://www.irs.gov/regs> or via the Federal eRulemaking Portal

at <http://www.regulations.gov> (IRS and REG-116265-04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, J. Peter Baumgarten, 202-622-4920; concerning submissions of comments and/or requests for a public hearing, Guy Traynor, 202-622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

#### Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend 26 CFR Part 1 relating to section 1031(a)(1). The temporary regulations substitute NAICS classification codes for the SIC classification codes in the regulatory text and permit the use of NAICS codes for determining product classes, and therefore property of like kind, of depreciable tangible personal property exchanged under section 1031. The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

#### Special Analyses

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

#### Comments and 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 request comments on the clarity of these proposed regulations and how they may be made easier to understand. 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 regulations is J. Peter Baumgarten, Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

#### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

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

Par. 2. In §1.1031(a)-2, paragraphs (b)(3) through (b)(6), and *Example 3* and *Example 4* of paragraph (b)(7) are revised to read as follows:

*§1.1031(a)-2 Additional rules for exchanges of personal property.*

[The text of proposed §1.1031(a)-2, paragraphs (b)(3) through (b)(6), and *Example 3* and *Example 4* of paragraph (b)(7) is the same as the text of §1.1031(a)-2T, paragraphs (b)(3) through (b)(6), and *Example 3* and *Example 4* of paragraph (b)(7) published elsewhere in this issue of the Bulletin.] §1.1031(j)-1 [Amended]

Par. 3. Section 1.1031(j)-1 is amended by removing the language “(SIC Code 3531)” in *Example 3(ii)(C)* and *Example 5(i)* of paragraph (d) and adding the language “(NAICS code 333120)” in its place.

Linda M. Kroening,  
*Acting Deputy Commissioner for  
Services and Enforcement.*

(Filed by the Office of the Federal Register on August 12, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 13, 2004, 69 F.R. 50108)

## Notice of Proposed Rulemaking

### Consolidated Returns; Intercompany Transactions

#### REG-131264-04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the treatment of manufacturer incentive payments between members of a consolidated group. The proposed regulations are necessary to provide additional guidance for a variety of transactions involving manufacturer incentive payments. The regulations will affect corporations filing consolidated returns.

DATES: Written or electronic comments and requests for a public hearing must be received by November 11, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-131264-04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-131264-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically, via the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS and REG-131264-04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Frances Kelly, (202) 622-7770; concerning submissions of comments and/or requests for a public hearing,

Treena Garrett, (202) 622-7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

#### Background and Explanation of Provisions

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 1502 of the Internal Revenue Code. On July 18, 1995, final regulations (T.D. 8597, 1995-2 C.B. 147) under §1.1502-13, amending the intercompany transaction system of the consolidated return regulations, were published in the **Federal Register** (60 FR 36671). Those final regulations provide rules for taking into account items of income, gain, deduction, and loss of members from intercompany transactions. Their purpose is to clearly reflect the taxable income (and tax liability) of the group by preventing intercompany transactions from creating, accelerating, avoiding, or deferring consolidated taxable income or consolidated tax liability.

#### Accounting for Intercompany Transactions

Under §1.1502-13(b)(1), an intercompany transaction is a transaction between corporations that are members of the same consolidated group immediately after the transaction. For purposes of §1.1502-13, S is the member transferring property or providing services, and B is the member receiving the property or services.

S's income, gain, deduction, and loss from an intercompany transaction, whether directly or indirectly, are its intercompany items, and may include amounts from an intercompany transaction that are not yet taken into account under its separate entity method of accounting. B's income, gain, deduction, and loss from an intercompany transaction, or from property acquired in an intercompany transaction, are its corresponding items. An item is a corresponding item whether it is directly or indirectly from an intercompany transaction (or from property acquired in an intercompany transaction). The recomputed corresponding item is the corresponding item that B would take into account if S and B were divisions of a single corporation and the intercompany

transaction were between those divisions. Although neither S nor B actually takes the recomputed corresponding item into account, it is computed as if B did take it into account.

### Matching Rule

In general, under the matching rule of §1.1502-13(c), B takes its corresponding item into account under its separate entity accounting method and S takes its intercompany item into account to reflect the difference for the year between B's corresponding item taken into account and the recomputed corresponding item. The matching rule determines when the intercompany transaction regulations override the members' timing of items under their otherwise applicable separate entity methods of accounting.

### Manufacturer Incentive Payments

Section 1.1502-13(c)(7)(ii), *Example 13*, illustrates how the matching rule of the intercompany transaction regulations treats manufacturer incentive payments made by one member of a group to another. In this example, B is a manufacturer that sells its products to dealers, and S is a credit company that offers financing, including financing to customers of the dealers. Under B's incentive program, in Year 1, S purchases the product from an independent dealer for \$100 and leases it to a nonmember. S pays \$90 to the dealer for the product, and assigns to the dealer its \$10 incentive payment from B. Under their separate entity accounting methods, B would deduct the \$10 incentive payment in Year 1 and S would take a \$90 basis in the product. The example assumes that if S and B were divisions of a single corporation, the \$10 payment would not be deductible and S's basis in the property would be \$100. The example concludes that under the matching rule of §1.1502-13(c), S takes its \$10 intercompany item into account as income in Year 1 to reflect the difference between B's \$10 corresponding item (the \$10 deduction taken into account by B) and the \$0 recomputed corresponding item. S's basis in the product is \$100 (rather than the \$90 it would be under S's separate entity method of accounting) and the additional \$10 of basis in the product is recovered based on

subsequent events (e.g., S's cost recovery deductions or its sale of the product).

Since §1.1502-13 was issued, it has become clear that the facts and the underlying assumptions in *Example 13* do not provide adequate guidance to address the variety of transactions involving manufacturer incentive payments. Accordingly, the IRS and Treasury Department believe that § 1.1502-13(c)(7)(ii), *Example 13*, should be amended to address certain of these transactions and to clarify the proper treatment of such payments under the intercompany transaction regulations. Therefore, these proposed regulations supplement the fact pattern of *Example 13* with two additional fact patterns involving manufacturer incentive payments.

### Proposed Effective Date

The regulations are proposed to apply to any consolidated return year for which the due date of the income tax return (without regard to extensions) is on or after the date that is sixty days after the date these regulations are filed as final regulations with the **Federal Register**.

### 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 these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rule making will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their 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 (a signed

original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic 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 William F. Barry, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

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

Section 1.1502-13 also issued under 26 U.S.C. 1502. \* \* \*

Par. 2. Section 1.1502-13 is amended by adding paragraph (c)(7)(ii), *Example 13(c)*, (d), and (e), and paragraph (c)(7)(iii) to read as follows:

#### §1.1502-13 Intercompany transactions.

\* \* \* \* \*

(c) \* \* \*

(7) \* \* \* (i) \* \* \*

(ii) \* \* \*

*Example 13.* \* \* \* (a) \* \* \*

(c) *Deduction for incentive payment on single entity basis.* B is a manufacturer that sells its products to independent dealers for resale. S is a credit company that offers financing, including financing to customers of the independent dealers. During Year 1, B initiates a program of incentive payments. Under B's program, an independent dealer sells product to a customer under a retail installment sales contract (RISC) in which the customer agrees to pay for the product

over the term of the contract at a below market interest rate. The customer purchases the product from the independent dealer and enters into a RISC. The RISC has a face amount of \$100 but a fair market value of \$90. The independent dealer assigns the RISC to S in exchange for a \$100 payment from S. B pays \$10 to S to compensate S for the \$10 overpayment to the independent dealer. Assume that under their respective separate entity accounting methods, B would deduct the \$10 payment in Year 1, and S would take a \$90 basis in the RISC and would take the \$10 into account over the term of the RISC. Assume that, if S and B were divisions of a single corporation, the \$10 overpayment to the independent dealer would be deductible in Year 1 and the basis of the RISC would be \$90.

(d) *Timing and attributes.* Under paragraph (b)(1) of this section, the incentive payment transaction is an intercompany transaction. Under paragraph (b)(2)(iii) of this section, S has a \$10 intercompany item not yet taken into account under its separate entity method of accounting. Under the matching rule, S takes its intercompany item into account to reflect the difference between B's corresponding item taken into account and the recomputed corresponding item. In Year 1, there is no difference between B's \$10 deduction taken into account and the \$10 recomputed deduction. Accordingly, under the matching rule, S does not take the \$10 incentive payment into account as intercompany income in Year 1. Instead, S takes the \$10 into income over the term of the RISC. S's basis in the RISC is \$90.

(e) *No intercompany transaction.* B is a manufacturer that sells its products to independent dealers for resale. S is a credit company that offers financing to purchasers of goods and services, including the independent dealers. During Year 1, B initiates a program of incentive payments to the independent dealers. Under B's program, S loans \$100 to an independent dealer at a below market interest rate to finance the independent dealer's purchase of product from B. The independent dealer issues a note to S at a below market interest rate. B pays \$10 to S to compensate S for the below market interest rate on the note. Under §1.1273-2(g)(4), the payment from B to S is treated as a payment from B to the independent dealer and then as a payment from the independent dealer to S. Because the incentive payment is treated as being made by a member of the group to a non-member, the transaction is not an intercompany transaction under paragraph (b)(1) of this section. Therefore, §1.1502-13 is not applicable.

\* \* \* \* \*

(iii) *Effective date.* Section 1.1502-13 (c)(7)(ii), *Example 13(c)*, (d), and (e) are proposed to apply to any consolidated return year for which the due date of the income tax return (without regard to exten-

sions) is on or after the date that is sixty days after the date these regulations are filed as final regulations with the **Federal Register**.

\* \* \* \* \*

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

(Filed by the Office of the Federal Register on August 12, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 13, 2004, 69 F.R. 50112)

## Section 1045 Application to Partnerships; Correction Announcement 2004-68

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains corrections to proposed regulations (REG-150562-03, 2004-32 I.R.B. 175) that were published in the **Federal Register** on July 15, 2004 (69 FR 42370). This regulation relates to the application of section 1045 of the Internal Revenue Code to partnerships and their partners.

DATES: These corrections are made as of July 15, 2004.

FOR FURTHER INFORMATION CONTACT: Charlotte Chyr at (202) 622-3070 or Jian H. Grant at (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### Background

The proposed regulations that are the subject of these corrections are under section 1045 of the Internal Revenue Code.

### Need for correction

As published, the notice of proposed rulemaking contains errors that may prove to be misleading and are in need of clarification.

### Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG-150562-03), which was the subject of FR Doc. 04-15964, is corrected as follows:

1. On page 42371, column 1, in the preamble, under the subject heading "Background", line 3, the language "the sale of QSB stock held by non-" is corrected to read "the sale of qualified small business (QSB) stock (as defined in section 1202(c)) held by non-".

2. On page 42371, column 1, in the preamble, under the subject heading "Background" lines 8 thru 10 are corrected to read "percent of gain on the sale of QSB stock from gross income if".

3. On page 42372, column 1, in the preamble, under the subject heading "Explanation of Provisions" paragraph 2, line 7, the language "though approach to the sale and" is corrected to read "through approach to the sale and".

### §1.1045-1 [Corrected]

4. On page 42377, column 1, §1.1045-1, paragraph (g), *Example 2*, line 5, the language "PRS interest for \$50x, realizing \$25 of capital" is corrected to read "PRS interest for \$50, realizing \$25 of capital".

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

(Filed by the Office of the Federal Register on August 9, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 10, 2004, 69 F.R. 48428)

# Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance

of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

## Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

A—Individual.  
Acq.—Acquiescence.  
B—Individual.  
BE—Beneficiary.  
BK—Bank.  
B.T.A.—Board of Tax Appeals.  
C—Individual.  
C.B.—Cumulative Bulletin.  
CFR—Code of Federal Regulations.  
CI—City.  
COOP—Cooperative.  
Ct.D.—Court Decision.  
CY—County.  
D—Decedent.  
DC—Dummy Corporation.  
DE—Donee.  
Del. Order—Delegation Order.  
DISC—Domestic International Sales Corporation.  
DR—Donor.  
E—Estate.  
EE—Employee.  
E.O.—Executive Order.

ER—Employer.  
ERISA—Employee Retirement Income Security Act.  
EX—Executor.  
F—Fiduciary.  
FC—Foreign Country.  
FICA—Federal Insurance Contributions Act.  
FISC—Foreign International Sales Company.  
FPH—Foreign Personal Holding Company.  
F.R.—Federal Register.  
FUTA—Federal Unemployment Tax Act.  
FX—Foreign corporation.  
G.C.M.—Chief Counsel's Memorandum.  
GE—Grantee.  
GP—General Partner.  
GR—Grantor.  
IC—Insurance Company.  
I.R.B.—Internal Revenue Bulletin.  
LE—Lessee.  
LP—Limited Partner.  
LR—Lessor.  
M—Minor.  
Nonacq.—Nonacquiescence.  
O—Organization.  
P—Parent Corporation.  
PHC—Personal Holding Company.  
PO—Possession of the U.S.  
PR—Partner.

PRS—Partnership.  
PTE—Prohibited Transaction Exemption.  
Pub. L.—Public Law.  
REIT—Real Estate Investment Trust.  
Rev. Proc.—Revenue Procedure.  
Rev. Rul.—Revenue Ruling.  
S—Subsidiary.  
S.P.R.—Statement of Procedural Rules.  
Stat.—Statutes at Large.  
T—Target Corporation.  
T.C.—Tax Court.  
T.D.—Treasury Decision.  
TFE—Transferee.  
TFR—Transferor.  
T.I.R.—Technical Information Release.  
TP—Taxpayer.  
TR—Trust.  
TT—Trustee.  
U.S.C.—United States Code.  
X—Corporation.  
Y—Corporation.  
Z—Corporation.



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<sup>1</sup> A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2004–1 through 2004–26 is in Internal Revenue Bulletin 2004–26, dated June 28, 2004.

## Findings List of Current Actions on Previously Published Items<sup>1</sup>

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### Notices:

#### 98-65

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#### 2001-50

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### Proposed Regulations:

#### INTL-116-90

Withdrawn by  
REG-208246-90, 2004-36 I.R.B. 450

#### REG-208254-90

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REG-136481-04, 2004-37 I.R.B. 480

#### REG-104683-00

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Ann. 2004-64, 2004-35 I.R.B. 402

#### REG-150562-03

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Ann. 2004-68, 2004-38 I.R.B. 508

### Revenue Procedures:

#### 79-61

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#### 89-37

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#### 94-64

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#### 96-18

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#### 96-53

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#### 96-60

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Rev. Proc. 2004-53, 2004-34 I.R.B. 320

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#### 2002-9

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#### 2003-30

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#### 2003-52

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#### 2004-23

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#### 62-60

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#### 70-58

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#### 73-354

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#### 80-7

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