Internal Revenue
bulletin

Bulletin No. 2006-24
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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

T.D. 9262, page 1040.
REG–111578–06, page 1060.

Temporary and proposed regulations concern the application of section 199 of the Code, which provides a deduction for income attributable to domestic production activities, to certain transactions involving computer software. A public hearing on the proposed regulations is scheduled for August 29, 2006.

REG–139059–02, page 1052.

Proposed regulations under section 21 of the Code conform the rules relating to the child and dependent care credit to statutory changes including amendments under the Working Families Tax Relief Act of 2004, and address significant issues that have arisen administratively. The regulations are renumbered to conform to the renumbering of the statute.

Notice 2006–30, page 1044.

This notice informs trustees and middlemen of non-mortgage widely held fixed investment trusts (NMWHFITs) that the date for satisfying the qualified NMWHFIT exception in regulations section 1.671–5(c)(2)(iv)(E) is extended by 60 days.

Notice 2006–46, page 1044.

This notice announces that the IRS and Treasury intend to issue final regulations under sections 897(d) and (e) of the Code, which will revise the current rules under temporary regulations sections 1.897–5T and 1.897–6T and Notice 89–85, 1989–2 C.B. 403. When finalized, regulations will revise temporary regulations section 1.897–5T(c)(4) to take into account inbound statutory mergers and consolidations described in section 368(a)(1)(A). The regulations will also revise the rules of temporary regulations section 1.897–6T(b)(1) to take into account foreign-to-foreign statutory mergers and consolidations described in section 368(a)(1)(A) and to create two new exceptions to gain recognition under section 1.897–6(b)(1) for certain foreign-to-foreign asset reorganizations. The regulations will also revise the stock disposition rule of temporary regulations section 1.897–6T(b)(1)(iii) and eliminate the conditions specified for nonrecognition in temporary regulations section 1.897–6T(b)(2). Lastly, the regulations will modify the period that must be considered for imposing taxes and accrued interest on prior dispositions of the stock of foreign corporations. Notice 89–85 amplified.

Rev. Proc. 2006–21, page 1050.

Section 1502. The Service eliminates impediments to e-filing consolidated returns and reduces reporting requirements. Rev. Procs. 89–56, 90–39, and 2002–32 modified.

Announcement 2006–35, page 1061.

Insurance companies; interest rate tables. This announcement corrects an error in Rev. Rul. 2006–25, 2006–20 I.R.B. 882 (May 15, 2006).

Announcement 2006–38, page 1062.

This document contains corrections to final regulations (T.D. 9243, 2006–8 I.R.B. 475) that amend the income tax regulations under various provisions of the Code to account for statutory mergers and consolidations.

Actions Relating to Court Decisions is on the page following the Introduction.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. "Nonacquiescence" signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a "nonacquiescence" indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletin are consolidated semiannually and appear in the first Bulletin for July and the Cumulative Bulletin for the first half of the year. A semiannual consolidation also appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner does NOT ACQUIESCE in the following decision:

Erickson Post Acquisition, Inc. v. Commissioner,[1]
Docket Number: 8218–00
T.C. Memo. 2003–218

[1] Nonacquiescence relating to whether the cash payment from the wholesaler to the retailer was a taxable advance payment or a nontaxable loan.

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

Section 21.—Expenses for Household and Dependent Care Services Necessary for Gainful Employment

Taxpayers who pay for household and dependent care services in order to be employed are entitled to a credit if they have "qualifying individuals" (generally, children under 13 or disabled dependents). These proposed regulations renumber, restructure, and revise the current regulations to reflect statutory amendments and address significant issues that have arisen recently. See REG-139059-02, page 1052.

Section 199.—Income Attributable to Domestic Production Activities

26 CFR 1.199–3T: Domestic production gross receipts (temporary).

T.D. 9262

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Computer Software Under Section 199(c)(5)(B)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations concerning the application of section 199 of the Internal Revenue Code, which provides a deduction for income attributable to domestic production activities, to certain transactions involving computer software. The regulations will affect taxpayers engaged in certain domestic production activities involving computer software. The text of these temporary regulations also serves as the text of the proposed regulations (REG–111578–06) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

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

Applicability Date: For date of applicability, see §1.199–8T(i)(4).

FOR FURTHER INFORMATION CONTACT: Paul Handleman or Lauren Ross Taylor, (202) 622–3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends 26 CFR part 1 to provide rules relating to the deduction for income attributable to domestic production activities under section 199 of the Internal Revenue Code (Code). Section 199 was added to the Code by section 102 of the American Jobs Creation Act of 2004 (Public Law 108–357, 118 Stat. 1418), and amended by section 403(a) of the Gulf Opportunity Zone Act of 2005 (Public Law 109–135, 119 Stat. 25) and section 514 of the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109–222, 120 Stat. 345). On January 19, 2005, the IRS and Treasury Department issued Notice 2005–14, 2005–1 C.B. 498, providing interim guidance on section 199. On November 4, 2005, the IRS and Treasury Department published in the **Federal Register** proposed regulations under section 199 (REG–105847–05, 2005–47 I.R.B. 987 [70 FR 67220]). On January 11, 2006, the IRS and Treasury Department held a public hearing on the proposed regulations. Written and electronic comments responding to the proposed regulations were received. Contemporaneous with the publication of these temporary regulations, final regulations have been published under section 199.

General Overview

Section 199(a)(1) allows a deduction equal to 9 percent (3 percent in the case of taxable years beginning in 2005 or 2006, and 6 percent in the case of taxable years beginning in 2007, 2008, or 2009) of the lesser of (A) the qualified production activities income (QPAI) of the taxpayer for the taxable year, or (B) taxable income (determined without regard to section 199) for the taxable year (or, in the case of an individual, adjusted gross income (AGI)).

Qualified Production Activities Income

Section 199(c)(1) defines QPAI for any taxable year as an amount equal to the excess (if any) of (A) the taxpayer's domestic production gross receipts (DPGR) for such taxable year, over (B) the sum of (i) the cost of goods sold (CGS) that are allocable to such receipts; and (ii) other expenses, losses, or deductions (other than the deduction under section 199) that are properly allocable to such receipts.

Section 199(c)(4)(A)(i) defines DPGR, in part, to mean the taxpayer's gross receipts that are derived from any lease, rental, license, sale, exchange, or other disposition of qualifying production property (QPP) that was manufactured, produced, grown, or extracted (MPGE) by the taxpayer in whole or in significant part within the United States. Section 199(c)(5) defines QPP to mean: (A) tangible personal property; (B) any computer software; and (C) any property described in section 168(f)(4) (certain sound recordings).

Computer Software

Section 4.04(7)(d) of Notice 2005–14 provides that gross receipts derived from computer software do not include gross receipts derived from Internet access services, online services, customer support, telephone services, games played through a website, provider-controlled software online access services, and other services that do not constitute the lease, rental, license, sale, exchange, or other disposition of computer software that was developed by the taxpayer. Consistent with Notice 2005–14, the proposed regulations in §1.199–3(h)(6)(i) state that the provision of online computer software does not rise to the level of a lease, rental, license, sale, exchange, or other disposition as required under section 199, but is instead a service.

Congressional Letter

On July 21, 2005, the Chairman and Ranking Member of the Senate Finance

Committee and the Chairman of the House Ways and Means Committee sent a letter to the Treasury Department suggesting that the Treasury Department consider further the treatment of online access to computer software and, in particular, whether such treatment should be similar to the treatment of computer software distributed by other means, such as by physical delivery or delivery via Internet download. The letter notes that gross receipts from the provision of services are not treated as DPGR, regardless of the fact that computer software may be used to facilitate such service transactions.

Summary of Comments

Numerous commentators have suggested that the provision of computer software for online use should qualify under section 199. Some commentators proposed that gross receipts derived from providing online access to computer software should qualify under section 199 if the substance of the transaction that gives rise to the gross receipts is the distribution of the computer software's functionality to end users. These commentators suggested that factors to be considered in determining the substance of the transaction should include: (1) whether an agreement exists, regardless of its form, between the computer software producer and the customer that gives the customer permission to use the computer software; (2) whether the use of computer software is merely incidental to the provision of a separate service or transaction; (3) whether the end user has made a payment to the computer software producer directly for the right to access and use the computer software's functionality, as opposed to a payment for a separate service or good in which the use of the underlying computer software is only incidental to the separate service or transaction; (4) whether the computer software producer holds itself out to the public as being in the computer software business; (5) whether the computer software producer uses alternate channels for distributing its computer software product or functionality other than through online access; and (6) whether a competitive marketplace exists for the same or similar computer software functionality that provides customers with alternative distribution choices in addition to online access. The commentators explained that this proposed list of factors is not exhaustive and there may be other relevant factors. The commentators suggested that no single factor should control and that failure to satisfy one or more factors should not necessarily result in gross receipts derived from online access to computer software being non-DPGR.

Other commentators suggested that a customer's use of computer software is tantamount to a license of the computer software. In addition, several commentators asserted that the phrase "other disposition" in section 199(c)(4)(A) is broad enough to include the provision of computer software for online use.

Explanation of Provisions

The temporary regulations do not adopt these comments. However, as a matter of administrative convenience, the temporary regulations provide two exceptions under which gross receipts derived by a taxpayer from providing computer software to customers for the customers' direct use while connected to the Internet will be treated as being derived from the lease, rental, license, sale, exchange, or other disposition of such computer software. Such gross receipts will be treated as DPGR if all the other requirements of section 199 are met (for example, the taxpayer MPGE computer software in whole or in significant part within the United States).

The first exception applies to a taxpayer that derives gross receipts from providing computer software to customers for the customers' direct use while connected to the Internet (online software) and also derives gross receipts from the lease, rental, license, sale, exchange, or other disposition to customers that are unrelated persons of computer software that has been provided to such customers affixed to a tangible medium or by allowing them to download the computer software from the Internet. The second exception applies if a taxpayer derives gross receipts from providing online software and an unrelated person derives on a regular and ongoing basis in the unrelated person's business gross receipts from the lease, rental, license, sale, exchange, or other disposition of substantially identical software to its customers affixed to a tangible medium or by allowing its customers to download the substantially identical computer software from the Internet.

The temporary regulations define substantially identical software as computer software that, from a customer's perspective, has the same functional result as the online software and has a significant overlap of features or purpose with the online software. To avoid controversy between taxpayers and the IRS, the temporary regulations provide a safe harbor under which all computer software games are deemed to be substantially identical software.

If a taxpayer's provision of computer software for online use meets the requirements set forth in the temporary regulations, then an allocation of gross receipts between DPGR and non-DPGR will be necessary if, as part of the same transaction, the taxpayer derives gross receipts other than from providing computer software to a customer for the customer's direct use while connected to the Internet. For example, if in connection with providing computer software to a customer for the customer's direct use while connected to the Internet, a taxpayer also provides a service such as storing its customers' data or providing telephone support, then the taxpayer must allocate its gross receipts between DPGR and non-DPGR using any reasonable method.

These rules are specifically limited to the deduction under section 199 and no inference can be drawn with respect to any other provision of the Code (such as the tax treatment of these transactions under those provisions regarding character, timing, or source).

Effective Date

Section 199 applies to taxable years beginning after December 31, 2004. These temporary regulations are applicable for taxable years beginning on or after June 1, 2006. A taxpayer may apply these temporary regulations to taxable years beginning after December 31, 2004, and before June 1, 2006. The applicability of these temporary regulations expires on or before May 22, 2009. Section 1.199–8(i)(1) of the final regulations issued contemporaneous with these temporary regulations provides that, in certain circumstances, a taxpayer may rely on the guidance in Notice 2005–14, 2005–1 C.B. 498, the proposed regulations under section 199 that

were published in the **Federal Register** on November 4, 2005 (70 FR 67220), or the final regulations. Regardless of which guidance a taxpayer applies, the taxpayer may apply these temporary regulations.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), refer to the cross-reference 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 authors of these regulations are Paul Handleman and Lauren Ross Taylor, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department 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 is amended by adding entries in numerical order to read, in part, as follows:

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

Section 1.199–3T also issued under 26 U.S.C. 199(d). * * *

Section 1.199–8T also issued under 26 U.S.C. 199(d). * * *

Par. 2. Section 1.199–3T is added to read as follows:

§1.199–3T Domestic production gross receipts (temporary).

(a) through (h) [Reserved]. For further guidance, see §1.199–3(a) through (h).

(i) *Derived from the lease, rental, license, sale, exchange, or other disposition.* (1) through (5) [Reserved]. For further guidance, see §1.199–3(i)(1) through (5).

(6) *Computer software*—(i) [Reserved]. For further guidance, see §1.199–3(i)(6)(i).

(ii) *Gross receipts derived from services*. Gross receipts (as defined in §1.199–3(c)) derived from customer and technical support, telephone and other telecommunication services, online services (such as Internet access services, online banking services, providing access to online electronic books, newspapers, and journals), and other similar services do not constitute gross receipts derived from a lease, rental, license, sale, exchange, or other disposition of computer software (as defined in §1.199–3(j)(3)).

(iii) *Exceptions*. Notwithstanding paragraph (i)(6)(ii) of this section, if a taxpayer derives gross receipts from providing to customers computer software MPGE in whole or in significant part by the taxpayer within the United States for the customers' direct use while connected to the Internet (online software), then such gross receipts will be treated as being derived from the lease, rental, license, sale, exchange, or other disposition of computer software only if—

(A) The taxpayer also derives, on a regular and ongoing basis in the taxpayer's business, gross receipts from the lease, rental, license, sale, exchange, or other disposition to customers that are unrelated persons (as defined in §1.199–3(b)(1)) of computer software that—

(*1*) Has only minor or immaterial differences from the online software;

(*2*) Has been MPGE (as defined in §1.199–3(e)) by the taxpayer (as defined in §1.199–3(f)) in whole or in significant part (as defined in §1.199–3(g)) within the United States (as defined in §1.199–3(h)); and

(*3*) Has been provided to such customers either affixed to a tangible medium (for example, a disk or DVD) or by allowing them to download the computer software from the Internet; or

(B) An unrelated person derives, on a regular and ongoing basis in the unrelated person's business, gross receipts from the lease, rental, license, sale, exchange, or other disposition of substantially identical software (as described in paragraph (i)(6)(iv)(A) of this section) (as compared to the taxpayer's online software) to its customers pursuant to an activity described in paragraph (i)(6)(iii)(A)(*3*) of this section.

(iv) *Definitions and special rules*—(A) *Substantially identical software*. For purposes of paragraph (i)(6)(iii)(B) of this section, *substantially identical software* is computer software that—

(*1*) From a customer's perspective, has the same functional result as the online software described in paragraph (i)(6)(iii) of this section; and

(*2*) Has a significant overlap of features or purpose with the online software described in paragraph (i)(6)(iii) of this section.

(B) *Safe harbor for computer software games*. For purposes of paragraph (i)(6)(iv)(A) of this section, all computer software games are deemed to be substantially identical software. For example, computer software sports games are deemed to be substantially identical to computer software card games.

(C) *Regular and ongoing basis*. For purposes of paragraph (i)(6)(iii) of this section, in the case of a newly-formed trade or business or a taxpayer in its first taxable year, the taxpayer is considered to be engaged in an activity described in paragraph (i)(6)(iii) of this section on a regular and ongoing basis if the taxpayer reasonably expects that it will engage in the activity on a regular and ongoing basis.

(D) *Attribution*. For purposes of paragraph (i)(6)(iii)(A) of this section—

(*1*) All members of an expanded affiliated group (as defined in §1.199–7(a)(1)) are treated as a single taxpayer; and

(*2*) In the case of an EAG partnership (as defined in §1.199–9(j)), the EAG partnership and all members of the EAG to which the EAG partnership's partners belong are treated as a single taxpayer.

(E) *Qualified computer software maintenance agreements*. Section 1.199–3(i)(4)(i)(B)(*5*) does not apply if the computer software is online software under paragraph (i)(6)(ii) of this section.

(v) *Examples.* The following examples illustrate the application of this paragraph (i)(6):

Example 1. L is a bank and produces computer software within the United States that enables its customers to receive online banking services for a fee. Under paragraph (i)(6)(ii) of this section, gross receipts derived from online banking services are attributable to a service and do not constitute a lease, rental, license, sale, exchange, or other disposition of computer software. Therefore, L's gross receipts derived from the online banking services are non-DPGR.

Example 2. M is an Internet auction company that produces computer software within the United States that enables its customers to participate in Internet auctions for a fee. Under paragraph (i)(6)(ii) of this section, gross receipts derived from online services are attributable to a service and do not constitute a lease, rental, license, sale, exchange, or other disposition of computer software. M's activities constitute the provision of online services. Therefore, M's gross receipts derived from the Internet auction services are non-DPGR.

Example 3. N provides telephone services, voicemail services, and e-mail services. N produces computer software within the United States that runs all of these services. Under paragraph (i)(6)(ii) of this section, gross receipts derived from telephone and related telecommunication services are attributable to a service and do not constitute a lease, rental, license, sale, exchange, or other disposition of computer software. Therefore, N's gross receipts derived from the telephone and other telecommunication services are non-DPGR.

Example 4. O produces tax preparation computer software within the United States. O derives, on a regular and ongoing basis in its business, gross receipts from both the sale to customers that are unrelated persons of O's computer software that has been affixed to a compact disc as well as from the sale to customers of O's computer software that customers have downloaded from the Internet. O also derives gross receipts from customers from providing the computer software to its customers for the customers' direct use while connected to the Internet. Assume that the computer software sold on compact disc or by download has only minor or immaterial differences from the computer software provided over the Internet, and O does not provide any services in connection with the computer software provided over the Internet. Under paragraph (i)(6)(iii)(A) of this section, O's gross receipts derived from providing its computer software to customers over the Internet will be treated as derived from the lease, rental, license, sale, exchange, or other disposition of computer software and are domestic production gross receipts (DPGR) (as defined in §1.199–3) (assuming all the other requirements of §1.199–3 are met).

Example 5. The facts are the same as in *Example 4*, except that O does not sell the tax preparation computer software to customers affixed to a compact disc or by download and O's only method of providing the tax preparation computer software to customers is over the Internet. P, an unrelated person, derives, on a regular and ongoing basis in its business, gross receipts from the sale to customers of P's substantially identical tax preparation computer software that has been affixed to a compact disc as well as from the sale to customers of P's substantially identical tax preparation computer software that customers have downloaded from the Internet. Under paragraph (i)(6)(iii)(B) of this section, O's gross receipts derived from providing its tax preparation computer software to customers over the Internet will be treated as derived from the lease, rental, license, sale, exchange, or other disposition of computer software and are DPGR (assuming all the other requirements of §1.199–3 are met).

Example 6. P produces payroll management computer software within the United States. For a fee, P provides the payroll management computer software to customers for the customers' direct use while connected to the Internet. This is P's sole method of providing its payroll management computer software to customers. In conjunction with the payroll management computer software, P provides storage of customers' data and telephone support. Q, an unrelated person, derives, on a regular and ongoing basis in its business, gross receipts from the sale to customers of Q's substantially identical payroll management software that has been affixed to a compact disc as well as from the sale to customers of Q's substantially identical payroll management software that customers have downloaded from the Internet. Under paragraph (i)(6)(iii)(B) of this section, P's gross receipts derived from providing its payroll management computer software to customers over the Internet will be treated as derived from the lease, rental, license, sale, exchange, or other disposition of computer software and are DPGR (assuming all the other requirements of §1.199–3 are met). However, P's gross receipts derived from the fees it receives that are properly allocable to the storage of customers' data and telephone support are non-DPGR.

Par. 3. Section 1.199–8T is added to read as follows:

§1.199–8T Other rules (temporary).

(a) through (h) [Reserved]. For further guidance, see §1.199–8(a) through (h).

(i) *Effective dates.* (1) through (3) [Reserved]. For further guidance, see §1.199–8(i)(1) through (3).

(4) *Computer software.* Section 1.199–3T(i)(6)(ii) through (v) are applicable for taxable years beginning on or after June 1, 2006. A taxpayer may apply these temporary regulations to taxable years beginning after December 31, 2004, and before June 1, 2006. The applicability of §1.199–3T(i)(6)(ii) through (v) expires on or before May 22, 2009.

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

Approved May 2, 2006.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 24, 2006, 11:47 a.m., and published in the issue of the Federal Register for June 1, 2006, 71 F.R. 31074)

Section 1502.—Regulations

26 CFR 1.1502–33: Earnings and profits.
26 CFR 1.1502–75: Filing of consolidated returns.
26 CFR 1.1502–76: Taxable year of members of group.

Service eliminates impediments to e-filing consolidated returns and reduces reporting requirements. Rev. Proc. 89–56, 1989–2 C.B. 643, Rev. Proc. 90–39, 1990–2 C.B. 365, and Rev. Proc. 2002–32, 2002–1 C.B. 959 are modified. See Rev. Proc. 2006-21, page 1050.

Section 1504.—Definitions

26 CFR 1.1504–1: Definitions.

Service eliminates impediments to e-filing consolidated returns and reduces reporting requirements. Rev. Proc. 89–56, 1989–2 C.B. 643, Rev. Proc. 90–39, 1990–2 C.B. 365, and Rev. Proc. 2002–32, 2002–1 C.B. 959, are modified. See Rev. Proc. 2006-21, page 1050.

Part III. Administrative, Procedural, and Miscellaneous

Qualified NMWHFIT Exception Extension

Notice 2006–30

PURPOSE

This notice informs taxpayers that § 1.671–5, which provides reporting rules for widely held fixed investment trusts (WHFITs), will be amended to provide that the availability of the Qualified NMWHFIT (non-mortgage widely held fixed investment trust) Exception in § 1.671–5(c)(2)(iv)(E) is extended by 60 days from the date indicated in Notice 2006–29, 2006–12 I.R.B. 644, issued by the IRS and the Treasury Department on February 23, 2006.

BACKGROUND

On January 24, 2006, the IRS and Treasury Department published final regulations under § 1.671–5 (Reporting Requirements for Widely Held Fixed Investment Trusts) in the Federal Register (T.D. 9241, 2006–7 I.R.B. 427 [71 FR 4002]). Following the publication of those final regulations, the IRS and Treasury Department received a number of comments regarding the applicability of those regulations to NMWHFITs. The commentators requested that the IRS and the Treasury Department issue additional guidance to clarify and simplify the application of the final regulations to NMWHFITs. Commentators also requested that the availability of the qualified NMWHFIT exception in § 1.671–5(c)(2)(iv)(E) be extended while the additional guidance was being developed. The qualified NMWHFIT exception, if satisfied, excepts trustees and middlemen from specific reporting requirements in the final regulations regarding market discount, bond premium, sales and dispositions, redemptions, and sales of trust interests. In response, the IRS and Treasury Department issued Notice 2006–29 which, among other things, indicated that the IRS and Treasury Department intended to amend §1.671–5 to extend the availability of the qualified NMWHFIT exception to NMWHFITs created on or after February 23, 2006 which was the cut-off date for qualifying for the exception in the final regulations. Under Notice 2006–29, to satisfy the qualified NMWHFIT exception, a NMWHFIT's registration statement must become effective under the Securities Act of 1933, as amended (15 U.S.C. 77a, *et. seq.*) (Securities Act of 1933) and trust interests must be offered for sale to the public by June 1, 2006 and the NMWHFIT must be fully funded by August 1, 2006.

60 DAY EXTENSION

The IRS and the Treasury Department expect to issue additional guidance under § 1.671–5 in the near future that will include minor modifications to the reporting rules for sales and dispositions in § 1.671–5. Such guidance, however, will not be issued prior to June 1, 2006. Accordingly, the IRS and the Treasury Department are extending the availability of the qualified NMWHFIT exception beyond the date in Notice 2006–29. Specifically, taking into account the extensions indicated in Notice 2006–29 and the extension indicated in this notice, § 1.671–5(c)(2)(iv)(E) will be amended to provide that the qualified NMWHFIT exception is satisfied if the calendar year for which the trustee is reporting begins before January 1, 2011 and: (1) the NMWHFIT has a start-up date (as defined in § 1.671–5(b)(19)) before February 23, 2006; (2) the registration statement of the NMWHFIT becomes effective under the Securities Act of 1933 and trust interests are offered for sale to the public before February 23, 2006; or (3) the registration statement of the NMWHFIT becomes effective under the Securities Act of 1933 and trust interests are offered for sale to the public on or after February 23, 2006 and before July 31, 2006, and the NMWHFIT is fully funded before October 1, 2006.

EFFECTIVE DATE

The effective date for amended § 1.671–5(c)(2)(iv)(E) will be the date of publication of those amendments in the Federal Register. Taxpayers, however, may apply those amendments as though they were included in § 1.671–5 as published in the Federal Register on January 24, 2006.

DRAFTING INFORMATION

The principal author of this notice is Faith P. Colson of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Faith P. Colson at (202) 622–3060 (not a toll-free call).

Announcement of Rules to be Included in Final Regulations Under Sections 897(d) and (e) of the Code

Notice 2006–46

PURPOSE

This notice announces that the Internal Revenue Service (IRS) and the Treasury Department (Treasury) will issue final regulations under sections 897(d) and (e) of the Internal Revenue Code (Code) that set forth and, to the extent described in this notice, revise, the current rules under sections 1.897–5T and 1.897–6T of the temporary income tax regulations and Notice 89–85, 1989–2 C.B. 403, regarding certain transactions involving the transfer of U.S. real property interests (USRPIs), as defined in section 897(c)(1) of the Code. When issued, the regulations will revise the rules of Notice 89–85 and Temp. Treas. Reg. § 1.897–5T(c)(4) relating to inbound asset reorganizations described in section 368(a)(1)(C), (D), or (F) to take into account statutory mergers and consolidations described in section 368(a)(1)(A). The final regulations will also revise the rules of Temp. Treas. Reg. § 1.897–6T(b)(1) to take into account foreign-to-foreign statutory mergers and consolidations described in section 368(a)(1)(A) and to create two additional exceptions that provide a foreign corporation with nonrecognition treatment on its transfer of a USRPI in certain foreign-to-foreign asset reorganizations. Moreover, the final regulations will incorporate a revised version of Temp. Treas. Reg. § 1.897–6T(b)(1)(iii). The final regulations will eliminate all the conditions required for nonrecognition treatment in Temp. Treas. Reg. § 1.897–6T(b)(2).

Finally, the final regulations will modify the period that must be considered for imposing taxes and accrued interest on prior dispositions of the stock of foreign corporations under Temp. Treas. Reg. § 1.897–5T(c)(2), (4), and Treas. Reg. §1.897–3(c)(5), (d).

The portion of the final regulations that will address distributions, transfers, or exchanges occurring in the context of a statutory merger or consolidation described in section 368(a)(1)(A) will generally apply to distributions, transfers, or exchanges occurring on or after January 23, 2006. Final regulations regarding the revisions to Temp. Treas. Reg. §1.897–5T(c)(2), (4), Treas. Reg. §1.897–3(c)(5), (d), and Temp. Treas. Reg. § 1.897–6T(b), except as such regulations are applicable to exchanges in section 368(a)(1)(A) reorganizations, will apply to distributions, transfers, or exchanges occurring on or after May 23, 2006. However, taxpayers may choose to apply these regulatory changes to all dispositions, transfers, or exchanges occurring before May 23, 2006, during any taxable year that is not closed by the period of limitations, provided they do so consistently with respect to all such dispositions, transfers, and exchanges.

BACKGROUND

Under section 897(a), the disposition of a USRPI by a nonresident alien individual or a foreign corporation is taxable as effectively connected income under section 871(b)(1) or section 882(a)(1), respectively, as if the taxpayer were engaged in a trade or business within the United States during the taxable year and the gain or loss were effectively connected with the trade or business.

Section 897(c)(1) generally defines a USRPI to include any interest (other than an interest solely as a creditor) in any domestic corporation, unless the taxpayer establishes that such corporation was not a U.S. real property holding corporation (USRPHC) at any time during the shorter of the period the taxpayer held such interest or the 5-year period ending on the date of the disposition of such interest. Under section 897(c)(2), a USRPHC is defined as any corporation if the fair market value of its USRPIs equals or exceeds 50-percent of the sum of the fair market value of (i) its USRPIs, (ii) its real property interests located outside of the United States, and (iii) any of its other assets used or held for use in a trade or business.

Under section 897(d)(1), except to the extent provided in regulations, gain is recognized by a foreign corporation on the distribution (including a distribution in liquidation or redemption) of a USRPI in a transaction that otherwise qualifies for nonrecognition under the Code. Section 897(d)(2) provides that gain is not recognized under section 897(d)(1) if either: (i) at the time of the receipt of the distributed property, the distributee would be subject to taxation on a subsequent disposition of the distributed property, and the basis of the distributed property in the hands of the distributee is not greater than the adjusted basis of such property before the distribution, increased by the amount of gain (if any) recognized by the distributing corporation; or (ii) nonrecognition treatment is provided for in regulations prescribed by the Secretary under section 897(e)(2). Temp. Treas. Reg. § 1.897–5T provides rules, exceptions, and limitations regarding section 897(d) distributions in the context of sections 332, 355, and 361. See Temp. Treas. Reg. § 1.897–5T(c)(2), (3), and (4). Notice 89–85 announced rules that would revise the application of certain of the exceptions set forth in the temporary regulations. As relevant to the changes announced in this notice, the provisions of those regulations and Notice 89–85 are discussed below.

Subject to the rules of section 897(d) and any regulations issued under section 897(e)(2), section 897(e)(1) provides that any nonrecognition provision will apply only in the case of an exchange of a USRPI for an interest the sale of which would be taxable under Chapter 1 of the Code. Under section 897(e)(2), Treasury has authority to prescribe regulations providing the extent to which nonrecognition provisions shall apply to transfers of USRPIs.

Pursuant to section 897(e)(2), Temp. Treas. Reg. § 1.897–6T(a)(1) states the general rule of section 897(e) and imposes certain requirements for nonrecognition. Among other things, that regulation provides that except as otherwise provided in Temp. Treas. Reg. §§ 1.897–5T and –6T, any nonrecognition provision applies to a transfer by a foreign person of a USRPI on which gain is realized only to the extent that the transferred USRPI is exchanged for a USRPI which, immediately following the exchange, would be subject to U.S. taxation upon its disposition, and the transferor complies with the filing requirements of Temp. Treas. Reg. § 1.897–5T(d)(1)(iii). Temp. Treas. Reg. § 1.897–6T(b) provides exceptions to this rule for certain exchanges in foreign-to-foreign nonrecognition transactions. The exceptions described in Temp. Treas. Reg. § 1.897–6T(b) are discussed below in the context of the changes announced by this notice to such provisions.

The IRS and Treasury issued final regulations on January 23, 2006, concerning statutory mergers and consolidations described in section 368(a)(1)(A). See T.D. 9242, 2006–7 I.R.B. 422 (February 13, 2006). Treasury Decision 9242 provides a revised definition of the term "statutory merger or consolidation" that permits transactions effected pursuant to the statutes of a foreign jurisdiction or of a United States possession to qualify as a statutory merger or consolidation. Further, that regulation generally applies to transactions occurring on or after January 23, 2006. Prior to the issuance of T.D. 9242, temporary regulations defined a statutory merger or consolidation as including only transactions effected pursuant to the laws of the United States or a State or the District of Columbia.

DISCUSSION

The IRS and Treasury have determined that the rules of Notice 89–85 and Temp. Treas. Reg. §§ 1.897–5T(c) and 1.897–6T(b) should be revised to reflect the recently issued regulations under section 368(a)(1)(A). This action is necessary because Notice 89–85 and the temporary regulations did not contemplate statutory mergers or consolidations under foreign or possessions law as qualifying under section 368(a)(1)(A). In addition, the IRS and Treasury believe that certain other changes to the scope of the rules under Treas. Reg. § 1.897–3 and Temp. Treas. Reg. §§ 1.897–5T and –6T are appropriate. Accordingly, this notice announces that the IRS and Treasury will issue final regulations under sections 897(d), (e), and (i) that generally incorporate the rules of Treas. Reg. § 1.897–3 and Temp. Treas. Reg. §§ 1.897–5T and –6T, and Notice 89–85, except as described below.

1. *Revision to the rules of Temp. Treas. Reg. § 1.897–5T(c)(4) relating to inbound asset reorganizations*

Temp. Treas. Reg. § 1.897–5T(c)(4) applies the rules of section 897(d) to certain distributions of stock of a USRPHC by a foreign corporation under section 361(c). Under the temporary regulations, a foreign corporation that transfers property to a domestic corporation (that is a USRPHC immediately after the transfer) in an exchange under section 361(a) or (b) pursuant to a reorganization under section 368(a)(1)(C), (D), or (F) must recognize gain under section 897(d)(1) and Temp. Treas. Reg. § 1.897–5T(c)(4)(i) when it distributes the stock of the USRPHC to its shareholders under section 361(c). Temp. Treas. Reg. § 1.897–5T(c)(4)(ii) and (iii) provide an exception and a limitation to this gain recognition.

In Notice 89–85, the IRS and Treasury announced that the exception and the limitation set forth in Temp. Treas. Reg. § 1.897–5T(c)(4)(ii) and (iii) would be replaced by a new exception. The new exception announced in Notice 89–85 provides that recognition of gain will not be required on the distribution under section 361(c)(1) of the stock of the USRPHC under Temp. Treas. Reg. § 1.897–5T(c)(4)(i) if the foreign corporation pays an amount equal to any taxes that section 897 would have imposed upon all persons who had disposed of interests in the transferor foreign corporation (or a corporation from which such assets were acquired in a transaction described in section 381) after June 18, 1980, as if it were a domestic corporation on the date of each such disposition, and if the conditions of Temp. Treas. Reg. § 1.897–5T(c)(4)(ii)(A) and (C) (relating to the distributee being subject to tax on a subsequent disposition and certain filing requirements) are met. Other requirements relating to the time and manner of payment of tax and interest are also set forth in the notice. The revisions announced in Notice 89–85 generally apply to all distributions of stock under Temp. Treas. Reg. § 1.897–5T(c)(4) occurring after July 31, 1989.

The IRS and Treasury have determined that when final regulations are issued, inbound statutory mergers and consolidations described in section 368(a)(1)(A) (including such reorganizations by reason of 368(a)(2)(D) or (E)) will be subject to the same rules set forth in Temp. Treas. Reg. § 1.897–5T(c)(4) and Notice 89–85 that apply to other inbound asset reorganizations. Further, as described in part 2, below, the period that a foreign corporation must consider with respect to prior stock dispositions under Temp. Treas. Reg. § 1.897–5T(c)(4) will be revised.

2. *Revisions to the Notice 89–95 stock disposition look-back period applicable to Temp. Treas. Reg. § 1.897–5T(c)(2)(ii) liquidations, Temp. Treas. Reg. § 1.897–5T(c)(4) inbound asset reorganizations, and section 897(i) elections*.

Section 1.897–5T(c)(2) of the temporary regulations applies the rules of section 897(d) to liquidating distributions of USRPIs by a foreign corporation to a domestic corporation pursuant to section 332(a). Under Temp. Treas. Reg. § 1.897–5T(c)(1), a foreign corporation that makes a liquidating distribution of a USRPI to a foreign or domestic shareholder must recognize gain on the distribution under section 897(d), unless the distribution comes within an exception described in Temp. Treas. Reg. § 1.897–5T(c)(2), (3), or (4). Temp. Treas. Reg. § 1.897–5T(c)(2)(i) and (ii) provide exceptions to this recognition rule that are applicable to liquidating distributions under section 332(a).

In Notice 89–85, the IRS and Treasury announced that the exceptions set forth in Temp. Treas. Reg. § 1.897–5T(c)(2)(i) and (ii) would be replaced by a new exception. The new exception announced in Notice 89–85 provides that recognition of gain shall not be required on the liquidating distribution of a USRPI by a foreign corporation to a domestic corporation meeting the stock ownership requirements of section 332(b) in a section 332(a) liquidation if the distributing foreign corporation pays the tax and interest on any prior disposition of its stock (or stock of a corporation from which such assets were acquired in a transaction described in section 381) after June 18, 1980, as if it were a domestic corporation on the date of such dispositions, and if the conditions of Temp. Treas. Reg. § 1.897–5T(c)(2)(i) are met (relating to the distributee being subject to tax on a subsequent disposition and certain basis carryover and filing requirements). The revisions announced in Notice 89–85 generally apply to all distributions of stock under Temp. Treas. Reg. § 1.897–5T(c)(2) occurring after July 31, 1989. Similarly, as described in part 1 of this notice, above, Notice 89–85 revised the look-back period applicable to inbound reorganizations under Temp. Treas. Reg. § 1.897–5T(c)(4) to encompass certain dispositions of the stock of the foreign corporation that occur after June 18, 1980. The rules of Notice 89–85 also require the payment of interest, as determined under section 6621, that would have accrued had tax actually been due with respect to the prior stock dispositions.

Further, section 897(i), which permits a foreign corporation to elect to be treated as a domestic corporation for purposes of section 897, requires as a condition to making the election that the electing foreign corporation verify that no interest in the corporation was disposed of during the shorter of: (1) the period from June 19, 1980 through the date of the election, (2) the period from the date on which the corporation first holds a USPRI through the date of the election, or (3) the five year period ending on the date of the election. *See* Treas. Reg. § 1.897–3(c)(5). If the foreign corporation cannot make such verification, then it must comply with the conditions of Treas. Reg. § 1.897–3(d) which, among other things, requires the payment of an amount equal to any taxes that section 897 would have imposed on all persons who had disposed of interests in the corporation during such period. The payment must also include any interest, as determined under section 6621, that would have accrued had the tax actually been due with respect to the dispositions. These rules were modified by Notice 89–85 to require the reporting and payment of tax and accrued interest on all dispositions of stock occurring after June 18, 1980 that would have been subject to taxation under section 897(a).

The IRS and Treasury have determined that when final regulations are issued, the look-back, tax, and interest payment periods applicable under Notice 89–85 to Temp. Treas. Reg. § 1.897–5T(c)(2) liquidating distributions, Temp. Treas. Reg. § 1.897–5T(c)(4) inbound asset reorganizations, and section 897(i) elections will be modified as described below.

Regarding distributions of USRPIs by a foreign corporation to a domestic corporation in a section 332 liquidation, the final regulations will amend the rules of Temp. Treas. Reg. § 1.897–5T(c)(2)(ii) and Notice 89–85 to provide that recognition of gain will not be required on the distribution of any USRPI by the distributing foreign corporation to the domestic corporation if the distributing foreign corporation pays an amount equal to the tax and interest that would have been imposed upon all persons who disposed of an interest in the foreign corporation (or a corporation from which such assets were acquired in a transaction described in section 381) during the period beginning on the date that is 10 years prior to the date on which the domestic corporation or any related person (within the meaning of section 267(b)) is in control (as determined under section 304(c)) of the liquidating foreign corporation, and ending on the date of the liquidation, as if the foreign corporation were a domestic corporation on the date of each such disposition and if the conditions of Temp. Treas. Reg. § 1.897–5T(c)(2)(i) are met.

Regarding inbound asset acquisitions described in Temp. Treas. Reg. § 1.897–5T(c)(4) as modified by this notice, the final regulations will amend the rules of Temp. Treas. Reg. § 1.897–5T(c)(4)(ii) and Notice 89–85 to provide that recognition of gain will not be required on the distribution of stock of a USRPHC if the foreign corporation pays an amount equal to any taxes and interest that would have been imposed upon all persons who disposed of an interest in the foreign corporation (or a corporation from which the assets were acquired in a transaction described in section 381) during the applicable period as if the foreign corporation were a domestic corporation on the date of each such disposition, and the conditions of Temp. Treas. § 1.897–5T(c)(4)(ii)(A) and (C) are met. The applicable period means the earliest of either:

- The period beginning on the date that is 10 years prior to the date on which the acquiring domestic corporation or a related person (within the meaning of section 267(b)) is in control (as determined under section 304(c)) of the foreign corporation and ending on the date of the reorganization. For purposes of the preceding sentence, the acquiring domestic corporation means the domestic corporation that is the transferee in the 361(a) exchange; or

- The period beginning on the date that is 10 years prior to the date of the reorganization and ending on the date of the reorganization.

Regarding the revisions to Treas. Reg. §1.897–3(c)(5), and (d) pertaining to a foreign corporation's election under section 897(i), the final regulations will provide that the applicable period will be the earliest of either:

- The period beginning on the date that is 10 years prior to the date on which one or more domestic shareholders or related persons (within the meaning of section 267(b)) are in control (as determined under section 304(c)) of the foreign corporation and ending on the date of the election; or

- The period beginning on the date that is 10 years prior to the date of the section 897(i) election and ending on the date of the election.

3. *Revisions to the rules of Temp. Treas. Reg. § 1.897–6T*

(a) *Revision to the rules of Temp. Treas. Reg. § 1.897–6T(b)(1)(ii) to take into account statutory mergers and consolidations described in section 368(a)(1)(A)*

As noted above, Temp. Treas. Reg. § 1.897–6T(a)(1) generally provides that any nonrecognition provision shall apply to a transfer by a foreign person of a USRPI only to the extent that the foreign person receives a USRPI in such exchange. Pursuant to the regulatory authority under section 897(e)(2) of the Code, Temp. Treas. Reg. § 1.897–6T(b)(1) and (2) provide exceptions to the rule of Temp. Treas. Reg. § 1.897–6T(a)(1) for certain foreign-to-foreign reorganizations and certain exchanges under section 351 where a foreign person transfers a USRPI for stock in a foreign corporation. These exceptions require that (1) the transferee's subsequent disposition of the transferred USRPI be subject to U.S. income taxation in accordance with Temp. Treas. Reg. § 1.897–5T(d)(1); (2) the filing requirements of Temp. Treas. Reg. § 1.897–5T(d)(1)(iii) be satisfied; (3) one of the five conditions set forth in paragraph (b)(2) exists; and (4) the exchange takes one of the three forms of exchange described in paragraph (b)(1).

Temp. Treas. Reg. § 1.897–6T(b)(1)(ii) describes one of the three permissible forms of exchange referenced above. That paragraph describes an exchange by a foreign corporation pursuant to section 361(a) or (b) in a reorganization described in section 368(a)(1)(C), where there is an exchange of the transferor corporation stock for the transferee corporation stock (or stock of the transferee corporation's parent in the case of a parenthetical C reorganization) under section 354(a), and the transferor corporation's shareholders own more than fifty percent of the voting stock of the transferee corporation (or stock of the transferee corporation's parent in the case of a parenthetical C reorganization) immediately after the reorganization. The fifty percent limitation restricts this exception to reorganizations described in section 368(a)(1)(C) that are restructurings where the transferor corporation shareholders control the transferee corporation after the transaction (*e.g.*, internal restructurings).

The IRS and Treasury have determined that when final regulations are issued, foreign-to-foreign statutory mergers and consolidations described in section 368(a)(1)(A) (including such reorganizations by reason of section 368(a)(2)(D) or (E)) will be subject to the same rules set forth in Temp. Treas. Reg. § 1.897–6T(b)(1)(ii) that apply to foreign-to-foreign reorganizations described in section 368(a)(1)(C) (including parenthetical C reorganizations). The exception for statutory mergers and consolidations described in section 368(a)(1)(A) will be limited to restructurings where the 50 percent control requirement is satisfied after the transaction. Further, the final regulations will provide that in determining whether the fifty percent requirement set forth in Temp. Treas. Reg. § 1.897–6T(b)(1)(ii) is met where the transferee corporation owns more than fifty percent of the transferor corporation before a reorganization under section 368(a)(1)(A) or 368(a)(1)(C) (*i.e.*, an upstream reorganization), the shareholders of the transferee corporation before the reorganization (that continue to be

shareholders of the transferee corporation after the reorganization) will be treated as shareholders of the transferor corporation before the reorganization to the extent of their indirect interest in the stock of the transferor corporation (owned by the transferee corporation) before the reorganization.

Accordingly, when issued, the final regulations will provide that gain shall not be recognized where an exchange is made by a foreign corporation pursuant to section 361(a) or (b) in a reorganization described in section 368(a)(1)(A) (including such reorganization by reason of section 368(a)(2)(D) or (E)); there is an exchange of the transferor corporation stock for the transferee corporation stock (or the stock of the transferee corporation's parent in the case of a reorganization by reason of section 368(a)(2)(D)) under section 354(a); immediately after the reorganization, the transferor corporation's shareholders own more than fifty percent of the voting stock of the transferee corporation (or the transferee corporation's parent in a reorganization by reason of section 368(a)(2)(D)), or in the case of a reorganization by reason of section 368(a)(2)(E), the shareholders of the corporation that controls the transferor corporation before the reorganization own more than fifty percent of the voting stock of that controlling corporation after the reorganization; and the other requirements of Temp. Treas. Reg. § 1.897–6T(b)(1) are satisfied.

(b) *Additional exceptions to be added to the rules of Temp. Treas. Reg. § 1.897–6T(b)(1)*

The IRS and Treasury have determined that when final regulations are issued, the rules of Temp. Treas. Reg. § 1.897–6T(b)(1) will be expanded to include two additional exceptions. Those exceptions will apply only in certain foreign-to-foreign statutory mergers and consolidations described in section 368(a)(1)(A) (including such reorganizations by reason of section 368(a)(2)(D) or (E)) and foreign-to-foreign reorganizations described in section 368(a)(1)(C) (including parenthetical C reorganizations). Accordingly, the new exceptions to be incorporated in the final regulations will revise the rules of Temp. Treas. Reg. § 1.897–6T(b)(1) to provide that such foreign-to-foreign reorganizations will be excepted from the general gain recognition rule of Temp. Treas. Reg. § 1.897–6T(a)(1) provided that the other requirements set forth in Temp. Treas. Reg. § 1.897–6T(b)(1) are met. The two additional exceptions apply where an exchange is made by a foreign corporation pursuant to section 361(a) or (b) in a reorganization described in section 368(a)(1)(A) (including a reorganization by reason of section 368(a)(2)(D) or (E)) or section 368(a)(1)(C) (including parenthetical C reorganizations); there is an exchange of the transferor corporation stock for the transferee corporation stock (or the transferee corporation's parent in the case of a reorganization by reason of section 368(a)(2)(D) or a parenthetical C reorganization) under section 354(a); and either:

- Stock in the transferor corporation (including a predecessor corporation in a transaction described in section 381(a)) would not be a USRPI at any time within the five year period ending on the date of the reorganization if the transferor corporation were a domestic corporation; or

- Regarding reorganizations under section 368(a)(1)(A) (other than by reason of section 368(a)(2)(D) or (E)) or section 368(a)(1)(C) (other than parenthetical reorganizations described in that section): prior to the exchange the stock of the transferor corporation and the stock of the transferee corporation, and after the exchange the stock of the transferee corporation are regularly traded under Treas. Reg. § 1.897–1(n) and Temp. Treas. Reg. § 1.897–9T(d)(1) and (2) on an established securities market under § 1.897–1(m), and in the case where the transferor corporation would have been a USRPHC at any time within the five year period ending on the date of the reorganization if the transferor corporation had been a domestic corporation, no foreign shareholder of the transferor corporation owned a more than five percent interest in the transferor corporation at such time under the rules of Treas. Reg. § 1.897–1(c)(2)(iii) and Temp. Treas. Reg. § 1.897–9T.

Regarding parenthetical C reorganizations and reorganizations under section 368(a)(1)(A) by reason of section 368(a)(2)(D): prior to the exchange the stock of the transferor corporation and the stock of the corporation in control of the transferee corporation, and after the exchange the stock of the corporation in control of the transferee corporation are regularly traded under Treas. Reg. § 1.897–1(n) and Temp. Treas. Reg. § 1.897–9T(d)(1) and (2) on an established securities market under § 1.897–1(m), and in the case where the transferor corporation would have been a USRPHC at any time within the five year period ending on the date of the reorganization if the transferor corporation had been a domestic corporation, no foreign shareholder of the transferor corporation owned a more than five percent interest in the transferor corporation at such time under the rules of Treas. Reg. § 1.897–1(c)(2)(iii) and Temp. Treas. Reg. § 1.897–9T.

Regarding reorganizations under section 368(a)(1)(A) by reason of section 368(a)(2)(E): prior to the exchange the stock of the transferee corporation and the stock of the corporation in control of the transferor corporation, and after the exchange the stock of the corporation that controls the transferee corporation are regularly traded under Treas. Reg. § 1.897–1(n) and Temp. Treas. Reg. § 1.897–9T(d)(1) and (2) on an established securities market under § 1.897–1(m), and in the case where the transferor corporation or the corporation in control of the transferor corporation would have been a USRPHC at any time within the five year period ending on the date of the reorganization if either corporation had been a domestic corporation, no foreign shareholder of the corporation in control of transferor corporation owned a more than five percent interest in the transferor corporation at such time under the rules of Treas. Reg. § 1.897–1(c)(2)(iii) and Temp. Treas. Reg. § 1.897–9T.

(c) *Revision to the rules of Temp. Treas. Reg. § 1.897–6T(b)(1)(iii) relating to foreign-to-foreign section 351 transactions and section 368(a)(1)(B) reorganizations*

As discussed above, Temp. Treas. Reg. § 1.897–6T(b)(1) contains exceptions to the general rule provided in Temp. Treas. Reg. § 1.897–6T(a)(1) if one of three forms of exchange occurs and certain other

requirements are met. Specifically, Temp. Treas. Reg. § 1.897–6T(b)(1)(iii) provides a foreign person with nonrecognition treatment if the foreign person exchanges stock in a USRPHC under section 351(a) or section 354(a) in a reorganization described in section 368(a)(1)(B), and, immediately after the exchange, all of the outstanding stock of the transferee corporation (or the stock of the transferee corporation's parent in the case of a parenthetical B reorganization) is owned in the same proportions by the same nonresident alien individuals and foreign corporations that immediately before the exchange owned the stock of the USRPHC. However, if any of the stock in the foreign corporation received by the individual or corporate transferor in the exchange is disposed of within three years from the date of its receipt, then the transferor must recognize that portion of the realized gain with respect to the stock of the USRPHC for which the foreign stock disposed of was received.

The IRS and Treasury have determined that the final regulations will revise Temp. Treas. Reg. § 1.897–6T(b)(1)(iii) in two respects. First, the exception will be revised so that "all of the stock of the transferee corporation" is removed and replaced with "substantially all of the outstanding stock of the transferee corporation" and the words "in the same proportions" will be removed. Second, the three year period will be revised to one year.

(d) *Removal of the conditions set forth in Temp. Treas. Reg. § 1.897–6T(b)(2)*

As discussed above, to come within an exception to Temp. Treas. Reg. § 1.897–6T(a)(1), not only must an exchange be described in Temp. Treas. Reg. § 1.897–6T(b)(1), but it must also satisfy one of the five conditions set forth in Temp. Treas. Reg. § 1.897–6T(b)(2). The IRS and Treasury have determined that the conditions of Temp. Treas. Reg. § 1.897–6T(b)(2) are no longer necessary. Accordingly, the final regulations will eliminate the conditions of Temp. Treas. Reg. § 1.897–6T(b)(2).

COMMENTS

Written comments on issues addressed in this notice may be submitted to the Office of Associate Chief Counsel International, Attention: Margaret Hogan (Notice 2006–46), room 4567, CC:INTL:B04, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to *Notice.Comments@m1.irscounsel.treas.gov* Comments will be available for public inspection and copying.

EFFECTIVE DATE

Final regulations to be issued incorporating the guidance set forth in this notice regarding exchanges occurring in the context of a statutory merger or consolidation described in section 368(a)(1)(A) will generally apply to distributions, transfers, or exchanges occurring on or after January 23, 2006. Final regulations regarding the revisions to Temp. Treas. Reg. §§ 1.897–5T(c)(2), (4), Treas. Reg. §1.897–3(c)(5), (d), and Temp. Treas. Reg. § 1.897–6T(b), except as applicable to section 368(a)(1)(A) transactions, will apply to distributions, transfers, or exchanges occurring on or after May 23, 2006. However, taxpayers may choose to apply these regulatory changes to all dispositions, transfers, or exchanges occurring before May 23, 2006 during any taxable year that is not closed by the period of limitations, provided they do so consistently with respect to all dispositions, transfers, and exchanges.

Prior to the issuance of the final regulations, taxpayers may rely on the guidance contained in this notice. Taxpayers applying this notice, however, must do so consistently with respect to all transactions within its scope.

PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545–2017. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The rules of this notice will apply to a foreign corporation distributing stock of a USRPHC to its shareholders pursuant to an inbound asset reorganization or a foreign corporation transferring a USRPI to another foreign corporation pursuant to an asset reorganization and will require such foreign corporations to satisfy the filing requirements of Temp. Treas. Reg. § 1.897–5T(d)(1)(iii), as modified by Notice 89–57, 1989–1 C.B. 698. The specific collections of information are contained in Temp. Treas. Reg. §§ 1.897–5T(c)(4)(ii)(C) and 1.897–6T(b)(1). These filing requirements notify the IRS of the transfer and enable it to verify that the transferor qualifies for nonrecognition and the transferee will be subject to U.S. tax on a subsequent disposition of the USRPI. Generally, they may be satisfied by: (1) filing the information statement required by Temp. Treas. Reg. § 1.897–5T(d)(1)(iii); (2) filing a notice of nonrecognition to the IRS in accordance with the provisions of Treas. Reg. § 1.1445–2(d)(2); or (3) filing a withholding certificate in accordance with the requirements of Treas. Reg. § 1.1445–3. The collections of information are required in order to obtain the benefit of the nonrecognition provisions. The likely respondents are businesses.

The estimated total annual reporting and/or recordkeeping burden is 500 hours. The estimated annual burden hour per respondent and/or recordkeeper is 1 hour. The estimated number of respondents and/or recordkeepers is 500. The estimated frequency of response is occasional.

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

EFFECT ON OTHER DOCUMENTS

Notice 89–85, 1989–2 C.B. 403 is amplified.

DRAFTING INFORMATION

The principal author of this notice is Margaret A. Hogan of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Ms. Hogan at (202) 622–3860 (not a toll-free call).

26 CFR 601.201: Ruling and determination letters. (Also Part I, §§ 1502, 1504; 1.1502–33, 1.1502–75, 1.1502–76, 1.1504–1.)

Rev. Proc. 2006–21

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 89–56, 1989–2 C.B. 643, Rev. Proc. 90–39, 1990–2 C.B. 365, and Rev. Proc. 2002–32, 2002–1 C.B. 959, to eliminate impediments to the electronic filing of Federal income tax returns (e-filing) and to reduce the reporting requirements in each of these revenue procedures.

SECTION 2. BACKGROUND

.01 Rev. Proc. 89–56, Rev. Proc. 90–39, and Rev. Proc. 2002–32 each provide a means for a consolidated group to obtain a specified consent or waiver from the Commissioner without requesting a private letter ruling. The revenue procedures each provide that, in order to obtain the subject consent or waiver, a statement containing specified information must be included on or with the group's return. The Internal Revenue Service has concluded that the amount of information required to be included in these statements is greater than is necessary to facilitate the administration of the tax law. Moreover, each of these statements presents an impediment to e-filing.

.02 Rev. Proc. 89–56 provides a means for a consolidated group to obtain the Commissioner's consent to file a consolidated Federal income tax return in which one or more members of the group use a 52–53 week tax year. Section 3.01 of the revenue procedure sets forth the information and representations that must be provided in a statement included on or with the group's return in order to obtain the consent. Section 3.02 requires the statement to be signed under penalties of perjury by a duly authorized officer of the common parent.

.03 Rev. Proc. 90–39 provides a means for a consolidated group to obtain the Commissioner's consent to elect or change its method of allocating the consolidated Federal income tax liability to its members for purposes of determining the earnings and profits of each member. Section 4.01 of the revenue procedure sets forth the information and representations that must be provided in a statement included on or with the group's return in order to obtain the consent. Section 4.02 requires the statement to be signed under penalties of perjury by a duly authorized officer of the common parent.

.04 Rev. Proc 2002–32 provides a means for a consolidated group to obtain the Commissioner's waiver of the prohibition against including a previously disaffiliated corporation in the group's return during the sixty-month period following the disaffiliation. See § 1504(a)(3)(A) of the Internal Revenue Code. Paragraphs 5.01 through 5.14 of the revenue procedure set forth the information and representations that must be provided in a statement included on or with the group's return in order to obtain the consent. In the unnumbered paragraph following the heading, Section 5 requires the statement to be filed under penalties of perjury.

SECTION 3. SCOPE

This revenue procedure applies to any taxpayer that applies for a consent or waiver under the provisions of Rev. Proc. 89–56, Rev. Proc. 90–39, or Rev. Proc. 2002–32.

SECTION 4. APPLICATION

.01 To remove e-filing impediments, this revenue procedure eliminates the signature requirement of each of Rev. Proc. 89–56, Rev. Proc. 90–39, and Rev. Proc. 2002–32. Thus, the following provisions of these revenue procedures are deleted: section 3.02 of Rev. Proc. 89–56, section 4.02 of Rev. Proc. 90–39, and the clause, "filed under penalties of perjury," in the second sentence in the unnumbered paragraph following the heading of Section 5 of Rev. Proc. 2002–32.

.02 To reduce the reporting requirements of Rev. Proc. 89–56, this revenue procedure permits a consolidated group to obtain consent under that revenue procedure by including the following statement on or with its return in lieu of the statement described in section 3.01 of Rev. Proc. 89–56: "THIS IS A REQUEST UNDER REV. PROC. 89–56 TO USE A 52–53 WEEK TAX YEAR. THE GROUP HAS COMPLIED, AND WILL CONTINUE TO COMPLY, WITH THE CONDITIONS SET FORTH IN SECTION 3.01 OF REV. PROC. 89–56."

.03 To reduce the reporting requirements of Rev. Proc. 90–39, this revenue procedure permits a consolidated group to obtain consent under that revenue procedure by including the following statement on or with its return in lieu of the statement described in section 4.01 of Rev. Proc. 90–39: "THIS IS A REQUEST UNDER REV. PROC. 90–39 TO ELECT OR CHANGE THE METHOD OF ALLOCATING CONSOLIDATED FEDERAL INCOME TAX LIABILITY FOR PURPOSES OF DETERMINING MEMBERS' EARNINGS AND PROFITS. THE GROUP HAS COMPLIED, AND WILL CONTINUE TO COMPLY, WITH THE CONDITIONS SET FORTH IN SECTION 4.01 OF REV. PROC. 90–39."

.04 To reduce the reporting requirements of Rev. Proc. 2002–32, this revenue procedure permits a consolidated group to obtain a waiver under that revenue procedure by including the following statement on or with its return in lieu of the statement described in section 5 of Rev. Proc. 2002–32: "THIS IS A REQUEST UNDER REV. PROC. 2002–32 FOR A WAIVER OF SECTION 1504(a)(3)(A) FOR [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF SUBSIDIARY]. THE GROUP HAS COMPLIED, AND WILL CONTINUE TO COMPLY, WITH THE CONDITIONS SET FORTH IN SECTIONS 5.01 THROUGH 5.14 OF REV. PROC. 2002–32."

.05 Although paragraphs 4.02, 4.03, and 4.04 of this revenue procedure reduce the amount of information that a taxpayer is required to include on or with its return, the taxpayer's recordkeeping requirement remains unchanged. Taxpayers should maintain records to establish the information described in Rev. Proc. 89–56 (Sec. 3.01), Rev. Proc. 90–39 (Sec. 4.01), and 2002–32 (Secs. 5.01 through 5.14) in order to substantiate their reporting positions. See § 1.6001–1(e) of the Procedure and Administration Regulations.

SECTION 5. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 89–56, Rev. Proc. 90–39, and Rev. Proc 2002–32 are modified. The IRS and Treasury Department intend to

modify Rev. Proc. 89–56 and Rev. Proc. 90–39 to reflect revisions to §§ 1.1502–13 and 1.1502–33 of the Income Tax Regulations. Until these revenue procedures are so modified, taxpayers should continue to apply the provisions of both revenue procedures in a manner that reflects the approach in the applicable regulations.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective on May 26, 2006. However, taxpayers may rely on this revenue procedure for prior taxable years.

SECTION 7. PAPERWORK REDUCTION ACT

The collections of information in this revenue procedure have been previously reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1784.

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

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

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Grid R. Glyer of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue procedure, contact Grid R. Glyer at (202) 622–7930 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Expenses for Household and Dependent Care Services Necessary for Gainful Employment

REG–139059–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the credit for expenses for household and dependent care services necessary for gainful employment. The proposed regulations reflect statutory amendments under the Deficit Reduction Act of 1984, the Omnibus Budget Reconciliation Act of 1987, the Family Support Act of 1988, the Small Business Job Protection Act of 1996, the Economic Growth and Tax Relief Reconciliation Act of 2001, the Job Creation and Worker Assistance Act of 2002, and the Working Families Tax Relief Act of 2004. The proposed regulations affect taxpayers who claim the credit for household and dependent care services and dependent care providers.

DATES: Written or electronic comments must be received by August 22, 2006.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–139059–02), 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–139059–02), 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 *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS and REG–139059–02).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Sara Shepherd, (202) 622–4960; concerning submissions of comments or a request for a public hearing, Richard Hurst, *Richard.A.Hurst@irscounsel.treas.gov*, or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations, 26 CFR part 1, relating to the credit for household and dependent care services necessary for gainful employment (the credit) under section 21 of the Internal Revenue Code (Code).

The credit was originally enacted as section 44A. Final regulations under section 44A were published as §§1.44A–1 through 1.44A–4 on August 27, 1979 (section 44A regulations). Section 44A was amended and renumbered section 21 by sections 423 and 471, respectively, of the Deficit Reduction Act of 1984 (Public Law 98–369, 98 Stat. 494). Section 21 was amended by section 10101 of the Omnibus Budget Reconciliation Act of 1987 (Public Law 100–203, 101 Stat. 1330), section 703 of the Family Support Act of 1988 (Public Law 100–485, 102 Stat. 2343), section 1615 of the Small Business Job Protection Act of 1996 (Public Law 104–188, 110 Stat. 1755), section 204 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107–16, 115 Stat. 38), section 418 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107–147, 116 Stat. 21), and sections 203 and 207 of the Working Families Tax Relief Act of 2004 (Public Law 108–311, 118 Stat. 1166), as well as other legislation that enacted clerical and conforming changes.

Section 21 allows a nonrefundable credit for a percentage of expenses for household and dependent care services necessary for gainful employment. For taxable years beginning after December 31, 2004, the credit is available to a taxpayer if there are one or more qualifying individuals with respect to that taxpayer. For those years, a *qualifying individual* is defined in section 21(b)(1) as the taxpayer's dependent (as defined in section 152(a)(1)) who has not attained age 13, the taxpayer's dependent who is physically or mentally incapable of self-care and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year, or the taxpayer's spouse who is physically or mentally incapable of self-care and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year.

For taxable years beginning before January 1, 2005, the credit is available to taxpayers who maintained households that include one or more qualifying individuals. For those years, a *qualifying individual* is defined in section 21(b)(1) as the taxpayer's dependent (as defined in section 151(c) as then in effect) under age 13, the taxpayer's dependent who is physically or mentally incapable of self-care, or the taxpayer's spouse who is physically or mentally incapable of self-care.

Under section 21(a), the amount of the credit is equal to the applicable percentage of employment-related expenses paid by the taxpayer during the taxable year. The applicable percentage ranges from 20 percent to 35 percent depending on the taxpayer's adjusted gross income. Section 21(c) limits the amount of employment-related expenses that may be taken into account in determining the credit in any taxable year to $2,400 if there is one qualifying individual and $4,800 if there are two or more qualifying individuals. These amounts are increased, respectively, to $3,000 and $6,000 in taxable years beginning after December 31, 2002, and before January 1, 2011.

Section 21(d) further limits the amount of employment-related expenses that may be taken into account in determining the credit to the lesser of the earned income of the taxpayer or the taxpayer's spouse (if any). The earned income for each month in which a taxpayer's spouse is a full-time student or incapable of self-care is deemed to be $200 (for one qualifying individual) or $400 (for two or more qualifying individuals), increased to $250 and $500 for taxable years beginning after December 31, 2002, and before January 1, 2011.

Section 21(b)(2) defines employment-related expenses as amounts paid

for household services and expenses for the care of a qualifying individual that enable the taxpayer to be gainfully employed for any period for which there are one or more qualifying individuals with respect to the taxpayer.

Explanation of Provisions

1. *Overview*

The proposed regulations incorporate many of the rules in the section 44A regulations, but are renumbered, restructured, and revised to improve clarity. The proposed regulations reflect statutory amendments enacted since publication of the section 44A regulations. Accordingly, the proposed regulations include a change in the definition of a qualifying individual, a reduction in the maximum age of a qualifying child from under 15 to under 13, and an increase in the maximum amount of creditable expenses and the monthly amount of deemed earned income of a spouse who is a full-time student or incapable of self-care for taxable years beginning after December 31, 2002, and before January 1, 2011. The proposed regulations provide additional rules that address significant issues that have arisen administratively since publication of the section 44A regulations and expand the number of examples. The substantive revisions, additions, and significant clarifications to the section 44A regulations are described below.

2. *Taxable Year of Credit*

Section 21 refers interchangeably to expenses "paid" by the taxpayer and expenses "incurred" by the taxpayer. Section 1.44A–1(a)(3) reconciles this use of various tax accounting terms by providing that, regardless of the taxpayer's method of accounting, the credit is allowable only for expenses both "paid" during the taxable year and "incurred" during the taxable year or an earlier taxable year. The proposed regulations restate this rule in plain language and provide that the credit is allowable only in the taxable year in which the services are provided or the taxable year in which the expenses are paid, whichever is later, regardless of the taxpayer's method of accounting.

3. *Special Rule for Children of Separated or Divorced Parents*

Section 21(e)(5) provides that, in the case of a child of divorced or separated parents, only the custodial parent may claim the credit, regardless of whether the noncustodial parent may claim the dependency exemption under section 152(e). The proposed regulations define *custodial parent* consistently with section 152(e)(3)(A) as the parent with whom the child shares the same principal place of abode for the greater portion of the calendar year.

4. *Employment-Related Expenses*

Under section 21(b)(2)(A), expenses are employment-related only if (1) the expenses are primarily for household services or for the care of a qualifying individual, and (2) the taxpayer's purpose in obtaining the services is to enable the taxpayer to be gainfully employed.

a. *Nature of the services provided*

(1) Expenses for nursery school and kindergarten

The section 44A regulations provide that expenses are primarily for the care of a qualifying individual if the primary nature of the services is to ensure the qualifying individual's well-being and protection. Amounts paid for food, lodging, clothing, or education are not for the care of a qualifying individual. However, if these services are incidental to and inseparably a part of the care of a qualifying individual, the entire amount of the expense is deemed to be for care. Section 1.44A–1(c)(3)(i).

Section 1.44A–1(c)(3)(i) provides an example that concludes that the full amount paid to a nursery school is for the care of a qualifying child even though the school furnishes lunch and educational services. Although intended to illustrate the incidental services rule, the example assumes that expenses for nursery school are for care. Section 1.44A–1(c)(3)(i) also provides that expenses for education in the first or higher grade are not for the care of a qualifying individual. The section 44A regulations do not address expenses for kindergarten.

The proposed regulations provide the rule that the expenses of pre-school or similar programs below the kindergarten level are for care and may be employment-related expenses, if otherwise qualified, although education may be a significant part of these programs. The proposed regulations clarify the existing rule that expenses for programs at the level of kindergarten and above, however, are primarily for education and, therefore, are not employment-related expenses.

(2) Specialty day camps

Section 21(b)(2)(A) provides that expenses for overnight camps are not employment-related expenses. Expenses for day camps may be employment-related expenses, if otherwise qualified. The IRS has received many inquiries about whether the cost of a day camp that specializes in a particular activity, such as soccer or computers, may be an employment-related expense. To provide certainty for taxpayers and enhance administrability, the proposed regulations provide that the full amount paid for a day camp or similar program may be for the care of a qualifying individual although the camp specializes in a particular activity.

(3) Transportation expenses

Section 1.44A–1(c)(3)(i) provides that expenses for transportation of a qualifying individual between the taxpayer's household and a place outside the taxpayer's household where care is provided are not for care. The proposed regulations provide that the cost of transportation (such as transportation to a day camp or to an after-school program not on school premises) furnished by a dependent care provider may be an employment-related expense if all other applicable requirements are satisfied.

(4) Other expenses for care

Section 1.44A–1(c)(1)(i) provides that employment taxes that a taxpayer pays are employment-related expenses if the related wages are employment-related expenses. Rev. Rul. 76–288, 1976–2 C.B. 83, holds that additional costs for a care provider's room and board are employment-related expenses. The proposed regulations incorporate these rules. Additionally, the proposed regulations clarify that indirect expenses such as application

and agency fees may be employment-related expenses if the taxpayer is required to pay the expenses to obtain the care.

b. *Expenses to enable the taxpayer to be gainfully employed*

Under section 21(b)(2)(A), an expense may be an employment-related expense only if its purpose is to enable the taxpayer to be gainfully employed. Section 1.44A–1(c)(1)(i) provides that an expense must be incurred while the taxpayer is gainfully employed or is in active search of gainful employment. An expense is not employment-related, however, merely because the services are provided while the taxpayer is employed. Rather, the purpose of the expense must be to enable the taxpayer to be gainfully employed.

Rev. Rul. 76–278, 1976–2 C.B. 84, holds that expenses for dependent care services during a taxpayer's 6-month absence from work due to illness do not qualify as employment-related expenses although the taxpayer was gainfully employed during that period. The expenses were not for the purpose of enabling the taxpayer to be gainfully employed because the expenses did not contribute to the taxpayer's ability to be gainfully employed during the absence.

Section 1.44A–1(c)(1)(ii) provides that a taxpayer must allocate on a daily basis expenses that relate to a period during only part of which the taxpayer is gainfully employed or in search of gainful employment. The proposed regulations clarify how this rule applies to temporary absences from work and part-time employment. The proposed regulations provide that, in general, dependent care expenses for a period in which the taxpayer is absent from work (whether paid or unpaid) are not employment-related expenses. However, for administrative convenience, short, temporary absences from work, such as for minor illness or vacation, are disregarded for taxpayers who must pay for dependent care expenses on a weekly or longer basis. Whether an absence is short and temporary depends on the facts and circumstances. The IRS and the Treasury Department request comments on appropriate periods to constitute temporary absence safe harbors.

The proposed regulations provide that, in general, taxpayers who work part-time must allocate expenses between days worked and days not worked. However, taxpayers who work part-time but are required to pay for dependent care expenses on a weekly or longer basis are not required to allocate expenses between days worked and days not worked.

5. *Limitations on Amount Creditable*

a. *Application of dollar limitation to two or more qualifying individuals*

Under section 21(c), the amount of employment-related expenses that a taxpayer may take into account in any taxable year is $2,400 for one qualifying individual and $4,800 for more than one qualifying individual (increased to $3,000 and $6,000 for taxable years beginning after December 31, 2002, and before January 1, 2011). The proposed regulations clarify that a taxpayer may apply the limitation for two or more qualifying individuals in unequal proportions. Thus, if in taxable year 2004 a taxpayer pays $4,000 of employment-related expenses for the care of one child and $2,000 for another child, the taxpayer may take into account the full $6,000.

b. *Earned income limitation*

Section 21(d) provides that the amount of employment-related expenses that may be taken into account during any taxable year cannot exceed the taxpayer's earned income or, if married, the earned income of the taxpayer's spouse (whichever is less). A spouse who is a full-time student or is incapable of self-care is deemed to have earned income for each month of not less than $200 if there is one qualifying individual or $400 if there are two or more qualifying individuals with respect to the taxpayer for the taxable year. These amounts are increased, respectively, to $250 and $500 for taxable years beginning after December 31, 2002, and before January 1, 2011.

Section 1.44A–2(b)(2) provides a definition of *earned income* that is similar to the definition under section 32 (relating to the earned income credit) and the regulations thereunder. Since this regulation was issued, the section 32 definition has changed several times. For ease of administration, the proposed regulations simplify the definition of earned income by cross-referencing the definition under section 32.

Section 1.44A–2(b)(3)(ii) defines a *full-time student* as a student pursuing a full-time course of study, which cannot be exclusively at night. The proposed regulations delete the night school restriction.

6. *Cost of Maintaining a Household*

For taxable years beginning before January 1, 2005, section 21(a)(1) provides that the credit is available to a taxpayer who maintains a household that includes one or more qualifying individuals. For those years, section 21(e)(1) provides that a taxpayer is treated as maintaining a household for any period only if over half the cost of maintaining the household is furnished by the taxpayer or by the taxpayer and spouse (if any). Section 1.44A–1(d)(3) defines *cost of maintaining a household* substantially identically to the definition in §1.2–2(d) (relating to the head of household filing status). For simplicity, the proposed regulations cross-reference to the definition of *cost of maintaining a household* in §1.2–2(d) without regard to the last sentence of that paragraph. In lieu of that sentence, the proposed regulations provide that, for purposes of section 21, the cost of maintaining a household does not include the value of services performed in the household by the taxpayer or a qualifying individual, or expenses paid or reimbursed by another person.

7. *Principal Place of Abode*

For taxable years beginning after December 31, 2004, the principal place of abode test statutorily replaces the maintaining a household test. Under section 21(b)(1), a qualifying individual must have the same principal place of abode as the taxpayer for more than one-half of the taxable year. For simplicity, the proposed regulations provide that *principal place of abode* has the same meaning as in section 152 and the regulations thereunder.

8. *Definition of Marital Status*

Under section 21(e)(2), the credit is allowed to married taxpayers only if they file a joint return. Section 21(e)(3) provides that taxpayers who are legally separated under a decree of divorce or separate maintenance are not married. The

proposed regulations, in general, adopt the rules of section 7703 and the regulations thereunder to determine whether taxpayers are married for purposes of section 21. However, to maintain continued consistency with section 21(e)(3), the proposed regulations provide, in addition, that taxpayers who are legally separated under a decree of divorce or separate maintenance are not married.

9. *Payments to Related Individuals*

Section 21(e)(6) provides that payments to a taxpayer's dependent or child under age 19 do not qualify for the credit. Payments to a relative may qualify for the credit if the relative is not a dependent. The proposed regulations clarify that payments to either the taxpayer's spouse or to a parent of the taxpayer's child who is not the taxpayer's spouse do not qualify for the credit. This rule is consistent with the requirement that a married couple must file a joint return to qualify for the credit, and with the principle that the tax treatment of a payment with respect to a child may be affected by an individual's underlying legal obligation to the child. See section 21(e)(2); compare section 677(b).

10. *Proposed Effective Date*

The regulations are proposed to apply to taxable years ending after the date the regulations are published as final regulations in the **Federal Register**. However, taxpayers may apply the proposed regulations in taxable years for which the period of limitation on credit or refund under section 6511 has not expired as of May 24, 2006.

11. *Effect on Other Documents*

When finalized, the regulations would obsolete Rev. Rul. 76–278, 1976–2 C.B. 84, and Rev. Rul. 76–288, 1976–2 C.B. 83.

Special Analyses

This notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. 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 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 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 who 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 Warren Joseph of the 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 parts 1 and 602 are proposed to be amended as follows:

PART I — INCOME TAXES

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

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

Section 1.21–1 also issued under 26 U.S.C. 21(f).

Section 1.21–2 also issued under 26 U.S.C. 21(f).

Section 1.21–3 also issued under 26 U.S.C. 21(f).

Section 1.21–4 also issued under 26 U.S.C. 21(f) * * *

§1.21–1 [Redesignated]

Par. 2. Section 1.21–1 is redesignated §1.15–1.

Par. 3. Sections 1.21–1, 1.21–2, 1.21–3, and 1.21–4 are added to read as follows:

§1.21–1 Expenses for household and dependent care services necessary for gainful employment.

(a) *In general.* (1) Section 21 allows a credit to a taxpayer against the tax imposed by chapter 1 for employment-related expenses for household services and care (as defined in paragraph (d) of this section) of a qualifying individual (as defined in paragraph (b) of this section). The purpose of the expenses must be to enable the taxpayer to be gainfully employed (as defined in paragraph (c) of this section). For taxable years beginning after December 31, 2004, a qualifying individual must have the same principal place of abode (as defined in paragraph (g) of this section) as the taxpayer for more than one-half of the taxable year. For taxable years beginning before January 1, 2005, the taxpayer must maintain a household (as defined in paragraph (h) of this section) that includes one or more qualifying individuals.

(2) The amount of the credit is equal to the applicable percentage of the employment-related expenses that may be taken into account by the taxpayer during the taxable year (but subject to the limits prescribed in §1.21–2). *Applicable percentage* means 35 percent reduced by 1 percentage point for each $2,000 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds $15,000, but not less than 20 percent. For example, if a taxpayer's adjusted gross income is $31,850, the applicable percentage is 26 percent.

(3) Expenses may be taken into account, regardless of the taxpayer's method of accounting, only in the taxable year the services are provided or the taxable year the expenses are paid, whichever is later.

(4) The requirements of section 21 and §§1.21–1 through 1.21–4 are applied at the time the services are provided, regardless of when the expenses are paid.

(b) *Qualifying individual*—(1) *In general.* For taxable years beginning after December 31, 2004, a qualifying individual is—

(i) The taxpayer's dependent (who is a qualifying child within the meaning of section 152) who has not attained age 13;

(ii) The taxpayer's dependent who is physically or mentally incapable of self-care and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year; or

(iii) The taxpayer's spouse who is physically or mentally incapable of self-care and who has the same principal abode as the taxpayer for more than one-half of the taxable year.

(2) *Taxable years beginning before January 1, 2005*. For taxable years beginning before January 1, 2005, a qualifying individual is—

(i) The taxpayer's dependent for whom the taxpayer is entitled to a deduction for a personal exemption under section 151(c) and who is under age 13;

(ii) The taxpayer's dependent who is physically or mentally incapable of self-care; or

(iii) The taxpayer's spouse who is physically or mentally incapable of self-care.

(3) *Qualification on a daily basis*. The status of an individual as a qualifying individual is determined on a daily basis. An individual is not a qualifying individual on the day the status terminates.

(4) *Physical or mental incapacity*. An individual is physically or mentally incapable of self-care if, as a result of a physical or mental defect, the individual is incapable of caring for the individual's hygiene or nutritional needs, or requires full-time attention of another person for the individual's own safety or the safety of others. The inability of an individual to engage in any substantial gainful activity or to perform the normal household functions of a homemaker or care for minor children by reason of a physical or mental condition does not of itself establish that the individual is physically or mentally incapable of self-care.

(5) *Special test for divorced or separated parents*—(i) *Scope*. This paragraph (b)(5) applies to a child (as defined in section 152(f)(1) for taxable years beginning after December 31, 2004, and in section 151(c)(3) for taxable years beginning before January 1, 2005) who—

(A) Is under age 13 or is physically or mentally incapable of self-care;

(B) Receives over one-half of his or her support during the calendar year from one or both parents who are divorced or legally separated under a decree of divorce or separate maintenance or who are separated under a written separation agreement; and

(C) Is in the custody of one or both parents for more than one-half of the calendar year.

(ii) *Custodial parent allowed the credit*. A child to whom this paragraph (b)(5) applies is the qualifying individual of only one parent in any taxable year and is the qualifying child of the custodial parent even if the noncustodial parent may claim the dependency exemption for that child for that taxable year. See section 152(e). The custodial parent is the parent with whom a child shared the same principal place of abode for the greater portion of the calendar year. See section 152(e)(3)(A).

(c) *Gainful employment*—(1) *In general*. Expenses are employment-related expenses only if they are for the purpose of enabling the taxpayer to be gainfully employed. The expenses must be for the care of a qualifying individual or household services provided during periods in which the taxpayer is gainfully employed or is in active search of gainful employment. Employment may consist of service within or outside the taxpayer's home and includes self-employment. An expense is not employment-related merely because it is paid or incurred while the taxpayer is gainfully employed. The purpose of the expense must be to enable the taxpayer to be gainfully employed. Whether the purpose of an expense is to enable the taxpayer to be gainfully employed depends on the facts and circumstances of the particular case. Work as a volunteer or for a nominal consideration is not gainful employment.

(2) *Determination of period of employment on a daily basis*—(i) *In general*. Expenses paid for a period during only part of which the taxpayer is gainfully employed or in active search of gainful employment must be allocated on a daily basis.

(ii) *Exception for short temporary absences*. A taxpayer who is gainfully employed and who pays for dependent care expenses on a weekly, monthly, or annual basis is not required to allocate expenses during short, temporary absences from work, such as for vacation or minor illness. Whether an absence is a short, temporary absence is determined based on all the facts and circumstances.

(iii) *Part-time employment*. A taxpayer who is employed part-time generally must allocate expenses for dependent care between days worked and days not worked. However, if a taxpayer employed part time is required to pay for dependent care on a periodic basis (such as weekly or monthly) that includes both days worked and days not worked, the taxpayer is not required to allocate the expenses. A day on which the taxpayer works at least 1 hour is a day of work.

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

Example 1. B, the custodial parent of two qualifying children, hires a housekeeper for a monthly salary to care for the children while B is gainfully employed. B becomes ill and as a result is absent from work for 4 months. B continues to pay the housekeeper to care for the children while B is absent from work. During this 4-month period, B performs no employment services, but receives payments under her employer's wage continuation plan. Although B may be considered to be gainfully employed during her absence from work, the absence is not a short, temporary absence within the meaning of paragraph (c)(2)(ii) of this section, and her payments for household and dependent care services during the period of illness are not for the purpose of enabling her to be gainfully employed. B's expenses are not employment-related expenses, and she may not take the expenses into account under section 21.

Example 2. C works 5 days per week and his child attends a dependent care center (that complies with all state and local requirements) to enable C to be gainfully employed. The dependent care center requires payment for periods of no less than 1 week. C takes 2 days off from work as vacation days. Under paragraph (c)(2)(ii) of this section, C is absent from work on a short, temporary basis, and is not required to allocate expenses between days working and days not working. The entire fee for that week may be an employment-related expense under section 21.

Example 3. D works 3 days per week and her child attends a dependent care center (that complies with all state and local requirements) to enable her to be gainfully employed. The dependent care center allows payment for any 3 days per week for $150 or 5 days per week for $250. D enrolls her child for 5 days per week. Under paragraph (c)(2)(iii) of this section, D must allocate her expenses for dependent care between days worked and days not worked. Three-fifths of the $250, or $150 per week, may be an employment-related expense under section 21.

Example 4. The facts are the same as in *Example 3*, except that the dependent care center does not offer a 3-day option. The entire $250 weekly fee may be an employment-related expense under section 21.

(d) *Care of qualifying individual and household services*—(1) *In general*. To qualify for the dependent care credit, expenses must be for the care of a qualifying individual. Expenses are for the care of a qualifying individual if the primary func-

tion is to assure the individual's well-being and protection. Not all expenses relating to a qualifying individual are provided for the individual's care. Amounts paid for food, lodging, clothing, or education are not for the care of a qualifying individual. If, however, the care is provided in such a manner that the expenses cover other goods or services that are incidental to and inseparably a part of the care, the full amount is for care.

(2) *Allocation of expenses*. If an expense is partly for household services or for the care of a qualifying individual and partly for other goods or services, a reasonable allocation must be made. Only so much of the expense that is allocable to the household services or care of a qualifying individual is an employment-related expense. An allocation must be made if a housekeeper or other domestic employee performs household duties and cares for the qualifying children of the taxpayer and also performs other services for the taxpayer. No allocation is required, however, if the expense for the other purpose is minimal or insignificant or if an expense is partly attributable to the care of a qualifying individual and partly to household services.

(3) *Household services*. Expenses for household services may be employment-related expenses if the services are provided in connection with the care of a qualifying individual. The household services must be the performance in and about the taxpayer's home of ordinary and usual services necessary to the maintenance of the household and attributable to the care of the qualifying individual. Services of a housekeeper are household services within the meaning of this paragraph (d)(3) if part of those services is provided to the qualifying individual. Such services as are provided by chauffeurs, bartenders, or gardeners are not household services.

(4) *Manner of providing care*. The manner of providing the care need not be the least expensive alternative available to the taxpayer. The cost of a paid caregiver may be an expense for the care of a qualifying individual even if another caregiver is available at no cost.

(5) *School or similar program*. Expenses for a child in nursery school, preschool, or similar programs for children below the level of kindergarten are for the care of a qualifying individual and may be employment-related expenses. Expenses for a child in kindergarten or a higher grade are not for the care of a qualifying individual. However, expenses for before- or after-school care of a child in kindergarten or a higher grade may be for the care of a qualifying individual.

(6) *Overnight camps*. Expenses for overnight camps are not employment-related expenses.

(7) *Day camps*. The cost of a day camp or similar program may be for the care of a qualifying individual and an employment-related expense, without allocation under paragraph (d)(2) of this section, even if the day camp specializes in a particular activity.

(8) *Transportation*. The cost of transportation by a dependent care provider of a qualifying individual to or from a place where care of that qualifying individual is provided may be for the care of the qualifying individual. The cost of transportation not provided by a dependent care provider is not for the care of the qualifying individual.

(9) *Employment taxes*. Taxes under section 3111 (relating to the Federal Insurance Contributions Act) and 3301 (relating to the Federal Unemployment Tax Act) and similar state payroll taxes are employment-related expenses if paid in respect of wages that are employment-related expenses.

(10) *Room and board*. The additional cost of providing room and board for a caregiver over usual household expenditures may be an employment-related expense.

(11) *Indirect expenses*. Expenses that relate to but are not directly for the care of a qualifying individual, such as application fees, agency fees, and deposits, may be for the care of a qualifying individual and may be employment-related expenses if the taxpayer is required to pay the expenses to obtain the related care. However, forfeited deposits and other payments are not for the care of a qualifying individual if care is not provided.

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

Example 1. To be gainfully employed, E sends his 3-year old child to a pre-school. The pre-school provides lunch and snacks. Under paragraph (d)(1) of this section, E is not required to allocate expenses between care and the lunch and snacks because the lunch and snacks are incidental to and inseparably a part of the care. Therefore, E may treat the full amount paid to the pre-school as for the care of his child.

Example 2. F, a member of the armed forces, is ordered to a combat zone. To be able to comply with the orders, F places her 10-year old child in boarding school. The school provides education, meals, and housing to F's child in addition to care. Under paragraph (d)(2) of this section, F must allocate the cost of the boarding school between expenses for care and expenses for education and other services not constituting care. Only the part of the cost of the boarding school that is for the care of F's child is an employment-related expense under section 21.

Example 3. To be gainfully employed, G employs a full-time housekeeper to care for G's two children, aged 9 and 13 years. The housekeeper regularly performs household services of cleaning and cooking and drives G to and from G's place of employment, a trip of 15 minutes each way. Under paragraph (d)(3) of this section, the chauffeur services are not household services. G is not required to allocate a portion of the expense of the housekeeper to the chauffeur services, however, because the chauffeur services are minimal and insignificant. Further, no allocation under paragraph (d)(2) of this section is required to determine the portion of the expenses attributable to the care of the 13-year old child (not a qualifying individual) because the household expenses are in part attributable to the care of the 9-year old child. Accordingly, the entire expense of employing the housekeeper is an employment-related expense. The amount that G may take into account as an employment-related expense under section 21, however, is limited to the amount allowable for one qualifying individual.

Example 4. To be gainfully employed, H sends her 9-year old child to a summer day camp that specializes in computer instruction and activities. Under paragraph (d)(7) of this section, the full cost of the summer day camp may be for care although it specializes in a particular activity, computers.

Example 5. In 2004, J pays a fee to an agency to obtain the services of an au pair to care for J's qualifying children to enable J to be gainfully employed. The au pair begins caring for J's children in 2005. Under paragraph (d)(11) of this section, the fee paid in 2004 may be an employment-related expense. However, under paragraph (a)(3) of this section, J may not take the expense into account under section 21 until 2005, when the au pair first provides the care.

Example 6. K places a deposit with a pre-school to reserve a place for her child. K sends the child to another pre-school and forfeits the deposit. Under paragraph (d)(11) of this section, the forfeited deposit is not an employment-related expense.

(e) *Services outside the taxpayer's household*—(1) *In general*. The credit is allowable for expenses for services performed outside the taxpayer's household only if the care is for one or more qualifying individuals who are described in this section at—

(i) Paragraph (b)(1)(i) or (b)(2)(i); or

(ii Paragraph (b)(2)(ii) or (b)(2)(iii) and regularly spend at least 8 hours each day in the taxpayer's household.

(2) *Dependent care centers*—(i) *In general*. The credit is allowable for services provided by a dependent care center only if—

(A) The center complies with all applicable laws and regulations, if any, of a state or local government, such as state or local licensing requirements and building and fire code regulations; and

(B) The requirements provided in this paragraph (e) are met.

(ii) *Definition*. The term *dependent care center* means any facility that provides full-time or part-time care for more than six individuals (other than individuals who reside at the facility) on a regular basis during the taxpayer's taxable year, and receives a fee, payment, or grant for providing services for the individuals (regardless of whether the facility is operated for profit). For purposes of the preceding sentence, a facility is presumed to provide full-time or part-time care for six or fewer individuals on a regular basis during the taxpayer's taxable year if the facility has six or fewer individuals (including the taxpayer's qualifying individual) enrolled for full-time or part-time care on the day the qualifying individual is enrolled in the facility (or on the first day of the taxable year the qualifying individual attends the facility if the qualifying individual was enrolled in the facility in the preceding taxable year) unless the Internal Revenue Service demonstrates that the facility provides full-time or part-time care for more than six individuals on a regular basis during the taxpayer's taxable year.

(f) *Reimbursed expenses*. Employment-related expenses for which the taxpayer is reimbursed (for example, under a dependent care assistance program) may not be taken into account for purposes of the credit.

(g) *Principal place of abode*. For purposes of this section, the term *principal place of abode* has the same meaning as in section 152 and the regulations thereunder.

(h) *Maintenance of a household*—(1) *In general*. For taxable years beginning before January 1, 2005, the credit is available only to taxpayers who maintain households that include one or more qualifying individuals. A taxpayer maintains a household for the taxable year (or lesser period) only if the taxpayer (and spouse, if applicable) occupies the household and furnishes over one-half of the cost for the taxable year (or lesser period) of maintaining the household. The household must be the principal place of abode (within the meaning of section 152 and the regulations thereunder) for the taxable year of the taxpayer and the qualifying individual or individuals described in paragraph (b) of this section.

(2) *Cost of maintaining a household*. (i) Except as provided in paragraph (h)(2)(ii) of this section, for purposes of this section, the term *cost of maintaining a household* has the same meaning as in §1.2–2(d) without regard to the last sentence thereof.

(ii) The cost of maintaining a household does not include the value of services performed in the household by the taxpayer or by a qualifying individual described in paragraph (b) of this section or any expense paid or reimbursed by another person.

(3) *Monthly proration of annual costs*. In determining the cost of maintaining a household for a period of less than a taxable year, the cost for the entire taxable year must be prorated on the basis of the number of calendar months within that period. A period of less than a calendar month is treated as a full calendar month.

(4) *Two or more families*. If two or more families occupy living quarters in common, each of the families is treated as maintaining a separate household. A taxpayer is maintaining a household if the taxpayer provides more than one-half of the cost of maintaining the separate household. For example, if two unrelated taxpayers with their respective children occupy living quarters in common and each taxpayer pays more than one-half of the household costs for each respective family, each taxpayer is treated as maintaining a household.

(i) Reserved.

(j) *Expenses qualifying as medical expenses*—(1) *In general*. A taxpayer may not take an amount into account as both an employment-related expense under section 21 and an expense for medical care under section 213.

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

Example 1. During 2004, L has $6,500 of employment-related expenses for the care of his child who is physically incapable of self-care. The expenses are for services performed in L's household that also qualify as expenses for medical care under section 213. Of the total expenses, L may take into account $3,000 under section 21. L may deduct the balance of the expenses, or $3,500, as expenses for medical care under section 213 to the extent the expenses exceed 7.5 percent of L's adjusted gross income.

Example 2. The facts are the same as in *Example 1*, however, L first takes into account the $6,500 of expenses under section 213. L deducts $500 as an expense for medical care, which is the amount by which the expenses exceed 7.5 percent of his adjusted gross income. L may not take into account the $6,000 balance as employment-related expenses under section 21 because he has taken the full amount of the expenses into account in computing the amount deductible under section 213.

(k) *Substantiation*. A taxpayer claiming a credit for employment-related expenses must maintain adequate records or other sufficient evidence to substantiate the expenses in accordance with section 6001 and the regulations thereunder.

(l) *Effective date*. This section and §§1.21–2 through 1.21–4 apply to taxable years ending after the date these regulations are published as final regulations in the **Federal Register**. However, taxpayers may apply this section and §§1.21–2 through 1.21–4 in taxable years for which the period of limitation on credit or refund under section 6511 has not expired as of May 24, 2006.

§1.21–2 Limitations on amount creditable.

(a) *Annual dollar limitation*. (1) The amount of employment-related expenses that may be taken into account under §1.21–1(a) for any taxable year cannot exceed—

(i) $2,400 ($3,000 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there is one qualifying individual with respect to the taxpayer at any time during the taxable year; or

(ii) $4,800 ($6,000 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there are two or more qualifying individuals with respect to the taxpayer at any time during the taxable year.

(2) The amount determined under paragraph (a)(1) of this section is reduced by the aggregate amount excludable from gross income under section 129 for the taxable year.

(3) A taxpayer may take into account the total amount of employment-related expenses that do not exceed the annual dollar limitation although the amount of employment-related expenses attributable to

one qualifying individual exceeds 50 percent of the limitation. For example, a taxpayer with expenses in 2004 of $4,000 for one qualifying individual and $1,500 for a second qualifying individual may take into account the full $5,500.

(4) A taxpayer is not required to prorate the annual dollar limitation if a qualifying individual ceases to qualify (for example, by turning age 13) during the taxable year. However, the taxpayer may take into account only expenses that qualify under §1.21–1(a)(3) before the disqualifying event.

(b) *Earned income limitation*—(1) *In general*. The amount of employment-related expenses that may be taken into account under section 21 for any taxable year cannot exceed—

(i) For a taxpayer who is not married at the close of the taxable year, the taxpayer's earned income for the taxable year; or

(ii) For a taxpayer who is married at the close of the taxable year, the lesser of the taxpayer's earned income or the earned income of the taxpayer's spouse for the taxable year.

(2) *Determination of spouse*. For purposes of this paragraph (b), a taxpayer must take into account only the earned income of a spouse to whom the taxpayer is married at the close of the taxable year. The spouse's earned income for the entire taxable year is taken into account, however, even though the taxpayer and the spouse were married for only part of the taxable year. The taxpayer is not required to take into account the earned income of a spouse who died or was divorced or separated from the taxpayer during the taxable year. See §1.21–3(b) for rules providing that certain married taxpayers legally separated or living apart are treated as not married.

(3) *Definition of earned income*. For purposes of this section, the term *earned income* has the same meaning as in section 32(c)(2) and the regulations thereunder.

(4) *Attribution of earned income to student or incapacitated spouse*. (i) For purposes of this section, a spouse is deemed, for each month during which the spouse is a full-time student or is a qualifying individual described in §1.21–1(b)(1)(iii) or § 1.21–1(b)(2)(iii), to be gainfully employed and to have earned income of not less than—

(A) $200 ($250 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there is one qualifying individual with respect to the taxpayer at any time during the taxable year; or

(B) $400 ($500 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there are two or more qualifying individuals with respect to the taxpayer at any time during the taxable year.

(ii) For purposes of this paragraph (b)(4), a full-time student is an individual who is enrolled at and attends an educational institution during each of 5 calendar months of the taxpayer's taxable year for the number of course hours considered to be a full-time course of study. The enrollment for 5 calendar months need not be consecutive. See section 152(f)(2) (for taxable years beginning after December 31, 2004), or section 151(c)(4) (for taxable years beginning before January 1, 2005), and the regulations thereunder.

(iii) Earned income may be attributed under this paragraph (b)(4), in the case of any husband and wife, to only one spouse in any month.

(c) *Examples*. The provisions of this section are illustrated by the following examples:

Example 1. In 2004, M, who is married, pays employment-related expenses of $5,000 for the care of one qualifying individual. M's earned income for the taxable year is $40,000 and her husband's earned income is $2,000. M did not exclude any dependent care assistance under section 129. Under paragraph (b)(1) of this section, M may take into account under section 21 only the amount of employment-related expenses that does not exceed the lesser of her earned income or the earned income of her husband, or $2,000.

Example 2. The facts are the same as in *Example 1* except that M's husband is a full-time student for 9 months of the taxable year and has no earned income. Under paragraph (b)(4) of this section, M's husband is deemed to have earned income of $2,250. M may take into account $2,250 of employment-related expenses under section 21.

Example 3. For all of 2004, N is a full-time student and O, N's husband, is an individual who is incapable of self-care (as defined in §1.21–1(b)(1)(iii)). N and O have no earned income and pay expenses of $5,000 for O's care. Under paragraph (b)(4) of this section, either N or O may be deemed to have $3,000 of earned income. However, earned income may be attributed to only one spouse under paragraph (b)(4)(iii) of this section. Under the limitation in paragraph (b)(1)(ii) of this section, the lesser of N's or O's earned income is zero. N and O may not take the expenses into account under section 21.

(d) *Cross-reference*. For an additional limitation on the credit under section 21, see section 26.

§1.21–3 Special rules applicable to married taxpayers.

(a) *Joint return requirement*. No credit is allowed under section 21 for taxpayers who are married (within the meaning of section 7703 and the regulations thereunder) at the close of the taxable year unless the taxpayer and spouse file a joint return for the taxable year. See section 6013 and the regulations thereunder relating to joint returns of income tax by husband and wife.

(b) *Taxpayers treated as not married*. The requirements of paragraph (a) of this section do not apply to a taxpayer who is legally separated under a decree of divorce or separate maintenance or who is treated as not married under section 7703(b) and the regulations thereunder (relating to certain married taxpayers living apart). A taxpayer who is treated as not married under this paragraph (b) is not required to take into account the earned income of the taxpayer's spouse for purposes of applying the earned income limitation on the amount of employment-related expenses under §1.21–2(b).

(c) *Death of married taxpayer*. If a married taxpayer dies during the taxable year and the survivor may make a joint return with respect to the deceased spouse under section 6013(a)(3), the credit is allowed for the year only if a joint return is made. If, however, the surviving spouse remarries before the end of the taxable year in which the deceased spouse dies, a credit may be allowed on the decedent spouse's separate return.

§1.21–4 Payments to certain related individuals.

(a) *In general*. A credit is not allowed under section 21 for any amount paid by the taxpayer to an individual—

(1) For whom a deduction under section 151(c) (relating to deductions for personal exemptions for dependents) is allowable either to the taxpayer or the taxpayer's spouse for the taxable year;

(2) Who is a child of the taxpayer (within the meaning of section 152(f)(1) for taxable years beginning after December 31, 2004, and section 151(c)(3) for taxable years beginning before January 1,

2005) and is under age 19 at the close of the taxable year;

(3) Who is the spouse of the taxpayer at any time during the taxable year; or

(4) Who is the parent of the taxpayer's child who is a qualifying individual described in §1.21–1(b)(1)(i) or §1.21–1(b)(2)(i).

(b) *Payments to partnerships or other entities*. In general, paragraph (a) of this section does not apply to services performed by partnerships or other entities. If, however, the partnership or other entity is established or maintained primarily to avoid the application of paragraph (a) of this section to permit the taxpayer to claim the credit, for purposes of section 21, the payments of employment-related expenses are treated as made directly to each partner or owner in proportion to that partner's or owner's ownership interest. Whether a partnership or other entity is established or maintained to avoid the application of paragraph (a) of this section is determined based on the facts and circumstances, including whether the partnership or other entity is established for the primary purpose of caring for the taxpayer's qualifying individual or providing household services to the taxpayer.

(c) *Examples*. The provisions of this section are illustrated by the following examples:

Example 1. P pays $5,000 to her mother for the care of P's 5-year old child during 2004. The expenses otherwise qualify as employment-related expenses. P's mother is not her dependent. P may take into account under section 21 the amounts paid to her mother for the care of P's child.

Example 2. Q, who is divorced and has custody of his 5-year old child, pays $6,000 during 2004 to R, who is his ex-wife and the child's mother, for the care of the child. The expenses otherwise qualify as employment-related expenses. Under paragraph (a)(4) of this section, Q may not take into account under section 21 the amounts paid to R because R is the child's mother.

Example 3. The facts are the same as in *Example 2*, except that R is not the mother of Q's child. Q may take into account under section 21 the amounts paid to R.

§§1.44A–1 through 1.44A–4 [Removed]

Par. 4. Sections 1.44A–1, 1.44A–2, 1.44A–3, and 1.44A–4 are removed.

§1.214–1 [Removed]

Par. 5. Section 1.214–1 is removed.

§§1.214A–1 through 1.214A–5 [Removed]

Par. 6. Sections 1.214A–1, 1.214A–2, 1.214A–3, 1.214A–4, and 1.214A–5 are removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

Authority: 26 U.S.C. 7805.

Par. 8. In §602.101, paragraph (b) is revised to remove entries as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.44A–1	1545–0068
1.44A–3	1545–0074
* * * * *	

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

(Filed by the Office of the Federal Register on May 23, 2006, 8:45 a.m., and published in the issue of the Federal Register for May 24, 2006, 71 F.R. 29847)

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

Computer Software Under Section 199(c)(5)(B)

REG–111578–06

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9262) concerning the application of section 199 of the Internal Revenue Code, which provides a deduction for income attributable to domestic production activities, to certain transactions involving computer software. The text of those regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by August 30, 2006. Outlines of topics to be discussed at the public hearing scheduled for Tuesday, August 29, 2006, must be received by August 8, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–111578–06), 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–111578–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS — REG–111578–06). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Paul Handleman or Lauren Ross Taylor,

(202) 622–3040; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard A. Hurst, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR Part 1) relating to section 199. The temporary regulations provide guidance under section 199 for taxpayers providing computer software to customers for the customers' direct use while connected to the Internet. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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 Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. In addition, the IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Tuesday, August 29, 2006, at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

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

Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by August 8, 2006. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Paul Handleman and Lauren Ross Taylor, 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 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 * * *

Section 1.199–3 also issued under 26 U.S.C. 199(d). * * *

Section 1.199–8 also issued under 26 U.S.C. 199(d). * * *

Par. 2. Section 1.199–3 is amended to read as follows:

§1.199–3 Domestic production gross receipts.

[The text of the amendments to this proposed section is the same as the text of §1.199–3T published elsewhere in this issue of the Bulletin.]

Par. 3. Section 1.199–8 is amended to read as follows:

§1.199–8 Other rules.

[The text of the amendments to this proposed section is the same as the text of §1.199–8T 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 May 24, 2006, 11:47 a.m., and published in the issue of the Federal Register for June 1, 2006, 71 F.R. 31128)

2006 Prevailing State Assumed Interest Rates; Correction

Announcement 2006–35

This announcement corrects an error in Rev. Rul. 2006–25 published in 2006–20 I.R.B. On page 883 of 2006–20 I.R.B., the numbers listed for Schedule A are incorrect. The numbers presently read 5.75 for guarantee durations of 10 or fewer years, 5.25 for guarantee durations of more than 10 years but not more than 20 years, and 5.00 for guarantee durations of more than 20 years. These numbers would be correct if the table referenced nonforfeiture interest rates but are not the valuation interest rates intended to be listed in Schedule A. The correct numbers for valuation interest rates are 4.50 for guarantee durations of 10 or fewer years, 4.25 for guarantee durations of more than 10 years but not more than 20 years, and 4.00 for guarantee durations of more than 20 years. No other information in the revenue ruling is changed.

DRAFTING INFORMATION

The principal author of this revenue ruling is Ann H. Logan of the Office of Asso-

ciate Chief Counsel (Financial Institutions and Products). For further information regarding this announcement, contact her at (202) 622–3970 (not a toll-free call).

Revision of Income Tax Regulations Under Sections 367, 884, and 6038B Dealing With Statutory Mergers or Consolidations Under Section 368(a)(1)(A) Involving One or More Foreign Corporations, and Guidance Necessary To Facilitate Business Electronic Filing Under Section 6038B; Correction

Announcement 2006–38

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains a correction to final regulations (T.D. 9243, 2006–8 I.R.B. 475), that was published in the **Federal Register** on Thursday, January 26, 2006 (71 FR 4276). This final regulation amends the income tax regulations under various provisions of the Internal Revenue Code to account for statutory mergers and consolidations.

DATES: This correction is effective January 23, 2006.

FOR FURTHER INFORMATION CONTACT: Christopher Trump (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulation (T.D. 9243) that is the subject of this correction is under section 367 of the Internal Revenue Code.

Need for Correction

As published, T.D. 9243 contains an error that may prove to be misleading and is in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR Part 1 is corrected by making the following correcting amendments:

PART 1—INCOME TAXES

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

Authority: 26 USC 7805 * * *

§1.367(b)–6 [Corrected]

Par. 2. Section 1.367(b)–6 is amended by removing the third sentence of paragraph (a) (1) and adding the following sentence in its place to read as follows:

§1.367(b)–6 Effective dates and coordination rules.

(a) * * *

(1) * * * Section 1.367(b)–4(b)(1)(ii) applies to all triangular reorganizations and reorganizations described in section 368(a)(1)(G) and (a)(2)(D) occurring on or after January 23, 2006, although taxpayers may apply §1.367(b)–4(b)(1)(ii) to triangular B reorganizations occurring on or after February 23, 2000, that is not closed by the period of limitations if done consistently with respect to all such triangular B reorganizations. * * *

* * * * *

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

(Filed by the Office of the Federal Register on May 15, 2006, 8:45 a.m., and published in the issue of the Federal Register for May 16, 2006, 71 F.R. 28266)

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

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