Internal Revenue bulletin

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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. 9271, page 224.

Final regulations under section 338 of the Code provide that the step transaction doctrine will not be applied if a taxpayer makes a valid section 338(h)(10) election with respect to a step in a multi-step transaction, even if the transaction would otherwise qualify as a reorganization if the step standing alone is a qualified stock purchase.

T.D. 9277, page 226.

Final regulations under section 4980G of the Code provide guidance regarding employer comparable contributions to Health Savings Accounts (HSAs). The regulations provide that if an employer makes comparable contributions to any employee's HSA, the employer must make comparable contributions for the calendar year to the HSAs of all comparable participating employees. In addition, the final regulations set forth the rules for calculating comparable contributions.

Notice 2006–67, page 248.

This notice provides guidance with respect to the 50-percent additional first year depreciation deduction provided by section 1400N(d) of the Code for qualified Gulf Opportunity (GO) Zone property. Rev. Proc. 2002–9 modified and amplified.

Notice 2006–70, page 252.

This notice states that the Treasury Department and IRS intend to amend the effective date provision of regulations section 1.7874–2T (and when it is finalized, 1.7874–2) so that it will not apply to certain acquisitions, otherwise described in section 7874(a)(2)(b)(i) of the Code which were completed on or after June 6, 2006, provided such acquisitions were entered into pursuant to a binding commitment which was in effect on December 28, 2005.

EXEMPT ORGANIZATIONS

Announcement 2006–54, page 254.

Nationwide Consumer Credit Services of Ft. Lauderdale, FL, no longer qualifies as an organization to which contributions are deductible under section 170 of the Code.

EXCISE TAX

T.D. 9277, page 226.

Final regulations under section 4980G of the Code provide guidance regarding employer comparable contributions to Health Savings Accounts (HSAs). The regulations provide that if an employer makes comparable contributions to any employee's HSA, the employer must make comparable contributions for the calendar year to the HSAs of all comparable participating employees. In addition, the final regulations set forth the rules for calculating comparable contributions.

ADMINISTRATIVE

T.D. 9270, page 237.

Final regulations under section 6045(f) of the Code relate to information reporting for payments of gross proceeds to attorneys. Regulations under section 6041 are also amended with respect to information reporting for payments for legal services.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

T.D. 9274, page 244.
Final regulations under section 6103 of the Code describe the circumstances under which IRS and the Office of Treasury Inspector General for Tax Administration (TIGTA) employees may disclose return information for investigative purposes. The regulations clarify and elaborate on the types of situations and contexts in which investigative disclosures may be made.

Announcement 2006–52, page 254.
Change in accounting methods; revised instructions for Form 3115. The instructions for Form 3115 have been revised as of May 2006. The May 2006 version of the instructions for Form 3115 is to be used with the December 2003 version of Form 3115, *Application for Change in Accounting Method*.

Announcement 2006–53, page 254.
This document provides a change of location for a public hearing on proposed regulations (REG–111578–06, 2006–24 I.R.B. 1060) under section 199 of the Code. The regulations provide a deduction for income attributable to domestic production activities to certain transactions involving computer software. The public hearing is scheduled for August 29, 2006.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Section 338.—Certain Stock Purchases Treated as Asset Acquisitions

26 CFR 1.338–3: Qualification for the section 338 election.

T.D. 9271

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Effect of Elections in Certain Multi-Step Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that give effect to section 338(h)(10) elections in certain multi-step transactions. These final regulations are necessary in order to provide taxpayers with guidance regarding the validity of certain elections made under section 338(h)(10). These final regulations affect corporations and their shareholders.

DATES: *Effective Date:* These regulations are effective July 5, 2006.

Applicability Date: For dates of applicability, see §1.338(h)(10)–1(h) of these regulations.

FOR FURTHER INFORMATION CONTACT: Daniel F. Heins, at (202) 622–7930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The IRS published temporary regulations (T.D. 9071, 2003–2 C.B. 560) in the **Federal Register** on July 9, 2003 (68 FR 40766) (the temporary regulations), along with a notice of proposed rulemaking by cross-reference to the temporary regulations (REG–143679–02, 2003–2 C.B. 592) (the proposed regulations). These temporary regulations provide, notwithstanding anything to the contrary in §1.338–3(c)(1)(i), a section 338(h)(10) election may be made for T where P's acquisition of T stock, viewed independently, constitutes a qualified stock purchase and, after the stock acquisition, T merges or liquidates into P (or another member of the affiliated group that includes P), whether or not, under relevant provisions of law, including the step transaction doctrine, the acquisition of the T stock and the merger or liquidation of T qualify as a reorganization described in section 368(a). If a section 338(h)(10) election is made in a case where the acquisition of T stock followed by a merger or liquidation of T into P qualifies as a reorganization described in section 368(a), for all Federal tax purposes, P's acquisition of T stock is treated as a qualified stock purchase and is not treated as part of a reorganization described in section 368(a). For rules about the operation of the step transaction doctrine and the relationship between section 338 and the reorganization provisions when a section 338 election is not made, see §1.338–3(d). See also Rev. Rul. 90–95, 1990–2 C.B. 67. See §601.601(d)(2).

No public hearing regarding the proposed regulations was requested or held. The IRS received written and electronic comments regarding the proposed regulations. After consideration of the comments, the proposed regulations are adopted by this Treasury decision. The most significant comments received with respect to the proposed regulations are discussed in this preamble.

Explanation of Provisions

A. *Section 338(g) Elections*

Some commentators recommend that the final regulations allow section 338(g) elections, as well as section 338(h)(10) elections, to turn off the step transaction doctrine in a multi-step transaction that constitutes a reorganization under section 368(a). Although a section 338(g) election is made by the purchasing corporation and the shareholders of the target corporation (target) do not consent to the election, one commentator states that the IRS will not be subject to whipsaw if the IRS provides regulations requiring the shareholders of the acquired corporation to treat the transaction consistently with the acquiring corporation's election, rather than as a reorganization under section 368(a).

The final regulations do not adopt the commentators' recommendation, and continue to turn off the step transaction doctrine only in the case of section 338(h)(10) elections. Extending the final regulations to section 338(g) elections would allow the acquiring corporation to unilaterally elect to treat the transaction, for all parties, as other than a reorganization under section 368(a). In light of potential whipsaw and other concerns, the final regulations continue to apply only to section 338(h)(10) elections, not section 338(g) elections.

B. *Corporate Purchaser Requirement*

One commentator suggests that §1.338–3(b) be amended to clarify under what circumstances a corporation will be considered, for tax purposes, to have purchased the stock of target pursuant to section 338(d)(3).

Under §1.338–3(b), an individual cannot make a qualified stock purchase of target. If an individual forms a corporation (new P) to acquire target stock, new P can make a qualified stock purchase of target if new P is considered, for tax purposes, to purchase the target stock. Facts that may indicate that new P does not purchase the target stock include new P's merging downstream into target, liquidating, or otherwise disposing of the target stock following the purported qualified stock purchase.

The IRS and Treasury Department are continuing to study whether any amendments to the portion of the regulations under section 338 related to the corporate purchaser requirement are appropriate.

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 is hereby certified that these regulations do not have a significant economic impact on a substantial amount of small entities. The number of corporations affected is limited because section 338(h)(10) elections are made only in extraordinary circumstances, the sale of a business. Furthermore, these regulations only affect transactions in which the stock of the acquiring corporation is a significant part of the consideration. Accordingly, a regulatory flexibility analysis does not apply. Since these final regulations make no changes to the current effective temporary regulations, a delayed effective date pursuant to 5 U.S.C. 553(d)(1) and (3) is not necessary. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Daniel F. Heins of the Office of the Associate Chief Counsel (Corporate).

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.338(h)(10)–1 also issued under 26 U.S.C. 337(d), 338, and 1502.

Par. 2. §1.338–3 is amended by revising the last sentence in paragraph (c)(1)(i) to read as follows:

§1.338–3 Qualification for the section 338 election.

* * * * *

(c) * * *

(1) * * *

(i) * * * See §1.338(h)(10)–1(c)(2) for special rules concerning section 338(h)(10) elections in certain multi-step transactions.

Par. 3. §1.338(h)(10)–1 is amended as follows:

1. Paragraph (c)(2) is revised.

2. Paragraph (e) *Examples 11* through *14* and paragraph (h) are added.

The revision and additions read as follows:

§1.338(h)(10)–1 Deemed asset sale and liquidation.

* * * * *

(c) * * *

(2) *Availability of section 338(h)(10) election in certain multi-step transactions*. Notwithstanding anything to the contrary in §1.338–3(c)(1)(i), a section 338(h)(10) election may be made for T where P's acquisition of T stock, viewed independently, constitutes a qualified stock purchase and, after the stock acquisition, T merges or liquidates into P (or another member of the affiliated group that includes P), whether or not, under relevant provisions of law, including the step transaction doctrine, the acquisition of the T stock and the merger or liquidation of T qualify as a reorganization described in section 368(a). If a section 338(h)(10) election is made in a case where the acquisition of T stock followed by a merger or liquidation of T into P qualifies as a reorganization described in section 368(a), for all Federal tax purposes, P's acquisition of T stock is treated as a qualified stock purchase and is not treated as part of a reorganization described in section 368(a).

* * * * *

(e) * * *

Example 11. Stock acquisition followed by upstream merger—without section 338(h)(10) election. (i) P owns all the stock of Y, a newly formed subsidiary. S owns all the stock of T. Each of P, S, T and Y is a domestic corporation. P acquires all of the T stock in a statutory merger of Y into T, with T surviving. In the merger, S receives consideration consisting of 50% P voting stock and 50% cash. Viewed independently of any other step, P's acquisition of T stock constitutes a qualified stock purchase. As part of the plan that includes P's acquisition of the T stock, T subsequently merges into P. Viewed independently of any other step, T's merger into P qualifies as a liquidation described in section 332. Absent the application of paragraph (c)(2) of this section, the step transaction doctrine would apply to treat P's acquisition of the T stock and T's merger into P as an acquisition by P of T's assets in a reorganization described in section 368(a). P and S do not make a section 338(h)(10) election with respect to P's purchase of the T stock.

(ii) Because P and S do not make an election under section 338(h)(10) for T, P's acquisition of the T stock and T's merger into P is treated as part of a reorganization described in section 368(a).

Example 12. Stock acquisition followed by upstream merger—with section 338(h)(10) election. (i) The facts are the same as in *Example 11* except that P and S make a joint election under section 338(h)(10) for T.

(ii) Pursuant to paragraph (c)(2) of this section, as a result of the election under section 338(h)(10), for all Federal tax purposes, P's acquisition of the T stock is treated as a qualified stock purchase and P's acquisition of the T stock is not treated as part of a reorganization described in section 368(a).

Example 13. Stock acquisition followed by brother-sister merger—with section 338(h)(10) election. (i) The facts are the same as in *Example 12*, except that, following P's acquisition of the T stock, T merges into X, a domestic corporation that is a wholly owned subsidiary of P. Viewed independently of any other step, T's merger into X qualifies as a reorganization described in section 368(a). Absent the application of paragraph (c)(2) of this section, the step transaction doctrine would apply to treat P's acquisition of the T stock and T's merger into X as an acquisition by X of T's assets in a reorganization described in section 368(a).

(ii) Pursuant to paragraph (c)(2) of this section, as a result of the election under section 338(h)(10), for all Federal tax purposes, P's acquisition of T stock is treated as a qualified stock purchase and P's acquisition of T stock is not treated as part of a reorganization described in section 368(a).

Example 14. Stock acquisition that does not qualify as a qualified stock purchase followed by upstream merger. (i) The facts are the same as in *Example 11*, except that, in the statutory merger of Y into T, S receives only P voting stock.

(ii) Pursuant to §1.338–3(c)(1)(i) and paragraph (c)(2) of this section, no election under section 338(h)(10) can be made with respect to P's acquisition of the T stock because, pursuant to relevant provisions of law, including the step transaction doctrine, that acquisition followed by T's merger into P is treated as a reorganization described in section 368(a)(1)(A), and that acquisition, viewed independently of T's merger into P, does not constitute a qualified stock purchase under section 338(d)(3). Accordingly, P's acquisition of the T stock and T's merger into P is treated as a reorganization described in section 368(a).

* * * * *

(h) *Effective date*. This section is applicable to stock acquisitions occurring on or after July 5, 2006. For stock acquisitions occurring before July 5, 2006, see §1.338(h)(10)–1T as contained in the edition of 26 CFR part 1, revised as of April 1, 2006.

* * * * *

§1.338(h)(10)–1T [Removed]

Par. 4. Section 1.338(h)(10)–1T is removed.

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

Approved June 20, 2006.

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

(Filed by the Office of the Federal Register on July 3, 2006, 8:45 a.m., and published in the issue of the Federal Register for July 5, 2006, 71 F.R. 38074)

Section 4980G.—Failure of Employer to Make Comparable Health Savings Account Contributions

26 CFR 54.4980G–1: Failure of employer to make comparable health savings account contributions

T.D. 9277

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 54

Employer Comparable Contributions to Health Savings Accounts Under Section 4980G

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance regarding employer comparable contributions to Health Savings Accounts (HSAs) under section 4980G. In general, these final regulations affect employers that contribute to employees' HSAs.

DATES: *Effective Date:* These regulations are effective on July 31, 2006.

Applicability Date: These regulations apply to employer contributions to HSAs made on or after January 1, 2007.

FOR FURTHER INFORMATION CONTACT: Mireille T. Khoury (202) 622–6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final Pension Excise Tax Regulations (26 CFR part 54) under section 4980G of the Internal Revenue Code (Code). Under section 4980G of the Code, an excise tax is imposed on an employer that fails to make comparable contributions to the HSAs of its employees.

Section 1201 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Act), Public Law 108–173, (117 Stat. 2066, 2003) added section 223 to the Code to permit eligible individuals to establish HSAs for taxable years beginning after December 31, 2003. Section 4980G was also added to the Code by the Act. Section 4980G(a) imposes an excise tax on the failure of an employer to make comparable contributions to the HSAs of its employees for a calendar year. Section 4980G(b) provides that rules and requirements similar to section 4980E (the comparability rules for Archer Medical Savings Accounts (Archer MSAs)) apply for purposes of section 4980G. Section 4980E(b) imposes an excise tax equal to 35% of the aggregate amount contributed by the employer to the Archer MSAs of employees during the calendar year if an employer fails to make comparable contributions to the Archer MSAs of its employees in a calendar year. Therefore, if an employer fails to make comparable contributions to the HSAs of its employees during a calendar year, an excise tax equal to 35% of the aggregate amount contributed by the employer to the HSAs of its employees during that calendar year is imposed on the employer. See Sections 4980G(a) and (b) and 4980E(b). See also Notice 2004–2, 2004–1 C.B. 269), Q & A–32. See §601.601(d)(2).

On August 26, 2005, proposed regulations (REG–138647–04, 2005–2 C.B. 697) were published in the **Federal Register** (70 FR 50233). The proposed regulations clarified and expanded upon the guidance regarding the comparability rules published in Notice 2004–2 and in Notice 2004–50, 2004–2 C.B. 196), Q & A–46 through Q & A–54. See §601.601(d)(2) of this chapter. Written public comments on the proposed regulations were received and a public hearing was requested. The hearing was held on February 23, 2006. After consideration of all the comments, these final regulations adopt the provisions of the proposed regulations with certain modifications, the most significant of which are highlighted in this preamble.

Explanation of Provisions and Summary of Comments

Several commentators requested that the effective date should be at least one year from the date the regulations are finalized to give employers sufficient time to implement changes required to comply with the final regulations. The final regulations will apply to employer contributions to HSAs made on or after January 1, 2007.

An employer is not required to contribute to the HSAs of its employees. In general, however, if an employer makes contributions to any employee's HSA, the employer must make comparable contributions to the HSAs of all comparable participating employees. Comparable participating employees are eligible individuals (as defined in section 223(c)(1)) who are in the same category of employees and who have the same category of high deductible health plan (HDHP) coverage. Under the proposed regulations, the categories of coverage were self-only HDHP coverage and family HDHP coverage. Several commentators recommended that the final regulations should recognize additional categories of coverage other than self-only and family HDHP. The final regulations adopt this recommendation and allow family HDHP coverage to be subdivided into the following additional categories of HDHP coverage: self plus one, self plus two and self plus three or more. In addition, the final regulations provide that an employer's contribution with respect to the self plus two category may not be less than the employer's contribution with respect to the self plus one category and the employer's contribution with respect to the self plus three or more category may not be less than the employer's contribution with respect to the self plus two category.

In addition, several commentators requested separate treatment for groups of collectively bargained employees, such that employers' HSA contributions to collectively bargained employees would not be subject to the comparability rules. In response to these comments, the final regulations provide that employees who are included in a unit of employees covered by a *bona fide* collective bargaining agreement between employee representatives and one or more employers are not comparable participating employees, if health benefits were the subject of good faith bargaining between such employee representatives and such employer or employers. Collectively bargained employees are, therefore, disregarded for purposes of section 4980G.

Numerous commentators requested guidance on the exception to the comparability rules for employer contributions made through a section 125 cafeteria plan. In response to these comments, the final regulations provide additional guidance on how employer HSA contributions are made through a cafeteria plan. Specifically, the final regulations provide that employer contributions to employees' HSAs are made through the cafeteria plan if under the written cafeteria plan, the employees have the right to elect to receive cash or other taxable benefits in lieu of all or a portion of an HSA contribution (*i.e.*, all or a portion of the HSA contributions are available as pre-tax salary reduction amounts), regardless of whether an employee actually elects to contribute any amount to the HSA by salary reduction. The final regulations also provide several examples that illustrate the application of the cafeteria plan exception to the comparability rules.

One commentator requested guidance on what actions an employer must take to locate any missing comparable participating former employees for purposes of contributions to eligible former employees. The final regulations provide guidance on this issue and explain that an employer making comparable contributions to former employees must take reasonable actions to locate any missing comparable participating former employees. In general, such reasonable actions include the use of certified mail, the Internal Revenue Service Letter Forwarding Program, see Rev. Proc. 94–22, 1994–1 C.B. 608, or the Social Security Administration's Letter Forwarding Service. See §601.601(d)(2).

Several commentators requested that testing for comparability purposes be permitted on a plan year, rather than calendar year, basis. Section 4980G mandates the use of a calendar year for testing purposes. Accordingly, the final regulations do not adopt the suggestion for plan year testing. Also, the final regulations have removed and reserved the provision dealing with instances where an employee has not established an HSA by the end of the calendar year.

Finally, one commentator requested clarification on what would constitute reasonable interest for purposes of section 4980G. In response to this comment, the final regulations provide that the determination of whether a rate of interest used by an employer is reasonable will be based on all of the facts and circumstances. However, if an employer calculates interest using the Federal short-term rate as determined by the Secretary in accordance with Code section 1274(d), the employer is deemed to use a reasonable interest rate.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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. These regulations do not impose a collection of information on small entities, thus the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Barbara E. Pie and Mireille T. Khoury, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities).

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 54 is amended as follows:

PART 54—PENSION EXCISE TAXES

Paragraph 1. The authority citation for part 54 is amended by adding entries in numerical order to read, in part, as follows:

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

Section 54.4980G–1 also issued under 26 U.S.C. 4980G.

Section 54.4980G–2 also issued under 26 U.S.C. 4980G.

Section 54.4980G–3 also issued under 26 U.S.C. 4980G.

Section 54.4980G–4 also issued under 26 U.S.C. 4980G.

Section 54.4980G–5 also issued under 26 U.S.C. 4980G. * * *

Par. 2. Sections 54.4980G–0, 54.4980G–1, 54.4980G–2, 54.4980G–3, 54.4980G–4, and 54.4980G–5 are added to read as follows:

§54.4980G–0 Table of contents.

This section contains the questions for §§ 54.4980G–1, 54.4980G–2, 54.4980G–3, 54.4980G–4, and 54.4980G–5.

§54.4980G–1 Failure of employer to make comparable health savings account contributions.

Q–1: What are the comparability rules that apply to employer contributions to Health Savings Accounts (HSAs)?

Q–2: What are the categories of HDHP coverage for purposes of applying the comparability rules?

Q–3: What is the testing period for making comparable contributions to employees' HSAs?

Q–4: How is the excise tax computed if employer contributions do not satisfy the comparability rules for a calendar year?

§54.4980G–2 Employer contribution defined.

Q–1: Do the comparability rules apply to amounts rolled over from an employee's HSA or Archer Medical Savings Account (Archer MSA)?

Q–2: If an employee requests that his or her employer deduct after-tax amounts from the employee's compensation and forward these amounts as employee contributions to the employee's HSA, do the comparability rules apply to these amounts?

§54.4980G–3 Employee for comparability testing.

Q–1: Do the comparability rules apply to contributions that an employer makes to the HSAs of independent contractors or self-employed individuals?

Q–2: May a sole proprietor who is an eligible individual contribute to his or her own HSA without contributing to the HSAs of his or her employees who are eligible individuals?

Q–3: Do the comparability rules apply to contributions by a partnership to a partner's HSA?

Q–4: How are members of controlled groups treated when applying the comparability rules?

Q–5: What are the categories of employees for comparability testing?

Q–6: Are employees who are included in a unit of employees covered by a collective bargaining agreement comparable participating employees?

Q–7: Is an employer permitted to make comparable contributions only to the HSAs of comparable participating employees who have coverage under the employer's HDHP?

Q–8: If an employee and his or her spouse are eligible individuals who work for the same employer and one employee-spouse has family coverage for both employees under the employer's HDHP, must the employer make comparable contributions to the HSAs of both employees?

Q–9: Does an employer that makes HSA contributions only for one class of non-collectively bargained employees who are eligible individuals, but not for another class of non-collectively bargained employees who are eligible individuals (for example, management v. non-management) satisfy the requirement that the employer make comparable contributions?

Q–10: If an employer contributes to the HSAs of former employees who are eligible individuals, do the comparability rules apply to these contributions?

Q–11: Is an employer permitted to make comparable contributions only to the HSAs of comparable participating former employees who have coverage under the employer's HDHP?

Q–12: If an employer contributes only to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP, must the employer make comparable contributions to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1))?

Q–13: How do the comparability rules apply if some employees have HSAs and other employees have Archer MSAs?

§54.4980G–4 Calculating comparable contributions.

Q–1: What are comparable contributions?

Q–2: How does an employer comply with the comparability rules when some non-collectively bargained employees who are eligible individuals do not work for the employer during the entire calendar year?

Q–3: How do the comparability rules apply to employer contributions to employees' HSAs if some non-collectively bargained employees work full-time during the entire calendar year, and other non-collectively bargained employees work full-time for less than the entire calendar year?

Q–4: May an employer make contributions for the entire year to the HSAs of its employees who are eligible individuals at the beginning of the calendar year (*i.e.*, on a pre-funded basis) instead of contributing on a pay-as-you-go or on a look-back basis?

Q–5: Must an employer use the same contribution method as described in Q & A–2 and Q & A–4 of this section for all employees who were comparable participating employees for any month during the calendar year?

Q–6: How does an employer comply with the comparability rules if an employee has not established an HSA at the time the employer contributes to its employees' HSAs?

Q–7: If an employer bases its contributions on a percentage of the HDHP deductible, how is the correct percentage or dollar amount computed?

Q–8: Does an employer that contributes to the HSA of each comparable participating employee in an amount equal to the employee's HSA contribution or a percentage of the employee's HSA contribution (matching contributions) satisfy the rule that all comparable participating employees receive comparable contributions?

Q–9: If an employer conditions contributions by the employer to an employee's HSA on an employee's participation in health assessments, disease management programs or wellness programs and makes the same contributions available to all employees who participate in the programs, do the contributions satisfy the comparability rules?

Q–10: If an employer makes additional contributions to the HSAs of all comparable participating employees who have attained a specified age or who have worked for the employer for a specified number of years, do the contributions satisfy the comparability rules?

Q–11: If an employer makes additional contributions to the HSAs of all comparable participating employees who are eligible to make the additional contributions (HSA catch-up contributions) under section 223(b)(3), do the contributions satisfy the comparability rules?

Q–12: If an employer's contributions to an employee's HSA result in non-comparable contributions, may the employer recoup the excess amount from the employee's HSA?

Q–13: What constitutes a reasonable interest rate for purposes of making comparable contributions?

§54.4980G–5 HSA comparability rules and cafeteria plans and waiver of excise tax.

Q–1: If an employer makes contributions through a section 125 cafeteria plan to the HSA of each employee who is an eligible individual, are the contributions subject to the comparability rules?

Q–2: If an employer makes contributions through a cafeteria plan to the HSA of each employee who is an eligible individual in an amount equal to the amount of the employee's HSA contribution or a percentage of the amount of the employee's HSA contribution (*i.e.*, matching contributions), are the contributions subject to the section 4980G comparability rules?

Q–3: If under the employer's cafeteria plan, employees who are eligible individuals and who participate in health assessments, disease management programs or wellness programs receive an employer contribution to an HSA and the employees have the right to elect to make pre-tax salary reduction contributions to their HSAs, are the contributions subject to the comparability rules?

Q–4: May all or part of the excise tax imposed under section 4980G be waived?

§54.4980G–1 Failure of employer to make comparable health savings account contributions.

Q–1: What are the comparability rules that apply to employer contributions to Health Savings Accounts (HSAs)?

A–1: If an employer makes contributions to any employee's HSA, the employer must make comparable contributions to the HSAs of all comparable participating employees. See Q & A–1 in §54.4980G–4 for the definition of comparable contributions. Comparable participating employees are eligible individuals (as defined in section 223(c)(1)) who are in the same category of employees and who have the same category of high deductible health plan (HDHP) coverage. See sections 4980G(b) and 4980E(d)(3). See section 223(c)(2) and (g) for the definition of an HDHP. See also Q & A–5 in §54.4980G–3 for the categories of employees and Q & A–2 of this section for the categories of HDHP coverage. But see Q & A–6 in §54.4980G–3 for treatment of collectively bargained employees.

Q–2: What are the categories of HDHP coverage for purposes of applying the comparability rules?

A–2: (a) *In general*. Generally, the categories of coverage are self-only HDHP coverage and family HDHP coverage. Family HDHP coverage means any coverage other than self-only HDHP coverage. The comparability rules apply separately to self-only HDHP coverage and family HDHP coverage. In addition, if an HDHP has family coverage options meeting the descriptions listed in paragraph (b) of this Q & A–2, each such coverage option may be treated as a separate category of coverage and the comparability rules may be applied separately to each category. However, if the HDHP has more than one category that provides coverage for the same number of individuals, all such categories are treated as a single category for purposes of the comparability rules. Thus, the categories of "employee plus spouse" and "employee plus dependent," each providing coverage for two individuals, are treated as the single category "self plus one" for comparability purposes. See, however, the final sentence of paragraph (a) of Q & A–1 of §54.4980G–4 for a special rule that applies if different amounts are contributed for different categories of family coverage.

(b) *HDHP Family coverage categories*. The coverage categories are—

(1) Self plus one;

(2) Self plus two; and

(3) Self plus three or more.

(c) *Examples*. The rules of this Q & A–2 are illustrated by the following examples:

Example 1. Employer A maintains an HDHP and contributes to the HSAs of eligible employees who elect coverage under the HDHP. The HDHP has self-only coverage and family coverage. Thus, the categories of coverage are self-only and family coverage. Employer A contributes $750 to the HSA of each eligible employee with self-only HDHP coverage and $1,000 to the HSA of each eligible employee with family HDHP coverage. Employer A's contributions satisfy the comparability rules.

Example 2. (i) Employer B maintains an HDHP and contributes to the HSAs of eligible employees who elect coverage under the HDHP. The HDHP has the following coverage options:

(A) Self-only;

(B) Self plus spouse;

(C) Self plus dependent;

(D) Self plus spouse plus one dependent;

(E) Self plus two dependents; and

(F) Self plus spouse and two or more dependents.

(ii) The self plus spouse category and the self plus dependent category constitute the same category of HDHP coverage (self plus one) and Employer B must make the same comparable contributions to the HSAs of all eligible individuals who are in either the self plus spouse category of HDHP coverage or the self plus dependent category of HDHP coverage. Likewise, the self plus spouse plus one dependent category and the self plus two dependents category constitute the same category of HDHP coverage (self plus two) and Employer B must make the same comparable contributions to the HSAs of all eligible individuals who are in either the self plus spouse plus one dependent category of HDHP coverage or the self plus two dependents category of HDHP coverage.

Example 3. (i) Employer C maintains an HDHP and contributes to the HSAs of eligible employees who elect coverage under the HDHP. The HDHP has the following coverage options:

(1) Self-only;

(2) Self plus one;

(3) Self plus two; and

(4) Self plus three or more.

(ii) Employer C contributes $500 to the HSA of each eligible employee with self-only HDHP coverage, $750 to the HSA of each eligible employee with self plus one HDHP coverage, $900 to the HSA of each eligible employee with self plus two HDHP coverage and $1,000 to the HSA of each eligible employee with self plus three or more HDHP coverage. Employer C's contributions satisfy the comparability rules.

Q–3: What is the testing period for making comparable contributions to employees' HSAs?

A–3: To satisfy the comparability rules, an employer must make comparable contributions for the calendar year to the HSAs of employees who are comparable participating employees. See section 4980G(a). See Q & A–3 and Q & A–4 in §54.4980G–4 for a discussion of HSA contribution methods.

Q–4: How is the excise tax computed if employer contributions do not satisfy the comparability rules for a calendar year?

A–4: (a) *Computation of tax*. If employer contributions do not satisfy the comparability rules for a calendar year, the employer is subject to an excise tax equal to 35% of the aggregate amount contributed by the employer to HSAs for that period.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–4:

Example. During the 2007 calendar year, Employer D has 8 employees who are eligible individuals with self-only coverage under an HDHP provided by Employer D. The deductible for the HDHP is $2,000. For the 2007 calendar year, Employer D contributes $2,000 each to the HSAs of two employees and $1,000 each to the HSAs of the other six employees, for total HSA contributions of $10,000. Employer D's contributions do not satisfy the comparability rules. Therefore, Employer D is subject to an excise tax of $3,500 (35% of $10,000) for its failure to make comparable contributions to its employees' HSAs.

§54.4980G–2 Employer contribution defined.

Q–1: Do the comparability rules apply to amounts rolled over from an employee's HSA or Archer Medical Savings Account (Archer MSA)?

A–1: No. The comparability rules do not apply to amounts rolled over from an employee's HSA or Archer MSA.

Q–2: If an employee requests that his or her employer deduct after-tax amounts from the employee's compensation and forward these amounts as employee contributions to the employee's HSA, do the comparability rules apply to these amounts?

A–2: No. Section 106(d) provides that amounts contributed by an employer to an eligible employee's HSA shall be treated as employer-provided coverage for medical expenses and are excludible from the employee's gross income up to the limit in section 223(b). After-tax employee contributions to an HSA are not subject to the comparability rules because they are not employer contributions under section 106(d).

§54.4980G–3 Employee for comparability testing.

Q–1: Do the comparability rules apply to contributions that an employer makes to the HSAs of independent contractors or self-employed individuals?

A–1: No. The comparability rules apply only to contributions that an employer makes to the HSAs of employees.

Q–2: May a sole proprietor who is an eligible individual contribute to his or her own HSA without contributing to the HSAs of his or her employees who are eligible individuals?

A–2: (a) *Sole proprietor not an employee*. Yes. The comparability rules apply only to contributions made by an employer to the HSAs of employees. Because a sole proprietor is not an employee, the comparability rules do not apply to contributions the sole proprietor makes to his or her own HSA. However, if a sole proprietor contributes to any employee's HSA, the sole proprietor must make comparable contributions to the HSAs of all comparable participating employees. In determining whether the comparability rules are satisfied, contributions that a sole proprietor makes to his or her own HSA are not taken into account.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–2:

Example. In a calendar year, B, a sole proprietor is an eligible individual and contributes $1,000 to B's own HSA. B also contributes $500 for the same calendar year to the HSA of each employee who is an eligible individual. The comparability rules are not violated by B's $1,000 contribution to B's own HSA.

Q–3: Do the comparability rules apply to contributions by a partnership to a partner's HSA?

A–3: (a) *Partner not an employee*. No. Contributions by a partnership to a *bona fide* partner's HSA are not subject to the comparability rules because the contributions are not contributions by an employer to the HSA of an employee. The contributions are treated as either guaranteed payments under section 707(c) or distributions under section 731. However, if a partnership contributes to the HSAs of any employee who is not a partner, the partnership must make comparable contributions to the HSAs of all comparable participating employees.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–3:

Example. (i) Partnership X is a limited partnership with three equal individual partners, A (a general partner), B (a limited partner), and C (a limited partner). C is to be paid $300 annually for services rendered to Partnership X in her capacity as a partner without regard to partnership income (a section 707(c) guaranteed payment). D and E are the only employees of Partnership X and are not partners in Partnership X. A, B, C, D, and E are eligible individuals and each has an HSA. During Partnership X's Year 1 taxable year, which is also a calendar year, Partnership X makes the following contributions—

(A) A $300 contribution to each of A's and B's HSAs which are treated as section 731 distributions to A and B;

(B) A $300 contribution to C's HSA in lieu of paying C the guaranteed payment directly; and

(C) A $200 contribution to each of D's and E's HSAs, who are comparable participating employees.

(ii) Partnership X's contributions to A's and B's HSAs are section 731 distributions, which are treated as cash distributions. Partnership X's contribution to C's HSA is treated as a guaranteed payment under section 707(c). The contribution is not excludible from C's gross income under section 106(d) because the contribution is treated as a distributive share of partnership income for purposes of all Code sections other than sections 61(a) and 162(a), and a guaranteed payment to a partner is not treated as compensation to an employee. Thus, Partnership X's contributions to the HSAs of A, B, and C are not subject to the comparability rules. Partnership X's contributions to D's and E's HSAs are subject to the comparability rules because D and E are employees of Partnership X and are not partners in Partnership X. Partnership X's contributions satisfy the comparability rules.

Q–4: How are members of controlled groups treated when applying the comparability rules?

A–4: All persons or entities treated as a single employer under section 414 (b), (c), (m), or (o) are treated as one employer. See sections 4980G(b) and 4980E(e).

Q–5: What are the categories of employees for comparability testing?

A–5: (a) *Categories*. The categories of employees for comparability testing are as follows (but see Q & A–6 of this section for the treatment of collectively bargained employees)—

(1) Current full-time employees;

(2) Current part-time employees; and

(3) Former employees (except for former employees with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1)).

(b) *Part-time and full-time employees*. For purposes of section 4980G, part-time employees are customarily employed for fewer than 30 hours per week and full-time employees are customarily employed for 30 or more hours per week. See sections 4980G(b) and 4980E(d)(4)(A) and (B).

(c) *In general*. Except as provided in Q & A–6 of this section, the categories of employees in paragraph (a) of this Q & A–5 are the exclusive categories of employees for comparability testing. An employer must make comparable contributions to the HSAs of all comparable participating employees (eligible individuals who are in the same category of employees with the same category of HDHP coverage) during the calendar year without regard to any classification other than these categories. For example, full-time eligible employees with self-only HDHP coverage and part-time eligible employees with self-only HDHP coverage are separate categories of employees and different amounts can be contributed to the HSAs for each of these categories.

Q–6: Are employees who are included in a unit of employees covered by a collective bargaining agreement comparable participating employees?

A–6: (a) *In general*. No. Collectively bargained employees who are covered by a *bona fide* collective bargaining agreement between employee representatives and one or more employers are not comparable participating employees, if health benefits were the subject of good faith bargaining between such employee representatives and such employer or employers. Former employees covered by a collective bargaining agreement also are not comparable participating employees.

(b) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–6. The examples read as follows:

Example 1. Employer A offers its employees an HDHP with a $1,500 deductible for self-only coverage. Employer A has collectively bargained and non-collectively bargained employees. The collectively bargained employees are covered by a collective bargaining agreement under which health benefits were bargained in good faith. In the 2007 calendar year, Employer A contributes $500 to the HSAs of all eligible non-collectively bargained employees with self-only coverage under Employer A's HDHP. Employer A does not contribute to the HSAs of the collectively bargained employees. Employer A's contributions to the HSAs of non-collectively bargained employees satisfy the comparability rules. The comparability rules do not apply to collectively bargained employees.

Example 2. Employer B offers its employees an HDHP with a $1,500 deductible for self-only coverage. Employer B has collectively bargained and non-collectively bargained employees. The collectively bargained employees are covered by a collective bargaining agreement under which health benefits were bargained in good faith. In the 2007 calendar year and in accordance with the terms of the collective bargaining agreement, Employer B contributes to the HSAs of all eligible collectively bargained employees. Employer B does not contribute to the HSAs of the non-collectively bargained employees. Employer B's contributions to the HSAs of collectively bargained employees are not subject to the comparability rules because the comparability rules do not apply to collectively bargained employees. Accordingly, Employer B's failure to contribute to the HSAs of the non-collectively bargained employees does not violate the comparability rules.

Example 3. Employer C has two units of collectively bargained employees — unit Q and unit R — each covered by a collective bargaining agreement under which health benefits were bargained in good faith. In the 2007 calendar year and in accordance with the terms of the collective bargaining agreement, Employer C contributes to the HSAs of all eligible collectively bargained employees in unit Q. In accordance with the terms of the collective bargaining agreement, Employer C makes no HSA contributions for collectively bargained employees in unit R. Employer C's contributions to the HSAs of collectively bargained employees are not subject to the comparability rules because the comparability rules do not apply to collectively bargained employees.

Example 4. Employer D has a unit of collectively bargained employees that are covered by a collective bargaining agreement under which health benefits were bargained in good faith. In accordance with the terms of the collective bargaining agreement, Employer D contributes an amount equal to a specified number of cents per hour for each hour worked to the HSAs of all eligible collectively bargained employees. Employer D's contributions to the HSAs of collectively bargained employees are not subject to the comparability rules because the comparability rules do not apply to collectively bargained employees.

Q–7: Is an employer permitted to make comparable contributions only to the HSAs of comparable participating employees who have coverage under the employer's HDHP?

A–7: (a) *Employer-provided HDHP coverage*. If during a calendar year, an employer contributes to the HSA of any employee who is an eligible individual covered under an HDHP provided by the employer, the employer is required to make comparable contributions to the HSAs of all comparable participating employees with coverage under any HDHP provided by the employer. An employer that contributes only to the HSAs of employees who are eligible individuals with coverage under the employer's HDHP is not required to make comparable contributions to HSAs of employees who are eligible individuals but are not covered under the employer's HDHP.

(b) *Non-employer provided HDHP coverage*. An employer that contributes to the HSA of any employee who is an eligible individual with coverage under any HDHP that is not an HDHP provided by the employer, must make comparable contributions to the HSAs of all comparable participating employees whether or not covered under the employer's HDHP. An employer that makes a reasonable good faith effort to identify all comparable participating employees with non-employer provided HDHP coverage and makes comparable contributions to the HSAs of such employees satisfies the requirements in paragraph (b) of this Q & A–7.

(c) *Examples*. The following examples illustrate the rules in this Q & A–7. None of the employees in the following examples are covered by a collective bargaining agreement. The examples read as follows:

Example 1. In a calendar year, Employer E offers an HDHP to its full-time employees. Most full-time employees are covered under Employer E's HDHP and Employer E makes comparable contributions only to these employees' HSAs. Employee W, a full-time employee of Employer E and an eligible individual, is covered under an HDHP provided by the employer of W's spouse and not under Employer E's HDHP. Employer E is not required to make comparable contributions to W's HSA.

Example 2. In a calendar year, Employer F does not offer an HDHP. Several full-time employees of Employer F, who are eligible individuals, have HSAs. Employer F contributes to these employees' HSAs. Employer F must make comparable contributions to the HSAs of all full-time employees who are eligible individuals.

Example 3. In a calendar year, Employer G offers an HDHP to its full-time employees. Most full-time employees are covered under Employer G's HDHP and Employer G makes comparable contributions to these employees' HSAs and also to the HSAs of full-time employees who are eligible individuals and who are not covered under Employer G's HDHP. Employee S, a full-time employee of Employer G and a comparable participating employee, is covered under an HDHP provided by the employer of S's spouse and not under Employer G's HDHP. Employer G must make comparable contributions to S's HSA.

Q–8: If an employee and his or her spouse are eligible individuals who work for the same employer and one employee-spouse has family coverage for both employees under the employer's HDHP, must the employer make comparable contributions to the HSAs of both employees?

A–8: (a) *In general*. If the employer makes contributions only to the HSAs of employees who are eligible individuals covered under its HDHP where only one employee-spouse has family coverage for both employees under the employer's HDHP, the employer is not required to contribute to the HSAs of both employee-spouses. The employer is required to contribute to the HSA of the employee-spouse with coverage under the employer's HDHP, but is not required to contribute to the HSA of the employee-spouse covered under the employer's HDHP by virtue of his or her spouse's coverage. However, if the employer contributes to the HSA of any employee who is an eligible individual with coverage under an HDHP that is not an HDHP provided by the employer, the employer must make comparable contributions to the HSAs of both employee-spouses if they are both eligible individuals. If an employer is required to contribute to the HSAs of both employee-spouses, the employer is not required to contribute amounts in excess of the annual contribution limits in section 223(b).

(b) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–8. None of the employees in the following examples are covered by a collective bargaining agreement. The examples read as follows:

Example 1. In a calendar year, Employer H offers an HDHP to its full-time employees. Most full-time employees are covered under Employer H's HDHP and Employer H makes comparable contributions only to these employees' HSAs. T and U are a married couple. Employee T, who is a full-time employee of Employer H and an eligible individual, has family coverage under Employer H's HDHP for T and T's spouse. Employee U, who is also a full-time employee of Employer H and an eligible individual, does not have coverage under Employer H's HDHP except as the spouse of Employee T. Employer H is required to make comparable contributions to T's HSA, but is not required to make comparable contributions to U's HSA.

Example 2. In a calendar year, Employer J offers an HDHP to its full-time employees. Most full-time employees are covered under Employer J's HDHP and Employer J makes comparable contributions to these employees' HSAs and to the HSAs of full-time employees who are eligible individuals but are not covered under Employer J's HDHP. R and S are a married couple. Employee S, who is a full-time employee of Employer J and an eligible individual, has family coverage under Employer J's HDHP for S and S's spouse. Employee R, who is also a full-time employee of Employer J and an eligible individual, does not have coverage under Employer J's HDHP except as the spouse of Employee S. Employer J must make comparable contributions to S's HSA and to R's HSA.

Q–9: Does an employer that makes HSA contributions only for one class of non-collectively bargained employees who are eligible individuals, but not for another class of non-collectively bargained employees who are eligible individuals (for example, management v. non-management) satisfy the requirement that the employer make comparable contributions?

A–9: (a) *Different classes of employees*. No. If the two classes of employees are comparable participating employees, the comparability rules are not satisfied. The only categories of employees for comparability purposes are current full-time employees, current part-time employees, and former employees. Collectively bargained employees are not comparable participating employees. But see Q & A–1 in §54.4980G–5 on contributions made through a cafeteria plan.

(b) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–9. None of the employees in the following examples are covered by a collective bargaining agreement. The examples read as follows:

Example 1. In a calendar year, Employer K maintains an HDHP covering all management and non-management employees. Employer K contributes to the HSAs of non-management employees who are eligible individuals covered under its HDHP. Employer K does not contribute to the HSAs of its management employees who are eligible individuals covered under its HDHP. The comparability rules are not satisfied.

Example 2. All of Employer L's employees are located in city X and city Y. In a calendar year, Employer L maintains an HDHP for all employees working in city X only. Employer L does not maintain an HDHP for its employees working in city Y. Employer L contributes $500 to the HSAs of city X employees who are eligible individuals with coverage under its HDHP. Employer L does not contribute to the HSAs of any of its city Y employees. The comparability rules are satisfied because none of the employees in city Y are covered under an HDHP of Employer L. (However, if any employees in city Y were covered by an HDHP of Employer L, Employer L could not fail to contribute to their HSAs merely because they work in a different city.)

Example 3. Employer M has two divisions — division N and division O. In a calendar year, Employer M maintains an HDHP for employees working in division N and division O. Employer M contributes to the HSAs of division N employees who are eligible individuals with coverage under its HDHP. Employer M does not contribute to the HSAs of division O employees who are eligible individuals covered under its HDHP. The comparability rules are not satisfied.

Q–10: If an employer contributes to the HSAs of former employees who are eligible individuals, do the comparability rules apply to these contributions?

A–10: (a) *Former employees*. Yes. The comparability rules apply to contributions an employer makes to former employees' HSAs. Therefore, if an employer contributes to any former employee's HSA, it must make comparable contributions to the HSAs of all comparable participating former employees (former employees who are eligible individuals with the same category of HDHP coverage). However, an employer is not required to make comparable contributions to the HSAs of former employees with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1)). See Q & A–5 and Q & A–12 of this section. The comparability rules apply separately to former employees because they are a separate category of covered employee. See Q & A–5 of this section. Also, former employees who were covered by a collective bargaining agreement immediately before termination of employment are not comparable participating employees. See Q & A–6 of this section.

(b) *Locating former employees*. An employer making comparable contributions to former employees must take reasonable actions to locate any missing comparable participating former employees. In general, such actions include the use of certified mail, the Internal Revenue Service Letter Forwarding Program or the Social Security Administration's Letter Forwarding Service.

(c) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–10. None of the employees in the following examples are covered by a collective bargaining agreement. The examples read as follows:

Example 1. In a calendar year, Employer N contributes $1,000 for the calendar year to the HSA of each current employee who is an eligible individual with coverage under any HDHP. Employer N does not contribute to the HSA of any former employee who is an eligible individual. Employer N's contributions satisfy the comparability rules.

Example 2. In a calendar year, Employer O contributes to the HSAs of current employees and former employees who are eligible individuals covered under any HDHP. Employer O contributes $750 to the HSA of each current employee with self-only HDHP coverage and $1,000 to the HSA of each current employee with family HDHP coverage. Employer O also contributes $300 to the HSA of each former employee with self-only HDHP coverage and $400 to the HSA of each former employee with family HDHP coverage. Employer O's contributions satisfy the comparability rules.

Q–11: Is an employer permitted to make comparable contributions only to the HSAs of comparable participating former employees who have coverage under the employer's HDHP?

A–11: If during a calendar year, an employer contributes to the HSA of any former employee who is an eligible individual covered under an HDHP provided by the employer, the employer is required to make comparable contributions to the HSAs of all former employees who are comparable participating former employees with coverage under any HDHP provided by the employer. An employer that contributes only to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP is not required to make comparable contributions to the HSAs of former employees who are eligible individuals and who are not covered under the employer's HDHP. However, an employer that contributes to the HSA of any former employee who is an eligible individual with coverage under an HDHP that is not an HDHP of the employer, must make comparable contributions to the HSAs of all former employees who are eligible individuals whether or not covered under an HDHP of the employer.

Q–12: If an employer contributes only to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP, must the employer make comparable contributions to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1))?

A–12: No. An employer that contributes only to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP is not required to make comparable contributions to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1)).

Q–13: How do the comparability rules apply if some employees have HSAs and other employees have Archer MSAs?

A–13: (a) *HSAs and Archer MSAs*. The comparability rules apply separately to employees who have HSAs and employees who have Archer MSAs. However, if an employee has both an HSA and an Archer MSA, the employer may contribute to either the HSA or the Archer MSA, but not to both.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–13:

Example. In a calendar year, Employer P contributes $600 to the Archer MSA of each employee who is an eligible individual and who has an Archer MSA. Employer P contributes $500 for the calendar year to the HSA of each employee who is an eligible individual and who has an HSA. If an employee has both an Archer MSA and an HSA, Employer P contributes to the employee's Archer MSA and not to the employee's HSA. Employee X has an Archer MSA and an HSA. Employer P contributes $600 for the calendar year to X's Archer MSA but does not contribute to X's HSA. Employer P's contributions satisfy the comparability rules.

§54.4980G–4 Calculating comparable contributions.

Q–1: What are comparable contributions?

A–1: (a) *Definition*. Contributions are comparable if, for each month in a calendar year, the contributions are either the same amount or the same percentage of the deductible under the HDHP for employees who are eligible individuals with the same category of coverage on the first day of that month. Employees with self-only HDHP coverage are tested separately from employees with family HDHP coverage. Similarly, employees with different categories of family HDHP coverage may be tested separately. See Q & A–2 in §54.4980G–1. An employer is not required to contribute the same amount or the same percentage of the deductible for employees who are eligible individuals with one category of HDHP coverage that it contributes for employees who are eligible individuals with a different category of HDHP coverage. For example, an employer that satisfies the comparability rules by contributing the same amount to the HSAs of all employees who are eligible individuals with family HDHP coverage is not required to contribute any amount to the HSAs of employees who are eligible individuals with self-only HDHP coverage, or to contribute the same percentage of the self-only HDHP deductible as the amount contributed with respect to family HDHP coverage. However, the contribution with respect to the self plus two category may not be less than the contribution with respect to the self plus one category and the contribution with respect to the self plus three or more category may not be less than the contribution with respect to the self plus two category.

(b) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–1. None of the employees in the following examples are covered by a collective bargaining agreement. The examples read as follows:

Example 1. In the 2007 calendar year, Employer A offers its full-time employees three health plans, including an HDHP with self-only coverage and a $2,000 deductible. Employer A contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the self-only HDHP coverage. Employer A makes no HSA contributions for employees with family HDHP coverage or for employees who do not elect the employer's self-only HDHP. Employer A's HSA contributions satisfy the comparability rules.

Example 2. In the 2007 calendar year, Employer B offers its employees an HDHP with a $3,000 deductible for self-only coverage and a $4,000 deductible for family coverage. Employer B contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the self-only HDHP coverage. Employer B contributes $2,000 for the calendar year to the HSA of each employee who is an eligible individual electing the family HDHP coverage. Employer B's HSA contributions satisfy the comparability rules.

Example 3. In the 2007 calendar year, Employer C offers its employees an HDHP with a $1,500 deductible for self-only coverage and a $3,000 deductible for family coverage. Employer C contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the self-only HDHP coverage. Employer C contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the family HDHP coverage. Employer C's HSA contributions satisfy the comparability rules.

Example 4. In the 2007 calendar year, Employer D offers its employees an HDHP with a $1,500 deductible for self-only coverage and a $3,000 deductible for family coverage. Employer D contributes $1,500 for the calendar year to the HSA of each employee who is an eligible individual electing the self-only HDHP coverage. Employer D contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the family HDHP coverage. Employer D's HSA contributions satisfy the comparability rules.

Example 5. (i) In the 2007 calendar year, Employer E maintains two HDHPs. Plan A has a $2,000 deductible for self-only coverage and a $4,000 deductible for family coverage. Plan B has a $2,500 deductible for self-only coverage and a $4,500 deductible for family coverage. For the calendar year, Employer E makes contributions to the HSA of each full-time employee who is an eligible individual covered under Plan A of $600 for self-only coverage and $1,000 for family coverage. Employer E satisfies the comparability rules, if it makes either of the following contributions for the 2007 calendar year to the HSA of each full-time employee who is an eligible individual covered under Plan B—

(A) $600 for each full-time employee with self-only coverage and $1,000 for each full-time employee with family coverage; or

(B) $750 for each employee with self-only coverage and $1,125 for each employee with family coverage (the same percentage of the deductible Employer E contributes for full-time employees covered under Plan A, 30% of the deductible for self-only coverage and 25% of the deductible for family coverage).

(ii) Employer E also makes contributions to the HSA of each part-time employee who is an eligible individual covered under Plan A of $300 for self-only coverage and $500 for family coverage. Employer E satisfies the comparability rules, if it makes either of the following contributions for the 2007 calendar year to the HSA of each part-time employee who is an eligible individual covered under Plan B—

(A) $300 for each part-time employee with self-only coverage and $500 for each part-time employee with family coverage; or

(B) $375 for each part-time employee with self-only coverage and $563 for each part-time employee with family coverage (the same percentage of the deductible Employer E contributes for part-time employees covered under Plan A, 15% of the deductible for self-only coverage and 12.5% of the deductible for family coverage).

Example 6. (i) In the 2007 calendar year, Employer F maintains an HDHP. The HDHP has the following coverage options—

(A) A $2,500 deductible for self-only coverage;

(B) A $3,500 deductible for self plus one dependent (self plus one);

(C) A $3,500 deductible for self plus spouse (self plus one);

(D) A $3,500 deductible for self plus spouse and one dependent (self plus two); and

(E) A $3,500 deductible for self plus spouse and two or more dependents (self plus three or more).

(ii) Employer F makes the following contributions for the calendar year to the HSA of each full-time employee who is an eligible individual covered under the HDHP—

(A) $750 for self-only coverage;

(B) $1,000 for self plus one dependent;

(C) $1,000 for self plus spouse;

(D) $1,500 for self plus spouse and one dependent; and

(E) $2,000 for self plus spouse and two or more dependents.

(iii) Employer F's HSA contributions satisfy the comparability rules.

Example 7. (i) In a calendar year, Employer G offers its employees an HDHP and a health flexible spending arrangement (health FSA). The health FSA reimburses employees for medical expenses as defined in section 213(d). Some of Employer G's employees have coverage under the HDHP and the health FSA, some have coverage under the HDHP and their spouse's FSA, and some have coverage under the HDHP and are enrolled in Medicare. For the calendar year, Employer G contributes $500 to the HSA of each employee who is an eligible individual. No contributions are made to the HSAs of employees who have coverage under Employer G's health FSA or under a spouse's health FSA or who are enrolled in Medicare.

(ii) The employees who have coverage under a health FSA (whether Employer H's or their spouse's FSA) or who are covered under Medicare are not eligible individuals. Specifically, the employees who have coverage under the health FSA or under a spouse's health FSA are not comparable participating employees because they are not eligible individuals under section 223(c)(1). Similarly, the employees who are enrolled in Medicare are not comparable participating employees because they are not eligible individuals under section 223(b)(7) and (c)(1). Therefore, employees who have coverage under the health FSA or under a spouse's health FSA and employees who are enrolled in Medicare are excluded from comparability testing. See sections 4980G(b) and 4980E. Employer G's contributions satisfy the comparability rules.

Q–2: How does an employer comply with the comparability rules when some non-collectively bargained employees who are eligible individuals do not work for the employer during the entire calendar year?

A–2: (a) *In general*. In determining whether the comparability rules are satisfied, an employer must take into account all full-time and part-time employees who were employees and eligible individuals for any month during the calendar year. (Full-time and part-time employees are tested separately. See Q & A–5 in §54.4980G–3.) There are two methods to comply with the comparability rules when some employees who are eligible individuals do not work for the employer during the entire calendar year; contributions may be made on a pay-as-you-go basis or on a look-back basis. See Q & A–9 through Q & A–11 in §54.4980G–3 for the rules regarding comparable contributions to the HSAs of former employees.

(b) *Contributions on a pay-as-you-go basis*. An employer may comply with the comparability rules by contributing amounts at one or more dates during the calendar year to the HSAs of employees who are eligible individuals as of the first day of the month, if contributions are the same amount or the same percentage of the HDHP deductible for employees who are eligible individuals as of the first day of the month with the same category of coverage and are made at the same time. Contributions made at the employer's usual payroll interval for different groups of employees are considered to be made at the same time. For example, if salaried employees are paid monthly and hourly employees are paid bi-weekly, an employer may contribute to the HSAs of hourly employees on a bi-weekly basis and to the HSAs of salaried employees on a monthly basis. An employer may change the amount that it contributes to the HSAs of employees at any point. However, the changed contribution amounts must satisfy the comparability rules.

(c) *Examples*. The following examples illustrate the rules in paragraph (b) of this Q & A–2: The examples read as follows:

Example 1. (i) Beginning on January 1st, Employer H contributes $50 per month on the first day of each month to the HSA of each employee who is an eligible individual on that date. Employer H does not contribute to the HSAs of former employees. In mid-March of the same year, Employee X, an eligible individual, terminates employment after Employer H has contributed $150 to X's HSA. After X terminates employment, Employer H does not contribute additional amounts to X's HSA. In mid-April of the same year, Employer H hires Employee Y, an eligible individual, and contributes $50 to Y's HSA in May and $50 in June. Effective in July of the same year, Employer H stops contributing to the HSAs of all employees and makes no contributions to the HSA of any employee for the months of July through December. In August, Employer H hires Employee Z, an eligible individual. Employer H does not contribute to Z's HSA. After Z is hired, Employer H does not hire additional employees. As of the end of the calendar year, Employer H has made the following HSA contributions to its employees' HSAs—

(A) Employer H contributed $150 to X's HSA;

(B) Employer H contributed $100 to Y's HSA;

(C) Employer H did not contribute to Z's HSA; and

(D) Employer H contributed $300 to the HSA of each employee who was an eligible individual and employed by Employer J from January through June.

(ii) Employer H's contributions satisfy the comparability rules.

Example 2. In a calendar year, Employer J offers its employees an HDHP and contributes on a monthly pay-as-you-go basis to the HSAs of employees who are eligible individuals with coverage under Employer J's HDHP. In the calendar year, Employer J contributes $50 per month to the HSA of each employee with self-only HDHP coverage and $100 per month to the HSA of each employee with family HDHP coverage. From January 1st through March 31st of the calendar year, Employee X is an eligible individual with self-only HDHP coverage. From April 1st through December 31st of the calendar year, X is an eligible individual with family HDHP coverage. For the months of January, February and March of the calendar year, Employer J contributes $50 per month to X's HSA. For the remaining months of the calendar year, Employer J contributes $100 per month to X's HSA. Employer J's contributions to X's HSA satisfy the comparability rules.

(d) *Contributions on a look-back basis*. An employer may also satisfy the comparability rules by determining comparable contributions for the calendar year at the end of the calendar year, taking into account all employees who were eligible individuals for any month during the calendar year and contributing the same percentage of the HDHP deductible or the same dollar amount to the HSAs of all employees with the same category of coverage for that month.

(e) *Examples*. The following examples illustrate the rules in paragraph (d) of this Q & A–2. The examples read as follows:

Example 1. In a calendar year, Employer K offers its employees an HDHP and contributes on a look-back basis to the HSAs of employees who are eligible individuals with coverage under Employer K's HDHP. Employer K contributes $600 ($50 per month) for the calendar year to the HSA of each employee with self-only HDHP coverage and $1,200 ($100 per month) for the calendar year to the HSA of each employee with family HDHP coverage. From January 1st through June 30th of the calendar year, Employee Y is an eligible individual with family HDHP coverage. From July 1st through December 31st, Y is an eligible individual with self-only HDHP coverage. Employer K contributes $900 on a look-back basis for the calendar year to Y's HSA ($100 per month for the months of January through June and $50 per month for the months of July through December). Employer K's contributions to Y's HSA satisfy the comparability rules.

Example 2. On December 31st, Employer L contributes $50 per month on a look-back basis to each employee's HSA for each month in the calendar year that the employee was an eligible individual. In mid-March of the same year, Employee T, an eligible individual, terminated employment. In mid-April of the same year, Employer L hired Employee U, who becomes an eligible individual as of May 1st and works for Employer L through December 31st. On December 31st, Employer L contributes $150 to Employee T's HSA and $400 to Employee U's HSA. Employer L's contributions satisfy the comparability rules.

(f) *Periods and dates for making contributions*. With both the pay-as-you go method and the look-back method, an employer may establish, on a reasonable and consistent basis, periods for which contributions will be made (for example, a quarterly period covering three consecutive months in a calendar year) and the dates on which such contributions will be made for that designated period (for example, the first day of the quarter or the last day of the quarter in the case of an employer who has established a quarterly period for making contributions). An employer that makes contributions on a pay-as-you-go basis for a period covering more than one month will not fail to satisfy the comparability rules because an employee who terminates employment prior to the end of the period for which contributions were made has received more contributions on a monthly basis than employees who have worked the entire period. In addition, an employer that makes contributions on a pay-as-you-go basis for a period covering more than one month must make HSA contributions for any comparable participating employees hired after the date of initial funding for that period.

(g) *Example*. The following example illustrates the rules in paragraph (f) of this Q & A–2:

Example. Employer M has established, on a reasonable and consistent basis, a quarterly period for making contributions to the HSAs of eligible employees on a pay-as-you-go basis. Beginning on January 1st, Employer M contributes $150 for the first three months of the calendar year to the HSA of each employee who is an eligible individual on that date. On January 15th, Employee V, an eligible individual, terminated employment after Employer M has contributed $150 to V's HSA. On January 15th, Employer M hired Employee W, who becomes an eligible individual as of February 1st. On April 1st, Employer M has contributed $100 to W's HSA for the two months (February and March) in the quarter period that Employee W was an eligible employee. Employer M's contributions satisfy the comparability rules.

Q–3: How do the comparability rules apply to employer contributions to employees' HSAs if some non-collectively bargained employees work full-time during the entire calendar year, and other non-collectively bargained employees work full-time for less than the entire calendar year?

A–3: Employer contributions to the HSAs of employees who work full-time for less than twelve months satisfy the comparability rules if the contribution amount is comparable when determined on a month-to-month basis. For example, if the employer contributes $240 to the HSA of each full-time employee who works the entire calendar year, the employer must contribute $60 to the HSA of each full-time employee who works on the first day of each three months of the calendar year. The rules set forth in this Q & A–2 apply to employer contributions made on a pay-as-you-go basis or on a look-back basis as described in Q & A–3 of this section. See sections 4980G(b) and 4980E(d)(2)(B).

Q–4: May an employer make contributions for the entire year to the HSAs of its employees who are eligible individuals at the beginning of the calendar year (on a pre-funded basis) instead of contributing on a pay-as-you-go or on a look-back basis?

A–4: (a) *Contributions on a pre-funded basis*. Yes. An employer may make contributions for the entire year to the HSAs of its employees who are eligible individuals at the beginning of the calendar year. An employer that pre-funds the HSAs of its employees will not fail to satisfy the comparability rules because an employee who terminates employment prior to the end of the calendar year has received more contributions on a monthly basis than employees who work the entire calendar year. See Q & A–12 of this section. Under section 223(d)(1)(E), an account beneficiary's interest in an HSA is nonforfeitable. An employer must make comparable contributions for all employees who are comparable participating employees for any month during the calendar year, including employees who are eligible individuals hired after the date of initial funding. An employer that makes HSA contributions on a pre-funded basis may also contribute on a pre-funded basis to the HSAs of employees who are eligible individuals hired after the date of initial funding. Alternatively, an employer that has pre-funded the HSAs of comparable participating employees may contribute to the HSAs of employees who are eligible individuals hired after the date of initial funding on a pay-as-you-go basis or on a look-back basis. An employer that makes HSA contributions on a pre-funded basis must use the same contribution method for all employees who are eligible individuals hired after the date of initial funding.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–4:

Example. (i) On January 1, Employer N contributes $1,200 for the calendar year on a pre-funded basis to the HSA of each employee who is an eligible individual. In mid-May, Employer N hires Employee B, who becomes an eligible individual as of June 1st. Therefore, Employer N is required to make comparable contributions to B's HSA beginning in June. Employer N satisfies the comparability rules with respect to contributions to B's HSA if it makes HSA contributions in any one of the following ways—

(A) Pre-funding B's HSA by contributing $700 to B's HSA;

(B) Contributing $100 per month on a pay-as-you-go basis to B's HSA; or

(C) Contributing to B's HSA at the end of the calendar year taking into account each month that B was an eligible individual and employed by Employer M.

(ii) If Employer M hires additional employees who are eligible individuals after initial funding, it must use the same contribution method for these employees that it used to contribute to B's HSA.

Q–5: Must an employer use the same contribution method as described in Q & A–2 and Q & A–4 of this section for all employees who were comparable participating employees for any month during the calendar year?

A–5: Yes. If an employer makes comparable HSA contributions on a pay-as-you-go basis, it must do so for each employee who is a comparable participating employee as of the first day of the month. If an employer makes comparable contributions on a look-back basis, it must do so for each employee who was a comparable participating employee for any month during the calendar year. If an employer makes HSA contributions on a pre-funded basis, it must do so for all employees who are comparable participating employees at the beginning of the calendar year and must make comparable HSA contributions for all employees who are comparable participating employees for any month during the calendar year, including employees who are eligible individuals hired after the date of initial funding. See Q & A–4 of this section for rules regarding contributions for employees hired after initial funding.

Q–6: How does an employer comply with the comparability rules if an employee has not established an HSA at the time the employer contributes to its employees' HSAs?

A–6: (a) *Employee has not established an HSA at the time the employer funds its employees' HSAs*. If an employee has not established an HSA at the time the employer funds its employees' HSAs, the employer complies with the comparability rules by contributing comparable amounts plus reasonable interest to the employee's HSA when the employee establishes the HSA, taking into account each month that the employee was a comparable participating employee. See Q & A–13 of this section for rules regarding reasonable interest.

(b) *Employee has not established an HSA by the end of the calendar year*. [Reserved].

(c) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–6:

Example. Beginning on January 1st, Employer O contributes $500 per calendar year on a pay-as-you-go basis to the HSA of each employee who is an eligible individual. Employee C is an eligible individual during the entire calendar year but does not establish an HSA until March. Notwithstanding C's delay in establishing an HSA, Employer O must make up the missed HSA contributions plus reasonable interest for January and February by April 15th of the following calendar year.

Q–7: If an employer bases its contributions on a percentage of the HDHP deductible, how is the correct percentage or dollar amount computed?

A–7: (a) *Computing HSA contributions*. The correct percentage is determined by rounding to the nearest 1/100th of a percentage point and the dollar amount is determined by rounding to the nearest whole dollar.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–7:

Example. In this *Example*, assume that each HDHP provided by Employer P satisfies the definition of an HDHP for the 2007 calendar year. In the 2007 calendar year, Employer P maintains two HDHPs. Plan A has a deductible of $3,000 for self-only coverage. Employer P contributes $1,000 for the calendar year to the HSA of each employee covered under Plan A. Plan B has a deductible of $3,500 for self-only coverage. Employer P satisfies the comparability rules if it makes either of the following contributions for the 2007 calendar year to the HSA of each employee who is an eligible individual with self-only coverage under Plan B—

(i) $1,000; or

(ii) $1,167 (33.33% of the deductible rounded to the nearest whole dollar amount).

Q–8: Does an employer that contributes to the HSA of each comparable participating employee in an amount equal to the employee's HSA contribution or a percentage of the employee's HSA contribution (matching contributions) satisfy the rule that all comparable participating employees receive comparable contributions?

A–8: No. If all comparable participating employees do not contribute the same amount to their HSAs and, consequently, do not receive comparable contributions to their HSAs, the comparability rules are not satisfied, notwithstanding that the employer offers to make available the same contribution amount to each comparable participating employee. But see Q & A–1 in §54.4980G–5 on contributions to HSAs made through a cafeteria plan.

Q–9: If an employer conditions contributions by the employer to an employee's HSA on an employee's participation in health assessments, disease management programs or wellness programs and makes the same contributions available to all employees who participate in the programs, do the contributions satisfy the comparability rules?

A–9: No. If all comparable participating employees do not elect to participate in all the programs and consequently, all comparable participating employees do not receive comparable contributions to their HSAs, the employer contributions fail to satisfy the comparability rules. But see Q & A–1 in §54.4980G–5 on contributions made to HSAs through a cafeteria plan.

Q–10: If an employer makes additional contributions to the HSAs of all comparable participating employees who have attained a specified age or who have worked for the employer for a specified number of years, do the contributions satisfy the comparability rules?

A–10: No. If all comparable participating employees do not meet the age or length of service requirement, all comparable participating employees do not receive comparable contributions to their HSAs and the employer contributions fail to satisfy the comparability rules.

Q–11: If an employer makes additional contributions to the HSAs of all comparable participating employees who are eligible to make the additional contributions (HSA catch-up contributions) under section 223(b)(3), do the contributions satisfy the comparability rules?

A–11: No. If all comparable participating employees are not eligible to make the additional HSA contributions under section 223(b)(3), all comparable participating employees do not receive comparable contributions to their HSAs, and the employer contributions fail to satisfy the comparability rules.

Q–12: If an employer's contributions to an employee's HSA result in non-comparable contributions, may the employer recoup the excess amount from the employee's HSA?

A–12: No. An employer may not recoup from an employee's HSA any portion of the employer's contribution to the employee's HSA. Under section 223(d)(1)(E), an account beneficiary's interest in an HSA is nonforfeitable. However, an employer may make additional HSA contributions to satisfy the comparability rules. An employer may contribute up until April 15th following the calendar year in which the non-comparable contributions were made. An employer that makes additional HSA contributions to correct non-comparable contributions must also contribute reasonable interest. However, an employer is not required to contribute amounts in excess of the annual contribution limits in section 223(b). See Q & A–13 of this section for rules regarding reasonable interest.

Q–13: What constitutes a reasonable interest rate for purposes of making comparable contributions?

A–13: The determination of whether a rate of interest used by an employer is reasonable will be based on all of the facts and circumstances. If an employer calculates interest using the Federal short-term rate as determined by the Secretary in accordance with section 1274(d), the employer is deemed to use a reasonable interest rate.

§54.4980G–5 HSA comparability rules and cafeteria plans and waiver of excise tax.

Q–1: If an employer makes contributions through a section 125 cafeteria plan to the HSA of each employee who is an eligible individual, are the contributions subject to the comparability rules?

A–1: (a) *In general*. No. The comparability rules do not apply to HSA contributions that an employer makes through a section 125 cafeteria plan. However, contributions to an HSA made through a cafeteria plan are subject to the section 125 nondiscrimination rules (eligibility rules, contributions and benefits tests and key employee concentration tests). See section 125(b), (c) and (g) and the regulations thereunder.

(b) *Contributions made through a section 125 cafeteria plan*. Employer contributions to employees' HSAs are made through a section 125 cafeteria plan and are subject to the section 125 cafeteria plan nondiscrimination rules and not the comparability rules if under the written cafeteria plan, the employees have the right to elect to receive cash or other taxable benefits in lieu of all or a portion of an HSA contribution (meaning that all or a portion of the HSA contributions are available as pre-tax salary reduction amounts), regardless of whether an employee actually elects to contribute any amount to the HSA by salary reduction.

Q–2: If an employer makes contributions through a cafeteria plan to the HSA of each employee who is an eligible individual in an amount equal to the amount of the employee's HSA contribution or a percentage of the amount of the employee's HSA contribution (matching contributions), are the contributions subject to the section 4980G comparability rules?

A–2: No. The comparability rules do not apply to HSA contributions that an employer makes through a section 125 cafeteria plan. Thus, where matching contributions are made by an employer through a cafeteria plan, the contributions are not subject to the comparability rules of section 4980G. However, contributions, including matching contributions, to an HSA made under a cafeteria plan are subject to the section 125 nondiscrimination rules (eligibility rules, contributions and benefits tests and key employee concentration tests). See Q & A–1 of this section.

Q–3: If under the employer's cafeteria plan, employees who are eligible individuals and who participate in health assessments, disease management programs or wellness programs receive an employer contribution to an HSA and the employees have the right to elect to make pretax salary reduction contributions to their HSAs, are the contributions subject to the comparability rules?

A–3: (a) *In general*. No. The comparability rules do not apply to employer contributions to an HSA made through a cafeteria plan. See Q & A–1 of this section.

(b) *Examples*. The following examples illustrate the rules in this §54.4980G–5. The examples read as follows:

Example 1. Employer A's written cafeteria plan permits employees to elect to make pre-tax salary reduction contributions to their HSAs. Employees making this election have the right to receive cash or other taxable benefits in lieu of their HSA pre-tax contribution. The section 125 cafeteria plan nondiscrimination rules and not the comparability rules apply because the HSA contributions are made through the cafeteria plan.

Example 2. Employer B's written cafeteria plan permits employees to elect to make pre-tax salary reduction contributions to their HSAs. Employees making this election have the right to receive cash or other taxable benefits in lieu of their HSA pre-tax contribution. Employer B automatically contributes a non-elective matching contribution or seed money to the HSA of each employee who makes a pre-tax HSA contribution. The section 125 cafeteria plan nondiscrimination rules and not the comparability rules apply to Employer B's HSA contributions because the HSA contributions are made through the cafeteria plan.

Example 3. Employer C's written cafeteria plan permits employees to elect to make pre-tax salary reduction contributions to their HSAs. Employees making this election have the right to receive cash or other taxable benefits in lieu of their HSA pre-tax contribution. Employer C makes a non-elective contribution to the HSAs of all employees who complete a health risk assessment and participate in Employer C's wellness program. Employees do not have the right to receive cash or other taxable benefits in lieu of Employer C's non-elective contribution. The section 125 cafeteria plan nondiscrimination rules and not the comparability rules apply to Employer C's HSA contributions because the HSA contributions are made through the cafeteria plan.

Example 4. Employer D's written cafeteria plan permits employees to elect to make pre-tax salary reduction contributions to their HSAs. Employees making this election have the right to receive cash or other taxable benefits in lieu of their HSA pretax contribution. Employees participating in the plan who are eligible individuals receive automatic employer contributions to their HSAs. Employees make no election with respect to Employer D's contribution and do not have the right to receive cash or other taxable benefits in lieu of Employer D's contribution, but are permitted to make their own pre-tax salary reduction contributions to fund their HSAs. The section 125 cafeteria plan nondiscrimination rules and not the comparability rules apply to Employer D's HSA contributions because the HSA contributions are made through the cafeteria plan.

Q–4: May all or part of the excise tax imposed under section 4980G be waived?

A–4: In the case of a failure which is due to reasonable cause and not to willful neglect, all or a portion of the excise tax imposed under section 4980G may be waived to the extent that the payment of the tax would be excessive relative to the failure involved. See sections 4980G(b) and 4980E(c).

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

Approved July 14, 2006.

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

(Filed by the Office of the Federal Register on July 28, 2006, 8:45 a.m., and published in the issue of the Federal Register for July 31, 2006, 71 F.R. 43056)

Section 6041.—Information at Source

Regulations under section 6041 are amended with respect to information reporting for payments for legal services. See T.D. 9270, page 237.

Section 6045.—Returns of Brokers

26 CFR 1.6045–5: Information reporting on payments to attorneys.

T.D. 9270

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Reporting of Gross Proceeds Payments to Attorneys

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the reporting of payments of gross proceeds to attorneys. The regulations reflect changes to the law made by the Taxpayer Relief Act of 1997 (1997 Act). The final regulations will affect attorneys who receive payments of gross proceeds on behalf of their clients and will affect certain payors (for example, defendants in lawsuits and their insurance companies and agents) that, in the course of their trades or businesses, make payments to these attorneys.

DATES: *Effective Dates:* These regulations are effective July 13, 2006.

Applicability Dates: For dates of applicability, see §1.6045–5(h).

FOR FURTHER INFORMATION CONTACT: Nancy Rose (202) 622–4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995

(44 U.S.C. 3507(d)) under control number 1545–1644.

Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, D.C. 20224. Comments on the collection of information should be received by September 11, 2006. Comments are specifically requested concerning:

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

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

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

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

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

The collections of information in the final regulations are in §§1.6041–3(p) and 1.6045–5(a). Section 1021(a) of the 1997 Act added section 6045(f) to the Internal Revenue Code (Code) and requires the IRS to implement information reporting of certain payments made to attorneys. Section 1021(b) of the 1997 Act provides that the exception to information reporting in the regulations under section 6041 for payments to corporations does not apply to payments to attorneys and requires the IRS to implement information reporting for payments to attorneys. This information will be used to verify compliance with sections 6045(f) and 6041 and to determine that the amount of these payments has been reported correctly. The collections of information are mandatory. The likely respondents (payors) are businesses and other for profit institutions.

Payors provide the information by completing Form 1099–MISC, "*Miscellaneous Income*," for each attorney who has received one or more payments aggregating $600 or more from the payor during the calendar year. The burden for this requirement is reflected in the burden estimate for Form 1099–MISC. The estimated burden of information collection for the 2005 Form 1099–MISC is 16 minutes per return.

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

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

Background

This document contains amendments to the 26 CFR Part 1 under sections 6041 and 6045 of the Code. These amendments to the Income Tax Regulations revise existing §§1.6041–1 and 1.6041–3 and add new §1.6045–5. This document finalizes proposed regulations relating to information reporting under section 6045(f) of the Code for gross proceeds paid to attorneys. The proposed regulations were contained in a notice of proposed rulemaking (REG–126024–01, 2002–2 C.B. 64) published in the **Federal Register** on May 17, 2002 (67 FR 35064).

Section 6045(f) was added to the Code by the 1997 Act (Public Law 105–34, section 1021 (111 Stat. 788)). Section 6045(f) generally requires information reporting for payments of gross proceeds made in the course of a trade or business to attorneys in connection with legal services (whether or not the services are performed for the payor). No information reporting is required under section 6045(f) for the portion of any payment that is required to be reported under section 6041(a) (relating to payments made in the course of a trade or business) (or that would be required to be reported under section 6041 but for the $600 limitation) or under section 6051 (relating to receipts for employees). The 1997 Act also provides that the general exception in §1.6041–3(p)(1) for reporting payments made to corporations does not apply to payments of attorneys' fees. Public Law 105–34, section 1021(b).

Proposed regulations under sections 6041 and 6045(f) were first published in the **Federal Register** on May 21, 1999 (REG–105312–98, 1999–1 C.B. 1193 [64 FR 27730]) (the 1999 proposed regulations). The IRS received written comments on the 1999 proposed regulations, and held a public hearing on September 22, 1999. After considering those comments and the testimony at the public hearing, the IRS and the Treasury Department decided to amend and repropose regulations under sections 6041 and 6045(f). Those proposed regulations (the reproposed regulations) were published in the **Federal Register** on May 17, 2002 (67 FR 35064), and incorporated the guidance in the 1999 proposed regulations with some modifications. A number of written comments were received in connection with the reproposed regulations. After considering those comments, the IRS is adopting the reproposed regulations with revisions, as discussed below.

Summary of Comments

Generally, the section 6045(f) information reporting requirement is intended to be broad, and few exceptions are warranted. See H. Conf. Rep. 105–220, at 546 (1997). As suggested by commentators, the final regulations adopt certain exceptions to the information reporting requirement, described below.

Section 6045–5(c) of the reproposed regulations contains an exception to the information reporting requirement relating to payments made to an attorney who conducts settlements for sales or exchanges of real estate. Commentators suggested an expansion of this exception to include payments made in connection with a refinance of a mortgage and certain other loan closings. After consideration of the comments, and the nature of these transactions, these final regulations expand the exception to include payments made to attorneys in connection with the financing of real estate. The exception now covers, for example, payments made to attorneys in connection with refinancings and mortgages, not limited to purchase-money mortgages.

Many commentators on the 1999 proposed regulations requested exceptions to the section 6045(f) information reporting requirements for payments to trustees and other fiduciaries such as administrators of estates and settlement funds. Those commentators suggested that the definition of legal services should be narrowed to except payments to those individuals, as the payments to attorneys acting as fiduciaries have no correlation to their income. The preamble to the reproposed regulations stated that this issue was considered, but reiterated that a broad definition of legal services is appropriate and consistent with the language and purpose of section 6045(f). (67 FR 35064) Although the reproposed regulations made an exception for payments to attorneys acting as real estate settlement agents, the reproposed regulations did not except payments to trustees and administrators. The preamble noted that in many situations, payments are or could be made to an estate or fund, rather than to an attorney acting as a trustee or administrator. If an estate or fund were the payee, information reporting under section 6045(f) would not be required.

With respect to payments to bankruptcy trustees in particular, *Example 10* of the reproposed regulations describes a situation in which a bankrupt's employer withholds amounts from the bankrupt's earnings pursuant to a wage garnishment order, and forwards that amount to the bankruptcy trustee. Commentators argued that a bankruptcy trustee who receives such payments is not practicing law, and is not receiving these amounts in connection with legal services. They pointed out that many bankruptcy trustees are not attorneys. Commentators also discussed the unique position of a bankruptcy trustee, which would make the bankruptcy trustee reluctant to disclose his or her taxpayer identifying number (TIN). They also described numerous administrative burdens bankruptcy trustees would face in connection with the receipt of a large number of information returns.

Further, numerous commentators stated that it is not always possible to avoid information reporting; in many bankruptcy situations, particularly in a Chapter 13 bankruptcy, a payor must write the check to the bankruptcy trustee and not to the bankrupt's estate. After considering the comments with respect to payments to bankruptcy trustees, and considering the unique position of attorneys acting in their capacity as bankruptcy trustees, it was determined that an exception for payments to bankruptcy trustees was appropriate. Therefore, the final regulations include an exception in §1.6045–5(c)(7) for payments to attorneys acting in the capacity of bankruptcy trustees, and remove the example contained in the reproposed regulations relating to payments to bankruptcy trustees.

Another commentator recommended that payments of life insurance made to an attorney on behalf of a client not be considered received in connection with legal services and therefore be excepted from the information reporting requirement. The IRS and the Treasury Department continue to believe that a broad definition of legal services is appropriate, and the final regulations do not adopt this suggestion. As in the fiduciary situation, information reporting under section 6045(f) would not be required if the attorney is not the named payee.

Commentators requested additional clarification of the interplay between the information reporting rules in existing §1.6041–1(e) and (f) and the reproposed regulations under section 6045(f). In response, many of the examples in the final regulations include more cross-references to other information reporting rules, and some examples illustrate the correct reporting under sections other than section 6045(f).

Some commentators asked that the IRS develop a new form for reporting settlement payments made to plaintiffs and their attorneys that would show the names and TINs of both plaintiff and attorney, the amounts paid to each, and backup withholding if applicable. The commentators proposed new Form 1099–SET, "*Settlement Proceeds*," to satisfy the reporting obligations set forth under both sections 6045 and 6041 with respect to these payments. The IRS already has several different forms in the Form 1099 series that allow for reporting of a variety of types of payments, including payments under section 6045(f). Adding another form to the Form 1099 series limited to only one type of payment would not increase efficiency for the IRS or taxpayers. Moreover, payors could not use the proposed Form 1099–SET in connection with settlement payments that constitute wages reportable on Form W–2, "*Wage and Tax Statement*." For these reasons, the final regulations do not adopt this suggestion.

A number of commentators correctly pointed out that under the reproposed regulations, information reporting for amounts paid to attorneys may be required even though the payors also must report these amounts to the attorneys' clients pursuant to section 6041. Commentators stated that duplicate reporting would be a problem under automated systems for generating information returns. In many cases, their systems are designed to generate only one Form 1099 for a payment. Nevertheless, Congress mandated reporting by a payor under both section 6045(f) (to an attorney) and 6041 (to the attorney's client) with respect to the same payment. Section 6045(f)(2)(B) provides an exception for payments required to be reported under section 6041. The IRS and the Treasury Department interpret the exception in section 6045(f)(2)(B) as applying only where the section 6045(f) payment otherwise would be required to be reported under section 6041 with respect to the same payee (*i.e.*, the attorney), and not where section 6041 imposes a separate reporting requirement with respect to another payee (*i.e.*, the client). See §1.6045–5(c)(4). In cases in which the payment is made to the attorney for the benefit of the client, section 6041 requires reporting with respect to the client, and section 6045(f) requires reporting with respect to the attorney. Each of these statutory reporting requirements serves an independent purpose — reporting the amount paid for the benefit of the client who has to include that amount in income, and reporting a gross proceeds payment to the attorney. Section 1.6041–1(a)(1) was revised to clarify that there is a requirement to report to both the attorney and client in that situation.

Other commentators discussed the requirement to backup withhold on payments to an attorney if the attorney does not provide an accurate TIN to the payor. The commentators suggested that there are both practical and ethical problems with respect to backup withholding on payments to attorneys. They noted that the amounts paid to the attorney generally belong to the attorney's client and that there may be difficulty in determining how to claim the withholding on the client's income tax return. The IRS and the Treasury Department believe that payments to attorneys for legal services are reportable payments under section 3406(b)(3)(C), and are thus subject to backup withholding. The legislative history to section 6045(f) makes clear that Congress intended such payments to be subject to backup withholding. H. Conf. Rep. 105–220, at 546 (1997). As the commentators point out, backup withholding on a payment to an attorney that constitutes the income of the attorney's client raises some practical concerns, but it is nonetheless required by the statute. Backup withholding can be avoided as long as the attorney provides an accurate TIN to the payor. Furthermore, there are procedures in place affording an opportunity to correct an inaccurate TIN before backup withholding is required. See §31.3406(d)–5; Rev. Proc. 93–37, 1993–2 C.B. 477.

A comment was received with respect to the exception in §1.6045–5(c)(5) of the reproposed regulations for payments to certain non-residents that are not engaged in a trade or business within the United States and that do not perform any labor or personal services within the United States. The commentator stated that, as drafted, the exception is too narrow and will result in unnecessary information reporting. The commentator suggested that the exception should be based solely on whether the payment to the non-resident alien individual, foreign partnership, or foreign corporation is in connection with legal services performed outside the United States. The commentator suggested that a payor be entitled to rely for purposes of making this determination on a signed statement by the attorney or law firm to the effect that the services for which payment is made were performed outside the United States, provided that the payor does not know that the statement is inaccurate. The commentator noted that payments of gross proceeds to non-resident alien attorneys may be reportable under this section although attorneys' fees paid to such attorneys would not be reportable under section 6041.

The gross proceeds reporting requirement under section 6045(f) is intended to be broad and has a different purpose than information reporting under section 6041 for payments for services. Congress expressed its intent with respect to section 6045(f) "that the IRS will administer this provision so that it will not apply to foreign attorneys who can clearly demonstrate that they are not subject to U.S. tax." Joint Committee on Taxation Staff, General Explanation of Tax Legislation Enacted in 1997, 105th Cong., 1st Sess. 215 (1997). Foreign persons not engaged in trade or business within the United States are subject to U.S. tax on amounts of certain types of income received from sources within the United States (*e.g.*, under section 871(a)). Foreign persons engaged in trade or business within the United States are subject to U.S. tax on taxable income effectively connected with the conduct of such trade or business within the United States (*e.g.*, under section 871(b)). Thus, a foreign person can demonstrate clearly that it is not subject to U.S. tax only if it clearly demonstrates both that the income in question would not be subject to U.S. tax if the foreign person were not engaged in trade or business in the United States and that the income in question is not effectively connected with the conduct of a trade or business within the United States. The commentator's proposed approach would not produce a clear demonstration that both conditions are satisfied and so would be inconsistent with the intent expressed by Congress. Therefore, the final regulations do not adopt the commentator's suggestion.

In addition to written comments, a number of telephone calls were received with questions and comments regarding the reproposed regulations. Many of the callers raised questions as to whether an attorney is the payee of a check where the check is made out to the attorney's client, but "in care of" the attorney, or to the attorney's client trust account, or other scenarios. Since these questions were raised by a number of callers, the final regulations address them. Generally, an attorney is the payee on a check written to the attorney's client trust fund, but not on a check which the attorney may not negotiate. (§1.6045–5(d)(4)).

The reproposed regulations indicated in §1.6045–5(h) that the regulations would become effective with payments made during the first calendar year that begins at least two months after the publication of the regulations as final regulations. Consequently, the final regulations will apply to payments made in or after 2007. This delayed effective date affords time to implement any changes required in automated information processing systems.

Section 6724(a) states that no penalty relative to information reporting shall be imposed with respect to a failure that is due to reasonable cause and not to willful neglect. Section 301.6724–1(a) provides in part that a penalty is waived for reasonable cause if the filer establishes that there are significant mitigating factors with respect to the failure, or that the failure arose from events beyond the filer's control, and that the filer acted in a responsible manner. Under §301.6724–1(b)(1), significant mitigating factors include the fact that prior to the failure the filer was never required to file the particular type of return with respect to which the failure occurred. Under §301.6724–1(d)(1)(i), acting in a responsible manner means that the filer exercised reasonable care, which is that standard of care that a reasonably prudent person would use under the circumstances in the course of its business in determining its filing obligations. Pursuant to these provisions, a penalty waiver may apply, for example, if an information report would have been required under the reproposed regulations, but not under the final 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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. This certification is based on the facts that: (1) the time required to prepare and file a 2005 Form 1099–MISC, "*Miscellaneous Income*," is minimal (currently estimated at 16 minutes per form); and (2) it is not anticipated that, as a result of these regulations, many small entities will have to prepare and file more than a few forms per year.

Pursuant to section 7805(f) of the Code, the Notice of Proposed Rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Nancy L. Rose of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

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Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.6041–1(a)(1) is amended as follows:

1. In paragraph (a)(1)(ii), the first sentence is removed and two sentences are added in its place.

2. Paragraph (a)(1)(iii) is added.

The revision and addition read as follows:

§1.6041–1 Return of information as to payments of $600 or more.

(a) * * *

(1) * * *

(ii) * * * The payments described in paragraphs (a)(1)(i)(A) and (B) of this section shall not include any payments of amounts with respect to which an information return is required by, or may be required under authority of, section 6042(a) (relating to dividends), section 6043(a)(2) (relating to distributions in liquidation), section 6044(a) (relating to patronage dividends), section 6045 (relating to brokers' transactions with customers and certain other transactions), sections 6049(a)(1) and (2) (relating to interest), section 6050N(a) (relating to royalties), or section 6050P(a) or (b) (relating to cancellation of indebtedness). For information returns required under section 6045(f) (relating to payments to attorneys), see special rules in §§1.6041–1(a)(1)(iii) and 1.6045–5(c)(4). * * *

(iii) Information returns required under section 6045(f) on or after January 1, 2007. For payments made on or after January 1, 2007, to which section 6045(f) (relating to payments to attorneys) applies, the following rules apply. Notwithstanding the provisions of paragraph (a)(1)(ii) of this section, payments to an attorney that are described in paragraph (a)(1)(i) of this section but which otherwise would be reportable under section 6045(f) are reported under section 6041 and this section and not section 6045(f). This exception applies only if the payments are reportable with respect to the same payee under both sections. Thus, a person who, in the course of a trade or business, pays $600 of taxable damages to a claimant by paying that amount to the claimant's attorney is required to file an information return under section 6041 with respect to the claimant, as well as another information return under section 6045(f) with respect to the claimant's attorney. For provisions relating to information reporting for payments to attorneys, see §1.6045–5.

* * * * *

Par. 3. Section 1.6041–3 is amended as follows:

1. Revising the first sentence in paragraph (p)(1).

2. In paragraph (p)(8), removing the language "(q)" and adding "(p)" in its place.

The revision reads as follows:

§1.6041–3 Payments for which no return of information is required under section 6041.

* * * * *

(p) * * *

(1) A corporation described in §1.6049–4(c)(1)(ii)(A), except with respect to payments made to a corporation after December 31, 1997 for attorneys' fees, and except a corporation engaged in providing medical and health care services or engaged in the billing and collecting of payments in respect to the providing of medical and health care services. * * *

* * * * *

Par. 4. Section 1.6045–5 is added to read as follows:

§1.6045–5 Information reporting on payments to attorneys.

(a) *Requirement of reporting*—(1) *In general.* Except as provided in paragraph (c) of this section, every payor engaged in a trade or business who, in the course of that trade or business, makes payments aggregating $600 or more during a calendar year to an attorney in connection with legal services (whether or not the services are performed for the payor) must file an information return for such payments. The information return must be filed on the form and in the manner required by the Commissioner. For the time and place for filing the form, see §1.6041–6. For definitions of the terms under this section, see paragraph (d) of this section. The requirements of this paragraph (a)(1) apply whether or not—

(i) A portion of a payment is kept by the attorney as compensation for legal services rendered; or

(ii) Other information returns are required with respect to some or all of a payment under other provisions of the Internal Revenue Code and the regulations thereunder.

(2) *Information required.* The information return required under paragraph (a)(1) of this section must include the following information:

(i) The name, address, and taxpayer identifying number (TIN) (as defined in section 7701(a)) of the payor;

(ii) The name, address, and TIN of the payee attorney;

(iii) The amount of the payment or payments (as defined in paragraph (d)(5) of this section); and

(iv) Any other information required by the Commissioner in forms, instructions or publications.

(3) *Requirement to furnish statement.* A person required to file an information return under paragraph (a)(1) of this section must furnish to the attorney a written statement of the information required to be shown on the return. This requirement may be met by furnishing a copy of the return to the attorney. The written statement must be furnished to the attorney on or before January 31 of the year following the calendar year in which the payment was made.

(b) *Special rules*—(1) *Joint or multiple payees*—(i) *Check delivered to one payee* *attorney*. If more than one attorney is listed as a payee on a check, an information return must be filed under paragraph (a)(1) of this section with respect to the payee attorney to whom the check is delivered.

(ii) *Check delivered to payee nonattorney*. If an attorney is listed as a payee on a check but the check is delivered to a nonattorney who is a payee on the check, an information return must be filed under paragraph (a)(1) of this section with respect to the payee attorney listed on the check. If more than one attorney is listed as a payee on a check but the check is delivered to a nonattorney who is a payee on the check, the information return must be filed with respect to the first-listed payee attorney on the check.

(iii) *Check delivered to nonpayee*. If two or more attorneys are listed as payees on a check, but the check is delivered to a person who is not a payee on the check, an information return must be filed under paragraph (a)(1) of this section with respect to the first-listed payee attorney on the check.

(2) *Attorney required to report payments made to other attorneys*. If an information return is required to be filed with respect to a payee attorney under paragraph (b)(1) of this section, the attorney with respect to whom the information return is required to be filed (tier-one attorney) must file an information return under this section for any payment that the tier-one attorney makes to other payee attorneys with respect to that check, regardless of whether the tier-one attorney is a payor under paragraph (d)(3) of this section.

(c) *Exceptions*. Notwithstanding paragraphs (a) and (b) of this section, a return of information is not required under section 6045(f) with respect to the following payments:

(1) Payments of wages or other compensation paid to an attorney by the attorney's employer.

(2) Payments of compensation or profits paid or distributed to its partners by a partnership engaged in providing legal services.

(3) Payments of dividends or corporate earnings and profits paid to its shareholders by a corporation engaged in providing legal services.

(4) Payments made by a person to the extent that the person is required to report with respect to the same payee the payments or portions thereof under section 6041(a) and §1.6041–1(a) (or would be required to so report the payments or portions thereof but for the dollar amount limitation contained in section 6041(a) and §1.6041–1(a)).

(5) Payments made to a nonresident alien individual, foreign partnership, or foreign corporation that is not engaged in trade or business within the United States, and does not perform any labor or personal services in the United States, in the taxable year to which the payment relates. For how a payor determines whether a payment is subject to this exception, see §1.6041–4(a)(1).

(6) Payments made to an attorney in the attorney's capacity as the person responsible for closing a transaction within the meaning of §1.6045–4(e)(3) for the sale or exchange or financing of any present or future ownership interest in real estate described in §1.6045–4(b)(2)(i) through (iv).

(7) Payments made to an attorney in the attorney's capacity as a trustee in bankruptcy under Title 11, United States Code.

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

(1) *Attorney* means a person engaged in the practice of law, whether as a sole proprietorship, partnership, corporation, or joint venture.

(2) *Legal services* means all services related to, or in support of, the practice of law performed by, or under the supervision of, an attorney.

(3) *Payor* means a person who makes a payment if that person is an obligor on the payment, or the obligor's insurer or guarantor. For example, a payor includes—

(i) A person who pays a settlement amount to an attorney of a client who has asserted a tort, contract, violation of law, or workers' compensation claim against that person; and

(ii) The person's insurer if the insurer pays the settlement amount to the attorney.

(4) *Payments to an attorney* include payments by check or other method such as cash, wire or electronic transfer. Payment by check to an attorney means a check on which the attorney is named as a sole, joint, or alternative payee. The attorney is the payee on a check written to the attorney's client trust fund. However, the attorney is not a payee when the attorney's name is included on the payee line as "in care of," such as a check written to "client c/o attorney," or if the attorney's name is included on the check in any other manner that does not give the attorney the right to negotiate the check.

(5) *Amount of the payment* means the amount tendered (*e.g.*, the amount of a check) plus the amount required to be withheld from the payment under section 3406(a)(1), because a condition for withholding exists with respect to the attorney for whom an information return is required to be filed under paragraph (a)(1) of this section.

(e) *Attorney to furnish TIN*. A payor that is required to file an information return under this section must solicit a TIN from the attorney at or before the time the payor makes a payment to the attorney. The attorney must furnish the correct TIN to the payor, but is not required to certify the TIN. A payment for which a return of information is required under this section is subject to backup withholding under section 3406 and the regulations thereunder.

(f) *Examples*. The following examples illustrate the provisions of this section. The examples assume that P is not a payor with respect to A, the attorney, under section 6041. See section 6041 and the regulations thereunder for rules regarding whether P is required under section 6041 to file information returns with respect to C. The examples are as follows:

Example 1. One check—joint payees—taxable to claimant. Employee C, who sues employer P for back wages, is represented by attorney A. P settles the suit for $300,000. The $300,000 represents taxable wages to C under existing legal principles. P writes a settlement check payable jointly to C and A in the amount of $200,000, net of income and FICA tax withholding with respect to C. P delivers the check to A. A retains $100,000 of the payment as compensation for legal services and disburses the remaining $100,000 to C. P must file an information return with respect to A for $200,000 under paragraph (a)(1) of this section. P also must file an information return with respect to C under sections 6041 and 6051, in the amount of $300,000. See §§1.6041–1(f) and 1.6041–2.

Example 2. One check—joint payees—excludable to claimant. C, who sues corporation P for damages on account of personal physical injuries, is represented by attorney A. P settles the suit for a $300,000 damage payment that is excludable from C's gross income under section 104(a)(2). P writes a $300,000 settlement check payable jointly to C and A and delivers the check to A. A retains $120,000 of the payment as compensation for legal services and remits the remaining $180,000 to C. P must file an information return with respect to A for $300,000 under paragraph (a)(1) of this section. P does not file an information return with respect to tax-free damages paid to C.

Example 3. Separate checks—taxable to claimant. C, an individual plaintiff in a suit for lost profits against corporation P, is represented by attorney A. P settles the suit for $300,000, all of which will be includible in C's gross income. A requests P to write two checks, one payable to A in the amount of $100,000 as compensation for legal services and the other payable to C in the amount of $200,000. P writes the checks in accordance with A's instructions and delivers both checks to A. P must file an information return with respect to A for $100,000 under paragraph (a)(1) of this section. Pursuant to §1.6041–1(a) and (f), P must file an information return with respect to C for the $300,000.

Example 4. Check made payable to claimant, but delivered to nonpayee attorney. Corporation P is a defendant in a suit for damages in which C, the plaintiff, has been represented by attorney A throughout the proceeding. P settles the suit for $300,000. Pursuant to a request by A, P writes the $300,000 settlement check payable solely to C and delivers it to A at A's office. P is not required to file an information return under paragraph (a)(1) of this section with respect to A, because there is no payment to an attorney within the meaning of paragraph (d)(4) of this section.

Example 5. Multiple attorneys listed as payees. Corporation P, a defendant, settles a lost profits suit brought by C for $300,000 by issuing a check naming C's attorneys, Y, A, and Z, as payees in that order. Y, A, and Z do not belong to the same law firm. P delivers the payment to A's office. A deposits the check proceeds into a trust account and makes payments by separate checks to Y of $30,000 and to Z of $15,000, as compensation for legal services, pursuant to authorization from C to pay these amounts. A also makes a payment by check of $155,000 to C. A retains $100,000 as compensation for legal services. P must file an information return for $300,000 with respect to A under paragraphs (a)(1) and (b)(1)(i) of this section. A, in turn, must file information returns with respect to Y of $30,000 and to Z of $15,000 under paragraphs (a)(1) and (b)(2) of this section because A is not required to file information returns under section 6041 with respect to A's payments to Y and to Z because A's role in making the payments to Y and to Z is merely ministerial. See §1.6041–1(e)(1), (e)(2) and (e)(5) *Example 7* for information reporting requirements with respect to A's payments to Y and Z. As described in *Example 3*, P must also file an information return with respect to C, pursuant to §1.6041–1(a) and (f).

Example 6. Amount of the payment—attorney does not provide TIN. (i) Corporation P, a defendant, settles a suit brought by C for $300,000 of damages. P will pay the damages by a joint check to C and his attorney, A. A failed to furnish P with A's TIN. P is required to deduct and withhold 28 percent tax from the $300,000 under section 3406(a)(1)(A) and paragraph (e) of this section. P writes the check to C and A as joint payees, in the amount of $216,000. P also must file an information return with respect to A under paragraph (a)(1) of this section in the amount of $300,000, as prescribed in paragraph (d)(5) of this section. If the damages are reportable under section 6041 because they are not excludable from gross income under existing legal principles, and are not subject to any exception under section 6041, P must also file an information return with respect to C pursuant to §1.6041–1(a) and (f) in the amount of $300,000.

(ii) Rather than paying by joint check to C and A, P will pay the damages by a joint check to C and F, A's law firm. F failed to furnish its TIN to P. P is required to deduct and withhold 28 percent tax from the $300,000 under section 3406(a)(1)(A) and paragraph (e) of this section. P writes the check to C and F as joint payees, in the amount of $216,000. P also must file an information return with respect to F under paragraph (a)(1) of this section in the amount of $300,000, as prescribed in paragraph (d)(5) of this section. If the damages are reportable under section 6041 because they are not excludable from gross income under existing legal principles, and are not subject to any exception under section 6041, P must also file an information return with respect to C pursuant to §1.6041–1(a) and (f) in the amount of $300,000.

Example 7. Home mortgage lending transaction. (i) Individual P agrees to purchase a house that P will use solely as a residence. P obtains a loan from lender L to finance a portion of the cost of acquiring the house. L disburses loan proceeds of $300,000 to attorney A, who is the settlement agent, by a check naming A as the sole payee. A, in turn, writes checks from the loan proceeds and from other funds provided by P to the persons involved in the purchase of the house, including a check for $800 to attorney B, whom P hired to provide P with legal services relating to the closing.

(ii) P, not L, is the payor of the payment to A under paragraph (d)(3) of this section. P, however, is not required to file an information return with respect to A under paragraph (a)(1) of this section because the payment was not made in the course of P's trade or business. Even if P made the payment in the course of P's trade or business, P would not be required to file an information return under section 6045(f) with respect to A because P is excepted under paragraph (c)(6) of this section.

(iii) A is not required to file an information return under paragraph (a)(1) of this section with respect to the payment to B because A is not the payor as that term is defined under paragraph (d)(3) of this section. A is not required to file an information return under paragraph (b)(2) with respect to the payment to B because A was listed as sole payee on the check it received from P. See section 6041 and §1.6041–1(e) for whether A or L must file information returns under that section. See section 6045(e) and §1.6045–4 for whether A is required to file an information return under that section.

Example 8. Business mortgage lending transaction. The facts are the same as in *Example 7* except that P buys real property that P will use in a trade or business. P, not L, is the payor of the payment to A under paragraph (d)(3) of this section. P, however, is not required to file an information return under section 6045(f) with respect to A because P is excepted under paragraph (c)(6) of this section. A is not required to file an information return under paragraphs (a) or (b)(2) of this section with respect to the payment to B. See section 6041 and §1.6041–1(e) to determine whether P or L must file an information return under that section with respect to the payment to A, and whether P or A must file a return with respect to the payment to B. See section 6045(e) for rules regarding whether A is required to file information returns under that section.

Example 9. Qualified settlement fund. Corporation P agrees to settle for $300,000 a class action lawsuit brought by attorney A on behalf of a claimant class. Pursuant to the settlement agreement and a preliminary order of approval by a court, A establishes a bank account in the name of Q Settlement Fund, which is a qualified settlement fund (QSF) under §1.468B–1. A is also designated by the court as the administrator of the QSF. Corporation P transfers $300,000 by wire in Year 1 to A, who deposits the funds into the Q Settlement Fund. In Year 2, the court approves an award of attorney's fees of $105,000 for A. In Year 2, Q Settlement Fund delivers $105,000 to A. P is required to file an information return under paragraph (a) of this section with respect to A for Year 1 for the $300,000 payment it made to A. The Q Settlement Fund is required to file an information return under section 6041(a) and §1.468B–2(l)(2) with respect to A for Year 2 for the $105,000 payment it made to A.

(g) *Cross reference to penalties*. See the following sections regarding penalties for failure to comply with the requirements of section 6045(f) and this section:

(1) Section 6721 for failure to file a correct information return.

(2) Section 6722 for failure to furnish a correct payee statement.

(3) Section 6723 for failure to comply with other information reporting requirements (including the requirement to furnish a TIN).

(4) Section 7203 for willful failure to supply information (including a TIN).

(h) *Effective date*. The rules in this section apply to payments made on or after January 1, 2007.

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

Approved June 8, 2006.

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

(Filed by the Office of the Federal Register on July 12, 2006, 8:45 a.m., and published in the issue of the Federal Register for July 13, 2006, 71 F.R. 39548)

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(k)(6)–1: Disclosure of return information by certain officers and employees for investigative purposes.

T.D. 9274

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Disclosure of Return Information by Certain Officers and Employees for Investigative Purposes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the disclosure of return information pursuant to section 6103(k)(6) of the Internal Revenue Code (Code). The final regulations describe the circumstances under which internal revenue and Office of Treasury Inspector General for Tax Administration (TIGTA) employees may disclose return information to the extent necessary to obtain information or to accomplish properly any activity connected with certain official duties. These regulations clarify and elaborate on the facts and circumstances in which disclosure pursuant to section 6103(k)(6) is authorized.

DATES: *Effective Date:* These regulations are effective July 6, 2006.

Applicability Date: For dates of applicability, see §301.6103(k)(6)–1(e).

FOR FURTHER INFORMATION CONTACT: Helene R. Newsome, 202–622–4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Under section 6103(a), returns and return information are confidential unless the Code authorizes disclosure. Section 6103(k)(6) authorizes an internal revenue officer or employee and an officer or employee of TIGTA, in connection with official duties relating to any audit, collection activity, civil or criminal tax investigation, or offense under the internal revenue laws, to disclose return information to a person other than the taxpayer to whom such return information relates (or his or her representative) to the extent that such disclosure is necessary to obtain information not otherwise reasonably available with respect to the correct determination of tax, liability for tax, or the amount to be collected, or with respect to the enforcement of any other provision of the Code or related statutes. Disclosure depends on situations and conditions prescribed by regulation.

On July 10, 2003, temporary regulations (T.D. 9073, 2003–2 C.B. 570) under section 6103(k)(6) were published in the **Federal Register** (68 FR 41073). A notice of proposed rulemaking (REG–140808–02, 2003–2 C.B. 582) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (68 FR 41089).

These regulations reflected a legislative amendment to section 6103(k)(6) clarifying that officers or employees of TIGTA are among those individuals authorized to make disclosures under section 6103(k)(6). See Consolidated Appropriations Act, 2001, Public Law 106–554 (114 Stat. 2763), section 1 enacting H.R. 5662, Community Renewal Tax Relief Act of 2000, section 313(c).

These regulations also clarified the standard for determining whether disclosures are authorized under section 6103(k)(6). In particular, the regulations addressed the issues surrounding the disclosures that occur when internal revenue or TIGTA employees introduce themselves to third party witnesses or communicate in writing, *e.g.*, using official letterhead that reveals affiliation with the IRS or TIGTA. The regulations also clarified that section 6103(k)(6) does not limit internal revenue or TIGTA employees with respect to the initiation or conduct of an investigation. Finally, the regulations clarified that section 6103 does not require internal revenue and TIGTA employees to contact a taxpayer for information before contacting third party witnesses.

No comments were received from the public in response to the notice of proposed rulemaking. No public hearing was requested or held. In this Treasury decision, the proposed regulations are adopted as revised below.

Explanation of Revisions

The proposed and temporary regulations provide that internal revenue and TIGTA employees may identify themselves, their organizational affiliation, and the nature of their investigation, when making an oral, written, or electronic contact with a third party witness through the use and presentation of any identification media (including, but not limited to, a Federal agency badge, credential, or business card) or through the use of an information document request, summons, or correspondence on Federal agency letterhead or which bears a return address or signature block that reveals affiliation with the Federal agency. In the final regulations, §301.6103(k)(6)–1(a)(3) has been revised to make clear that internal revenue and TIGTA employees may identify themselves, their organizational affiliation, and the nature of their investigation, when making any oral, written, or electronic contact with a third party witness, not just when making a contact with a third party witness through the use and presentation of identification media, or through the use of an information document request, summons, or correspondence. This revision is intended as a clarification rather than a change in the effect of the regulations.

The proposed and temporary regulations define the term *disclosure of return information to the extent necessary*. The fourth sentence of §301.6103(k)(6)–1(c)(1) states that section 6103(k)(6) does not limit or restrict IRS or TIGTA officers and employees with respect to initiating or conducting an investigation. The final regulations revise this sentence to clarify that section 6103(k)(6) applies to all internal revenue officers and employees, not just IRS officers and employees. There are individuals, in addition to IRS officers and employees, who are internal revenue officers and employees because they are responsible for administering and enforcing certain tax administration provisions. This revision is intended as a clarification rather than a change in the effect of the regulations.

The proposed and temporary regulations define the term *internal revenue employee* as an officer or employee of the IRS or Office of Chief Counsel for the IRS. The final regulations add a phrase to §301.6103(k)(6)–1(c)(4) to encompass individuals responsible for administering and enforcing certain tax administration provisions who are not officers and employees of the IRS or the Office of Chief Counsel for the IRS. Pursuant to the duties and powers established by the Homeland Security Act of 2002, Public Law 107–296, section 1111 *et seq.*, 116 Stat. 2135 (2002), the Tax and Trade Bureau (TTB) in the Department of the Treasury has the responsibility for administering and enforcing the taxes under Chapters 32 (Part III of Subchapter D), 51, and 52 of the Code, and the Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF) in the Department of Justice has the responsibility for administering and enforcing the taxes under Chapter 53 of the Code. Pursuant to section 412 of the Homeland Security Act, the United States Customs Service continues to have the responsibilities it had when it was a bureau within the Department of the Treasury, which include administering and enforcing certain provisions of Chapters 51 and 52 of the Code. Pursuant to section 821 of the Homeland Security Act, the United States Secret Service continues to have the responsibilities it had when it was a bureau within the Department of the Treasury, which include investigating tax refund check fraud under 18 U.S.C. 510. Accordingly, paragraph (c)(4) of the final regulations has been revised to state that internal revenue employee means an officer or employee of the IRS or Office of Chief Counsel for the IRS, or an officer or employee of a Federal agency responsible for administering and enforcing taxes under Chapters 32 (Part III of Subchapter D), 51, 52, or 53 of the Code, or investigating tax refund check fraud under 18 U.S.C. 510. This revision is intended as a clarification rather than a change in the effect of the regulations.

The proposed and temporary regulations address the disclosure of return information in connection with investigations that affect or may affect the personnel or employment status of Treasury employees or the status of persons authorized to practice before the Treasury Department. The final regulations revise §301.6103(k)(6)–1(b) to clarify that it applies to employees of ATF, United States Customs Service, and United States Secret Service, as well as to employees of the Treasury Department and that Federal officers and employees who are responsible for the investigations and who are properly in possession of relevant return information are authorized to disclose such return information for the purpose of obtaining, verifying, or establishing other information which is or may be relevant and material to the investigation. This revision is intended as a clarification rather than a change in the effect of the regulations.

The proposed and temporary regulations contain an example involving a private letter ruling request. Section 301.6103(k)(6)–1(d) *Example 4*. The final regulations revise this example to reflect a more common factual scenario involving a private letter ruling request. This revision is intended as a clarification rather than a change in the effect of the 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 has also been determined that 5 U.S.C. 553(b), the Administrative Procedure Act, does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Helene R. Newsome, Office of the Associate Chief Counsel (Procedure and Administration), Disclosure and Privacy Law Division.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301— PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read, in part, as follows:

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

Section 301.6103(k)(6)–1 also issued under 26 U.S.C. 6103(k)(6); * * *

Par. 2. Section 301.6103(k)(6)–1 is added to read as follows:

§301.6103(k)(6)–1 Disclosure of return information by certain officers and employees for investigative purposes.

(a) *General rule*. (1) Pursuant to the provisions of section 6103(k)(6) and subject to the conditions of this section, an internal revenue employee or an Office of Treasury Inspector General for Tax Administration (TIGTA) employee, in connection with official duties relating to any examination, administrative appeal, collection activity, administrative, civil or criminal investigation, enforcement activity, ruling, negotiated agreement, prefiling activity, or other proceeding or offense under the internal revenue laws or related statutes, or in preparation for any proceeding described in section 6103(h)(2) (or investigation which may result in such a proceeding), may disclose return information, of any taxpayer, to the extent necessary to obtain information relating to such official duties or to accomplish properly any activity connected with such official duties, including, but not limited to—

(i) Establishing or verifying the correctness or completeness of any return or return information;

(ii) Determining the responsibility for filing a return, for making a return if none has been made, or for performing such acts as may be required by law concerning such matters;

(iii) Establishing or verifying the liability (or possible liability) of any person, or the liability (or possible liability) at law or in equity of any transferee or fiduciary of any person, for any tax, penalty, interest, fine, forfeiture, or other imposition or offense under the internal revenue laws or related statutes or the amount thereof for collection;

(iv) Establishing or verifying misconduct (or possible misconduct) or other activity proscribed by the internal revenue laws or related statutes;

(v) Obtaining the services of persons having special knowledge or technical skills (such as, but not limited to, knowledge of particular facts and circumstances relevant to a correct determination of a liability described in paragraph (a)(1)(iii) of this section or skills relating to handwriting analysis, photographic development, sound recording enhancement, or voice identification) or having recognized expertise in matters involving the valuation of property if relevant to proper performance of official duties described in this paragraph;

(vi) Establishing or verifying the financial status or condition and location of the taxpayer against whom collection activity is or may be directed, to locate assets in which the taxpayer has an interest, to ascertain the amount of any liability described in paragraph (a)(1)(iii) of this section for collection, or otherwise to apply the provisions of the Internal Revenue Code relating to establishment of liens against such assets, or levy, seizure, or sale on or of the assets to satisfy any such liability;

(vii) Preparing for any proceeding described in section 6103(h)(2) or conducting an investigation which may result in such a proceeding; or

(viii) Obtaining, verifying, or establishing information concerned with making determinations regarding a taxpayer's liability under the Internal Revenue Code, including, but not limited to, the administrative appeals process and any ruling, negotiated agreement, or prefiling process.

(2) Disclosure of return information for the purpose of obtaining information to carry out properly the official duties described by this paragraph, or any activity connected with the official duties, is authorized only if the internal revenue or TIGTA employee reasonably believes, under the facts and circumstances, at the time of a disclosure, the information is not otherwise reasonably available, or if the activity connected with the official duties cannot occur properly without the disclosure.

(3) Internal revenue and TIGTA employees may identify themselves, their organizational affiliation (*e.g.*, Internal Revenue Service (IRS), Criminal Investigation (CI) or TIGTA, Office of Investigations (OI)), and the nature of their investigation, when making an oral, written, or electronic contact with a third party witness. Permitted disclosures include, but are not limited to, the use and presentation of any identification media (such as a Federal agency badge, credential, or business card) or the use of an information document request, summons, or correspondence on Federal agency letterhead or which bears a return address or signature block that reveals affiliation with the Federal agency.

(4) This section does not address or affect the requirements under section 7602(c) (relating to contact of third parties).

(b) *Disclosure of return information in connection with certain personnel or claimant representative matters*. In connection with official duties relating to any investigation concerned with enforcement of any provision of the Internal Revenue Code, including enforcement of any rule or directive prescribed by the Secretary or the Commissioner of Internal Revenue under any provision of the Internal Revenue Code, or the enforcement of any provision related to tax administration, that affects or may affect the personnel or employment rights or status, or civil or criminal liability, of any former, current, or prospective employee of the Treasury Department, Bureau of Alcohol, Tobacco, Firearms, and Explosives, United States Customs Service, United States Secret Service, or any successor agency, or the rights of any person who is, or may be, a party to an administrative action or proceeding pursuant to 31 U.S.C. 330 (relating to practice before the Treasury Department), an internal revenue, TIGTA, or other Federal officer or employee who is responsible for investigating such employees and persons and is properly in possession of relevant return information is authorized to disclose such return information to the extent necessary for the purpose of obtaining, verifying, or establishing other information which is or may be relevant and material to the investigation.

(c) *Definitions*. The following definitions apply to this section—

(1) *Disclosure of return information to the extent necessary* means a disclosure of return information which an internal revenue or TIGTA employee, based on the facts and circumstances, at the time of the disclosure, reasonably believes is necessary to obtain information to perform properly the official duties described by this section, or to accomplish properly the activities connected with carrying out those official duties. The term *necessary* in this context does not mean essential or indispensable, but rather appropriate and helpful in obtaining the information sought. Nor does *necessary* in this context refer to the necessity of conducting an investigation or the appropriateness of the means or methods chosen to conduct the investigation. Section 6103(k)(6) does not limit or restrict internal revenue or TIGTA employees with respect to the decision to initiate or the conduct of an investigation. Disclosures under this paragraph (c)(1), however, may not be made indiscriminately or solely for the benefit of the recipient or as part of a negotiated *quid pro quo* arrangement. This paragraph (c)(1) is illustrated by the following examples:

Example 1. A revenue agent contacts a taxpayer's customer regarding the customer's purchases made from the taxpayer during the year under investigation. The revenue agent is able to obtain the purchase information only by disclosing the taxpayer's identity and the fact of the investigation. Depending on the facts and circumstances known to the revenue agent at the time of the disclosure, such as the way the customer maintains his records, it also may be necessary for the revenue agent to inform the customer of the date of the purchases and the types of merchandise involved for the customer to find the purchase information.

Example 2. A revenue agent contacts a third party witness to obtain copies of invoices of sales made to a taxpayer under examination. The third party witness provides copies of the sales invoices in question and then asks the revenue agent for the current address of the taxpayer because the taxpayer still owes money to the third party witness. The revenue agent may not disclose that current address because this disclosure would be only for the benefit of the third party witness and not necessary to obtain information for the examination.

Example 3. A revenue agent contacts a third party witness to obtain copies of invoices of sales made to a taxpayer under examination. The third party witness agrees to provide copies of the sales invoices in question only if the revenue agent provides him with the current address of the taxpayer because the taxpayer still owes money to the third party witness. The revenue agent may not disclose that current address because this disclosure would be a negotiated *quid pro quo* arrangement.

(2) *Disclosure of return information to accomplish properly an activity connected with official duties* means a disclosure of return information to carry out a function associated with official duties generally consistent with established practices and procedures. This paragraph (c)(2) is illustrated by the following example:

Example. A taxpayer failed to file an income tax return and pay the taxes owed. After the taxes were assessed and the taxpayer was notified of the balance due, a revenue officer filed a notice of federal tax lien and then served a notice of levy on the taxpayer's bank. The notices of lien and levy contained the taxpayer's name, social security number, amount of outstanding liability, and the tax period and type of tax involved. The taxpayer's assets were levied to satisfy the tax debt, but it was determined that, prior to the levy, the revenue officer failed to issue the taxpayer a notice of intent to levy, as required by section 6331, and a notice of right to hearing before the levy, as required by section 6330. The disclosure of the taxpayer's return information in the notice of levy is authorized by section 6103(k)(6) despite the revenue officer's failure to issue the notice of intent to levy or the notice of right to hearing. The ultimate validity of the underlying levy is irrelevant to the issue of whether the disclosure was authorized by section 6103(k)(6).

(3) *Information not otherwise reasonably available* means information that an internal revenue or TIGTA employee reasonably believes, under the facts and circumstances, at the time of a disclosure, cannot be obtained in a sufficiently accurate or probative form, or in a timely manner, and without impairing the proper performance of the official duties described by this section, without making the disclosure. This definition does not require or create the presumption or expectation that an internal revenue or TIGTA employee must seek information from a taxpayer or authorized representative prior to contacting a third party witness in an investigation. Neither the Internal Revenue Code, IRS procedures, nor these regulations require repeated contacting of an uncooperative taxpayer. Moreover, an internal revenue or TIGTA employee may make a disclosure to a third party witness to corroborate information provided by a taxpayer. This paragraph (c)(3) is illustrated by the following examples:

Example 1. A revenue agent is conducting an examination of a taxpayer. The taxpayer refuses to cooperate or provide any information to the revenue agent. Information relating to the taxpayer's examination would be information not otherwise reasonably available because of the taxpayer's refusal to cooperate and supply any information to the revenue agent. The revenue agent may seek information from a third party witness.

Example 2. A special agent is conducting a criminal investigation of a taxpayer. The special agent has acquired certain information from the taxpayer. Although the special agent has no specific reason to disbelieve the taxpayer's information, the special agent contacts several third party witnesses to confirm the information. The special agent may contact third party witnesses to verify the correctness of the information provided by the taxpayer because the IRS is not required to rely solely on information provided by a taxpayer, and a special agent may take appropriate steps, including disclosures to third party witnesses under section 6103(k)(6), to verify independently or corroborate information obtained from a taxpayer.

(4) *Internal revenue employee* means, for purposes of this section, an officer or employee of the IRS or Office of Chief Counsel for the IRS, or an officer or employee of a Federal agency responsible for administering and enforcing taxes under Chapters 32 (Part III of Subchapter D), 51, 52, or 53 of the Internal Revenue Code, or investigating tax refund check fraud under 18 U.S.C. 510.

(5) *TIGTA employee* means an officer or employee of the Office of Treasury Inspector General for Tax Administration.

(d) *Examples*. The following examples illustrate the application of this section:

Example 1. A revenue agent is conducting an examination of a taxpayer. The taxpayer has been very cooperative and has supplied copies of invoices as requested. Some of the taxpayer's invoices show purchases that seem excessive in comparison to the size of the taxpayer's business. The revenue agent contacts the taxpayer's suppliers for the purpose of corroborating the invoices the taxpayer provided. In contacting the suppliers, the revenue agent discloses the taxpayer's name, the dates of purchase, and the type of merchandise at issue. These disclosures are permissible under section 6103(k)(6) because, under the facts and circumstances known to the revenue agent at the time of the disclosures, the disclosures were necessary to obtain information (corroboration of invoices) not otherwise reasonably available because suppliers would be the only source available for corroboration of this information.

Example 2. A revenue agent is conducting an examination of a taxpayer. The revenue agent asks the taxpayer for business records to document the deduction of the cost of goods sold shown on Schedule C of the taxpayer's return. The taxpayer will not provide the business records to the revenue agent, who contacts a third party witness for verification of the amount on the Schedule C. In the course of the contact, the revenue agent shows the Schedule C to the third party witness. This disclosure is not authorized under section 6103(k)(6). Section 6103(k)(6) permits disclosure only of return information, not the return (including schedules and attachments) itself. If necessary, a revenue agent may disclose return information extracted from a return when questioning a third party witness. Thus, the revenue agent could have extracted the amount of cost of goods sold from the Schedule C and disclosed that amount to the third party witness.

Example 3. A special agent is conducting a criminal investigation of a taxpayer, a doctor, for tax evasion. Notwithstanding the records provided by the taxpayer and the taxpayer's bank, the special agent decided to obtain information from the taxpayer's patients to verify amounts paid to the taxpayer for his services. Accordingly, the special agent sent letters to the taxpayer's patients to verify these amounts. In the letters, the agent disclosed that he was a special agent with IRS-CI and that he was conducting a criminal investigation of the taxpayer. Section 6103(k)(6) permits these disclosures (including the special agent disclosing his affiliation with CI and the nature of the investigation) to confirm the taxpayer's income. The decision whether to verify information already obtained is a matter of investigative judgment and is not limited by section 6103(k)(6).

Example 4. Corporation A requests a private letter ruling (PLR) as to the tax consequences of a planned transaction. Corporation A has represented that it is in compliance with laws administered by Agency B that may relate to the tax consequences of the proposed transaction. Further information is needed from Agency B relating to possible tax consequences. Under section 6103(k)(6), the IRS may disclose Corporation A's return information to Agency B to the extent necessary to obtain information from Agency B for the purpose of properly considering the tax consequences of the proposed transaction that is the subject of the PLR.

(e) *Effective date*. This section is applicable on July 6, 2006.

§301.6103(k)(6)–1T [Removed]

Par. 3. Section 301.6103(k)(6)–1T is removed.

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

Approved July 5, 2006.

Eric Solomon,
Acting Deputy Assistant Secretary for Tax Policy.

(Filed by the Office of the Federal Register on July 6, 2006, 10:02 a.m., and published in the issue of the Federal Register for July 11, 2006, 71 F.R. 38985)

Part III. Administrative, Procedural, and Miscellaneous

GO Zone Bonus Depreciation

Notice 2006–67

SECTION 1. PURPOSE

This notice provides guidance with respect to the 50-percent additional first year depreciation deduction provided by § 1400N(d) of the Internal Revenue Code (GO Zone additional first year depreciation deduction) for qualified Gulf Opportunity Zone property (GO Zone property).

SECTION 2. BACKGROUND AND GO ZONE PROPERTY

.01 Section 1400N(d), added by section 101 of the Gulf Opportunity Zone Act of 2005, Pub. L. No. 109–135, 119 Stat. 2577, generally allows a 50-percent additional first year depreciation deduction for GO Zone property. The GO Zone additional first year depreciation deduction is allowable in the taxable year in which the GO Zone property is placed in service by the taxpayer. The computation of the allowable GO Zone additional first year depreciation deduction and the otherwise allowable depreciation deduction for GO Zone property is made in accordance with rules similar to the rules for 50-percent bonus depreciation property in § 1.168(k)–1T(d)(1)(i), (1)(iii), and (2) of the Income Tax Regulations.

.02 GO Zone property is depreciable property that meets all of the following requirements:

(1) Property that is described in § 168(k)(2)(A)(i) and § 1.168(k)–1T(b)(2)(i), or property that is nonresidential real property (as defined in § 168(e)(2)(B)) or residential rental property (as defined in § 168(e)(2)(A)) and depreciated under § 168;

(2) Substantially all of the use of the property is in the Gulf Opportunity (GO) Zone (as defined in § 1400M(1)) and in the active conduct of a trade or business by the taxpayer in the GO Zone (for further guidance, see section 3 of this notice);

(3) The original use of the property commences with the taxpayer in the GO Zone on or after August 28, 2005. For purposes of this section 2.02(3), rules similar to the original use rules in § 1.168(k)–1T(b)(3) apply. In addition, used property will satisfy the original use requirement so long as the property has not been previously used within the GO Zone;

(4) The property is acquired by the taxpayer by purchase (as defined in § 179(d) and § 1.179–4(c)) on or after August 28, 2005, but only if no written binding contract for the acquisition of the property was in effect before August 28, 2005. For purposes of this section 2.02(4), the rules in § 1.168(k)–1T(b)(4)(ii) (binding contract), rules similar to the rules in § 168(k)(2)(E)(i) and § 1.168(k)–1T(b)(4)(iii) (self-constructed property), and rules similar to the rules in § 168(k)(2)(E)(iv) and § 1.168(k)–1T(b)(4)(iv) (disqualified transactions) apply; and

(5) The property is placed in service by the taxpayer on or before December 31, 2007 (December 31, 2008, in the case of qualified nonresidential real property and residential rental property).

.03 Depreciable property is not eligible for the GO Zone additional first year depreciation deduction if:

(1) The property is described in § 168(k)(2)(D)(i) and § 1.168(k)–1T(b)(2)(ii)(A)(*2*);

(2) The property is described in § 168(f);

(3) Any portion of the property is financed with the proceeds of any obligation the interest on which is tax-exempt under § 103;

(4) The property is a qualified revitalization building (as defined in § 1400I(b)) for which the taxpayer has made an election under § 1400I(a)(1) or (a)(2) in accordance with section 7 of Rev. Proc. 2003–38, 2003–1 C.B. 1017;

(5) The property is included in any class of property for which the taxpayer elects not to deduct the GO Zone additional first year depreciation (for further guidance, see section 4 of this notice);

(6) The property is described in § 1400N(p)(3) (for further guidance, see section 5 of this notice);

(7) The property is placed in service and disposed of during the same taxable year. However, rules similar to the rules in § 1.168(k)–1T(f)(1)(ii) and (iii) (technical termination of a partnership under § 708(b)(1)(B) or transactions described in § 168(i)(7)) apply; or

(8) The property is converted from business or income-producing use to personal use in the same taxable year in which the property is placed in service by a taxpayer.

.04 The counties and parishes in Alabama, Louisiana, and Mississippi that comprise the GO Zone are listed on page 2 of IRS Publication 4492, *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma*, under Gulf Opportunity (GO) Zone (Core Disaster Area).

.05 If depreciable property is not GO Zone property in the taxable year in which the property is placed in service by the taxpayer, the GO Zone additional first year depreciation deduction is not allowable for the property even if a change in use of the property subsequent to the placed-in-service year of the property results in the property being GO Zone property. *See* § 1.168(k)–1T(f)(6)(iv)(B).

.06 Limitation provisions of the Code (for example, §§ 465, 469, and 704(d)) apply and may limit the amount of the GO Zone additional first year depreciation deduction that may be claimed by a taxpayer subject to such a provision.

SECTION 3. SUBSTANTIALLY ALL AND ACTIVE CONDUCT REQUIREMENTS UNDER § 1400N(d)(2)(A)(ii)

.01 *Substantially All Requirement*. Each depreciable property will meet the requirements of § 1400N(d)(2)(A)(ii) if substantially all of the use of the property is in the GO Zone and in the active conduct of a trade of business by the taxpayer in the GO Zone. For this purpose, the term "substantially all" means 80 percent or more during each taxable year. If greater than 20 percent of the use of the property either is outside the counties and parishes designated as being part of the GO Zone or is not in the active conduct of a trade or business by the taxpayer in the GO Zone, then the property is not GO Zone property and is not eligible for the GO Zone additional first year depreciation deduction.

The following example illustrates the provisions of this section 3.01 and section 2.05 of this notice.

Example. *A*, a calendar-year taxpayer, owns and operates a furniture store in the GO Zone. In December 2006, *A* purchases a new delivery truck and places it in service for use in *A*'s business. The delivery truck is used less than 80 percent in the GO Zone in 2006 and is used 80 percent or more in the GO Zone in 2007 and 2008. Because the delivery truck does not meet the substantially all requirement described in this section 3.01 in its placed-in-service year (2006), the truck is not GO Zone property. Thus, the truck does not qualify for the GO Zone additional first year depreciation deduction, regardless of the fact that substantially all of the use of the truck is in the GO Zone in 2007 and 2008.

.02 *Active Conduct of a Trade or Business Requirement*.

(1) *Trade or business definition*. For purposes of § 1400N(d)(2)(A)(ii), the term "trade or business" has the same meaning as in § 162 and the regulations thereunder. Thus, property held merely for the production of income or used in an activity not engaged in for profit (as described in § 183) does not qualify for the GO Zone additional first year depreciation deduction.

(2) *Active conduct*. Solely for purposes of § 1400N(d)(2)(A)(ii), the determination of whether a trade or business is actively conducted by the taxpayer is to be made based on all of the facts and circumstances. A taxpayer generally is considered to actively conduct a trade or business if the taxpayer meaningfully participates in the management or operations of the trade or business. Furthermore, for purposes of § 1400N(d)(2)(A)(ii), a partner, member, or shareholder of a partnership, limited liability company, or S corporation, respectively, is considered to actively conduct a trade or business of the partnership, limited liability company, or S corporation if the partnership, limited liability company, or S corporation meaningfully participates (through the activities performed by itself, or by others on behalf of the partnership, limited liability company, or S corporation, respectively) in the management or operations of the trade or business. Similar rules apply to other pass-thru entities such as trusts or estates.

(3) *Examples*. The following examples illustrate the provisions of section 3.02 of this notice.

(a) *Example 1*. During 2006, *MNO*, a limited liability company, constructs and places in service a new apartment building in the GO Zone. *MNO* is treated as a partnership for federal tax purposes. *B*, a member in *MNO*, manages and operates this apartment building for MNO. Because *B* manages and operates the apartment building for *MNO*, *MNO* meaningfully participates in the management and operations of the apartment building. Consequently, all of the use of the apartment building is in the GO Zone and in the active conduct of a trade or business by *MNO* in the GO Zone. Accordingly, the unadjusted depreciable basis (as defined in § 1.168(b)–1T(a)(3)) of the apartment building qualifies for the GO Zone additional first year depreciation deduction (assuming all other requirements are met). However, limitation provisions of the Code (for example, § 469) apply and may limit the amount of the GO Zone additional first year depreciation deduction that may be claimed by the members of *MNO*.

(b) *Example 2*. During 2006, *C*, an individual, places in service a new restaurant in the GO Zone and employs *D* to operate it. During 2006, C periodically met with *D* to review operations relating to the restaurant. *C* also approved the restaurant's budget for 2006 that was prepared by *D*. *D* performs all the necessary operating functions, including hiring chefs, acquiring the necessary food and restaurant supplies, and writing the checks to pay all bills and the chefs' salaries. Based on these facts and circumstances, *C* meaningfully participates in the management of the restaurant. Consequently, all of the use of the restaurant is in the GO Zone and in the active conduct of a trade or business by *C* in the GO Zone. Accordingly, the unadjusted depreciable basis of the restaurant qualifies for the GO Zone additional first year depreciation deduction (assuming all other requirements are met). However, limitation provisions of the Code (for example, § 469) apply and may limit the amount of the GO Zone additional first year depreciation deduction that may be claimed by *C*.

(c) *Example 3*. During 2006, *PRS*, a partnership, constructs and places in service a new small commercial building in the GO Zone and leases it to *E*, an unrelated party, who uses the building as a fast food restaurant. This building is the only property owned by *PRS*. The lease agreement between *PRS* and *E* is a triple net lease under which *E* is responsible for all of the costs relating to the building (for example, paying all taxes, insurance, and maintenance expenses) in addition to paying rent. Because of the triple net lease, *PRS* does not meaningfully participate in the management or operations of the building and the building is not used in the active conduct of a trade or business by *PRS* in the GO Zone. Accordingly, the building does not qualify for the GO Zone additional first year depreciation deduction.

(d) *Example 4*. Same facts as *Example 3*, except that *PRS*, during 2006, constructs and places in service two other new commercial buildings in the GO Zone and leases these buildings to *F*, an unrelated party, who uses the two other buildings as office space. The lease agreement between *PRS* and *F* is not a triple net lease. *G*, a partner in *PRS*, manages and operates the two office buildings for *PRS*. Because *G* manages and operates the two office buildings for *PRS*, *PRS* meaningfully participates in the management and operations of the two office buildings. Consequently, these two office buildings are used in the active conduct of a trade or business by *PRS* in the GO Zone. Accordingly, the total unadjusted depreciable basis of the two office buildings leased to *F* qualifies for the GO Zone additional first year depreciation deduction (assuming all other requirements are met). However, limitation provisions of the Code (for example, § 469) apply and may limit the amount of the GO Zone additional first year depreciation deduction that may be claimed by the partners of *PRS* with respect to the two buildings leased to *F*. Further, because the requirements of § 1400N(d)(2)(A)(ii) apply on a property-by-property basis, the building leased to *E* does not qualify for the GO Zone additional first year depreciation deduction, as provided in *Example 3*.

SECTION 4. ELECTION NOT TO DEDUCT GO ZONE ADDITIONAL FIRST YEAR DEPRECIATION

.01 *In General*. Pursuant to § 1400N(d)(2)(B)(iv), a taxpayer may make an election not to deduct the GO Zone additional first year depreciation for any class of property that is GO Zone property placed in service during the taxable year. If a taxpayer makes this election, then the election applies to all GO Zone property that is in the same class of property and placed in service in the same taxable year, and no additional first year depreciation deduction is allowable for the class of property. In addition, the depreciation adjustments under § 56 apply to that property for purposes of computing the taxpayer's alternative minimum taxable income. The election not to deduct the GO Zone additional first year depreciation is made by each person owning GO Zone property (for example, for each member of a consolidated group by the common parent of the group, by the partnership, or by the S corporation).

.02 *Definition of Class of Property*. For purposes of the election under § 1400N(d)(2)(B)(iv) not to deduct the GO Zone additional first year depreciation, the term "class of property" means:

(1) Except for the property described in this section 4.02(2), (3), (4), (5), and (6), each class of property described in § 168(e) (for example, 5-year property);

(2) Water utility property as defined in § 168(e)(5) and depreciated under § 168;

(3) Computer software as defined in, and depreciated under, § 167(f)(1) and the regulations thereunder;

(4) Qualified leasehold improvement property as defined in § 168(k)(3) and § 1.168(k)–1T(c) and depreciated under § 168;

(5) Nonresidential real property as defined in § 168(e)(2)(B) and depreciated under § 168; or

(6) Residential rental property as defined in § 168(e)(2)(A) and depreciated under § 168.

.03 *Time and Manner of Making the Election*.

(1) *In general*. An election not to deduct the GO Zone additional first year depreciation for any class of property that is GO Zone property placed in service during the taxable year must be made by the due date (including extensions) of the federal income tax return for the taxable year in which the GO Zone property is placed in service by the taxpayer. The election must be made in the manner prescribed on Form 4562, *Depreciation and Amortization*, and its instructions.

If a taxpayer files its 2004 or 2005 federal income tax return on or after September 13, 2006, then the taxpayer must follow the instructions for the 2005 Form 4562 (Rev. January 2006) for the manner for making the election not to deduct the GO Zone additional first year depreciation for any class of property that is GO Zone property placed in service by the taxpayer on or after August 28, 2005, during the taxpayer's taxable year beginning in 2004 or 2005 (2004 or 2005 taxable year). If a taxpayer files its 2004 or 2005 federal income tax return before September 13, 2006, then see section 4.03(2) of this notice for the procedures for making the election not to deduct the GO Zone additional first year depreciation for any class of property that is GO Zone property placed in service by the taxpayer on or after August 28, 2005, during the taxpayer's 2004 or 2005 taxable year.

(2) *Special rules for 2004 or 2005 federal income tax return filed before September 13, 2006*.

(a) *In general*. If a taxpayer files its 2004 or 2005 federal income tax return before September 13, 2006, then the taxpayer has made the election not to deduct the GO Zone additional first year depreciation for a class of property that is GO Zone property placed in service by the taxpayer on or after August 28, 2005, during the taxpayer's 2004 or 2005 taxable year, if the taxpayer:

(i) made the election within the time prescribed in section 4.03(1) of this notice and in the manner prescribed in the instructions for the 2005 Form 4562 (Rev. January 2006) (that is, attach a statement to the taxpayer's timely filed return (including extensions) indicating the class of property for which the taxpayer is making the election and that, for such class of property, the taxpayer is electing not to claim the GO Zone additional first year depreciation deduction); or

(ii) made the deemed election provided for in section 4.03(2)(b) of this notice.

(b) *Deemed election*. If section 4.03(2)(a)(i) of this notice does not apply, a taxpayer that files its 2004 or 2005 federal income tax return before September 13, 2006, will be treated as having made the election not to deduct the GO Zone additional first year depreciation for a class of property that is GO Zone property placed in service by the taxpayer on or after August 28, 2005, during the taxpayer's 2004 or 2005 taxable year, if the taxpayer:

(i) on that return, did not claim the GO Zone additional first year depreciation deduction for that class of property but did claim depreciation; and

(ii) does not file an amended federal tax return for the taxpayer's 2004 or 2005 taxable year on or before February 14, 2007, or a Form 3115, *Application for Change in Accounting Method*, with the taxpayer's federal tax return for the taxpayer's next succeeding taxable year, to claim the GO Zone additional first year depreciation deduction for that class of property.

If a Form 3115 is filed under section 4.03(2)(b)(ii) of this notice, the Form 3115 must be filed in accordance with the automatic change in method of accounting provisions of Rev. Proc. 2002–9, 2002–1 C.B. 327, as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432, or any successor. The change in method of accounting from filing the Form 3115 results in a § 481(a) adjustment. Further, the scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply. Moreover, for purposes of section 6.02(4)(a) of Rev. Proc. 2002–9, the taxpayer should include on line 1a of the Form 3115 the designated automatic accounting method change number "104".

Section 1.446–1(e)(3)(ii) authorizes the Commissioner of Internal Revenue to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting. In addition, section 2.04 of Rev. Proc. 2002–9 provides that unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in method of accounting, regardless of whether the change is from a permissible or an impermissible method. *See generally* Rev. Rul. 90–38, 1990–1 C.B. 57.

.04 *Revocation*. An election not to deduct the GO Zone additional first year depreciation for a class of property that is GO Zone property is revocable only with the prior written consent of the Commissioner. To seek the Commissioner's consent, the taxpayer must submit a request for a letter ruling in accordance with the provisions of Rev. Proc. 2006–1, 2006–1 I.R.B. 1 (or any successor).

.05 *Failure to Make Election Not to Deduct GO Zone Additional First Year Depreciation*. If a taxpayer does not make the election described in section 4.01 of this notice within the time and in the manner prescribed in section 4.03 of this notice, the amount of depreciation allowable for that property under § 167(f)(1) or under § 168, as applicable, must be determined for the placed-in-service year and for all subsequent taxable years by taking into account the GO Zone additional first year depreciation deduction. Thus, the election not to deduct the GO Zone additional first year depreciation cannot be made by the taxpayer in any other manner (for example, through a request under § 446(e) to change the taxpayer's method of accounting).

SECTION 5. CERTAIN PROPERTY NOT ELIGIBLE FOR THE GO ZONE ADDITIONAL FIRST YEAR DEPRECIATION DEDUCTION

.01 *In General*. Section 1400N(p)(1) disallows the GO Zone additional first year depreciation deduction for any property described in § 1400N(p)(3). Pursuant to § 1400N(p)(3)(A), such property includes:

(1) any property used in connection with any private or commercial golf course, massage parlor, hot tub facility, suntan facility, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises ("prohibited activities"); or

(2) any gambling or animal racing property.

.02 *Prohibited Activities*.

(1) *Real property used for both a prohibited activity and a non-prohibited activity*. Solely for purposes of § 1400N(d), the portion of any real property (determined by square footage) that is dedicated to any prohibited activity described in section 5.01(1) of this notice is not eligible for the GO Zone additional first year depreciation deduction. If real property is used for both a prohibited activity and an activity not described in section 5.01(1) of this notice, the portion of the real property (determined by square footage) that is not dedicated to the prohibited activity is eligible for the GO Zone additional first year depreciation deduction (assuming all other requirements under § 1400N(d) are met). For example, the GO Zone additional first year depreciation deduction for a shopping center that has both a suntan salon and businesses not described in section 5.01(1) of this notice (and that otherwise qualifies for the GO Zone additional first year depreciation deduction under § 1400N(d)), is determined without regard to the portion of the shopping center's unadjusted depreciable basis that bears the same percentage to the total unadjusted depreciable basis as the percentage of square footage dedicated to the prohibited activity (that is, the suntan salon) bears to the total square footage of the shopping center.

(2) *Trade or business activity that derives a small percentage of gross receipts from certain prohibited activities*.

(a) *De minimis rule*. Solely for purposes of § 1400N(p)(3)(A)(i), a taxpayer's trade or business activity that has less than 10 percent of its total gross receipts derived from massages, tanning services, or a hot tub facility is not treated as, respectively, a massage parlor, a suntan facility, or a hot tub facility. Such trade or business activity may include, for example, a physical therapy office or a beauty/day spa salon if its gross receipts derived from massages, suntanning, and hot tub facilities are less than 10 percent of its total gross receipts. In determining whether this less than 10 percent test is satisfied, only gross receipts from the taxpayer's trade or business activity that includes the massages, tanning services, or hot tub facility are taken into account. Further, if a taxpayer is a member of a consolidated group, only the gross receipts of the taxpayer (and not the consolidated group) are taken into account. Also, if the taxpayer is a partnership, S corporation, or other pass-thru entity, only the gross receipts of the pass-thru entity (and not the owners of the pass-thru entity) are taken into account.

(b) *Definition of gross receipts*. For purposes of this section 5.02(2), the term "gross receipts" means the taxpayer's receipts for the taxable year that are recognized under the taxpayer's methods of accounting used for federal income tax purposes for the taxable year. For this purpose, gross receipts include total sales (net of returns and allowances) and all amounts received for services. In addition, gross receipts include any income from investments, and from incidental or outside sources. For example, gross receipts include interest (including original issue discount and tax-exempt interest within the meaning of § 103), dividends, rents, royalties, and annuities, regardless of whether the amounts are derived in the ordinary course of the taxpayer's trade or business. Gross receipts are not reduced by cost of goods sold or by the cost of property sold if such property is described in § 1221(a)(1), (3), (4), or (5). With respect to sales of capital assets as defined in § 1221, or sales of property described in § 1221(a)(2) (relating to property used in a trade or business), gross receipts are reduced by the taxpayer's adjusted basis in such property. Gross receipts do not include the amounts received in repayment of a loan or similar instrument (for example, a repayment of the principal amount of a loan held by a commercial lender). Finally, gross receipts do not include amounts received by the taxpayer with respect to sales tax or other similar state and local taxes if, under the applicable state or local law, the tax is legally imposed on the purchaser of the good or service and the taxpayer merely collects and remits the tax to the taxing authority. If, in contrast, the tax is imposed on the taxpayer under the applicable law, then gross receipts include the amounts received that are allocable to the payment of such tax.

.03 *Gambling or Animal Racing Property*.

(1) *In general*. Section 1400N(p)(3)(B)(i) defines the term "gambling or animal racing property" as meaning:

(a) any equipment, furniture, software, or other property used directly in connection with gambling, the racing of animals, or the on-site viewing of such racing; and

(b) the portion of any real property (determined by square footage) that is dedicated to gambling, the racing of animals, or the on-site viewing of such racing. However, pursuant to § 1400N(p)(3)(B)(ii), if the portion of the real property dedicated to gambling, the racing of animals, or the on-site viewing of such racing is less than 100 square feet, then that portion is not gambling or animal racing property. For example, no apportionment is required under this 100-square-foot *de minimis* rule in the case of a retail store that sells lottery tickets in a less than 100 square foot area.

(2) *Real property not dedicated to gambling or animal racing*. Real property that is not dedicated to gambling, the racing of animals, or the on-site viewing of such racing but is attached to such gaming facilities is eligible for the GO Zone additional first year depreciation deduction (assuming all other requirements under § 1400N(d) are met). Such property may include, for example, hotels, restaurants, and parking lots of gaming facilities. For example, the GO Zone additional first year depreciation deduction for a building that is used as both a casino and a hotel (and that otherwise qualifies for the GO Zone additional first year depreciation deduction under § 1400N(d)), is determined without regard to the portion of the building's unadjusted depreciable basis that bears the same percentage to the total unadjusted depreciable basis as the percentage of square footage dedicated to gambling (that is, the casino floor) bears to the total square footage of the building.

SECTION 6. RECAPTURE RULES UNDER § 1400N(d)(5)

.01 *In General*. Section 1400N(d)(5) provides that for purposes of § 1400N(d), rules similar to the recapture rules under § 179(d)(10) and § 1.179–1(e) apply with respect to any GO Zone property that ceases to be GO Zone property.

.02 *Application*. If GO Zone property is no longer GO Zone property in the hands of the same taxpayer at any time before the end of the GO Zone property's recovery period as determined under § 167(f)(1) or § 168, as applicable, then the taxpayer must recapture in the taxable year in which the GO Zone property is no longer GO Zone property (the recapture year) the benefit derived from claiming the GO Zone additional first year depreciation deduction for such property. The benefit derived from claiming the GO Zone additional first year depreciation deduction for the property is equal to the excess of the total depreciation claimed (including the GO Zone additional first year depreciation deduction) for the property for the taxable years before the recapture year over the total depreciation that would have been allowable for the taxable years before the recapture year as a deduction under § 167(f)(1) or § 168, as applicable, had the GO Zone additional first year depreciation deduction not been claimed (regardless of whether such excess reduced the taxpayer's tax liability). The amount to be recaptured is treated as ordinary income for the recapture year. For the recapture year and subsequent taxable years, the taxpayer's deductions under § 167(f)(1) or § 168, as applicable, are determined as if no GO Zone additional first year depreciation deduction was claimed with respect to the property. If, subsequent to the recapture year, a change in the use of the property results in the property again being GO Zone property, then the GO Zone additional first year depreciation deduction is not allowable for the property.

.03 *Examples*. The following examples illustrate the provisions of this section 6.

(a) *Example 1*. *H*, a calendar-year taxpayer, owns and operates a furniture store in the GO Zone. In December 2006, *H* purchases a new delivery truck for $50,000 and places it in service for use in *H*'s business. For 2006, this delivery truck is GO Zone property and is 5-year property under § 168(e). *H* depreciates its 5-year property placed in service in 2006 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. During 2007, the delivery truck is used less than 80 percent in the GO Zone.

(i) For 2006, *H* is allowed the GO Zone additional first year depreciation deduction of $25,000 for the delivery truck (unadjusted depreciable basis of $50,000 multiplied by .50). In addition, *H*'s depreciation deduction allowable in 2006 for the remaining adjusted depreciable basis of $25,000 for the delivery truck (the unadjusted depreciable basis of $50,000 reduced by the GO Zone additional first year depreciation deduction of $25,000) is $5,000 (the remaining adjusted depreciable basis of $25,000 multiplied by the annual depreciation rate of .20 for recovery year 1). Thus, *H*'s depreciation deduction allowable in 2006 for the delivery truck totals $30,000.

(ii) For 2007, because the delivery truck does not meet the substantially all requirement described in section 3.01 of this notice, the delivery truck is no longer GO Zone property. Accordingly, for 2007, *H* must recapture as ordinary income $20,000 ($30,000 depreciation claimed by *H* for the truck before 2007 less the $10,000 depreciation that would have been allowable for the truck before 2007 had the GO Zone additional first year depreciation deduction not been claimed (unadjusted depreciable basis of $50,000 multiplied by the cumulative annual depreciation rate of .20 before 2007)). In addition, *H*'s depreciation deduction allowable in 2007 for the delivery truck is $16,000 (unadjusted depreciable basis of $50,000 multiplied by the annual depreciation rate of .32 for recovery year 2) (determined as if no GO Zone additional first year depreciation deduction was claimed for the truck).

(b) *Example 2*. Same facts as in *Example 1*, except that during 2008, the delivery truck is used 80 percent or more in the GO Zone. The GO Zone additional first year depreciation deduction is not allowable for the delivery truck even though the truck is GO Zone property in the hands of *H* in 2008. Thus, for 2008, *H*'s depreciation deduction allowable in 2008 for the delivery truck is $9,600 (unadjusted depreciable basis of $50,000 multiplied by the annual depreciation rate of .1920 for recovery year 3) (determined as if no GO Zone additional first year depreciation deduction was claimed for the truck).

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include the automatic change in method of accounting provided under section 4.03(2)(b) of this notice in section 2 of the APPENDIX of Rev. Proc. 2002–9.

SECTION 8. DRAFTING INFORMATION

The principal author of this notice is Douglas H. Kim of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Mr. Kim at (202) 622–3110 (not a toll-free call).

Regulation Section 1.7874–2T Effective Date for Acquisitions Initiated Prior to December 28, 2005

Notice 2006–70

This notice announces that the Treasury Department and the Internal Revenue Service (IRS) will, when finalizing Treas. Reg. § 1.7874–2T, amend the effective date in Treas. Reg. § 1.7874–2T(j), as it applies to certain acquisitions initiated prior to December 28, 2005.

BACKGROUND

On December 28, 2005, the Treasury Department and the IRS issued T.D. 9238, 2006–6 I.R.B. 408 (Feb. 6, 2006), Guidance Under Section 7874 for Determining Ownership by Former Shareholders or Partners of Domestic Entities, which promulgated Treas. Reg. § 1.7874–1T. The preamble to T.D. 9238 states that the IRS and the Treasury Department are considering issuing regulations, which may be retroactive, to address certain structures which have the effect of inversion transactions and therefore should be subject to section 7874. Those structures include situations in which the shareholders (or partners) of a domestic corporation (or domestic partnership) arrange to transfer their shares (or partnership interests) to a newly formed foreign entity for which an entity classification election under Treas. Reg. § 301.7701–3 is made to treat such entity as a foreign partnership for Federal tax purposes. The preamble noted that other such structures involve the use of exchangeable shares to avoid the application of section 7874.

On June 6, 2006, the Treasury Department and the IRS issued T.D. 9265, 2006–27 I.R.B. 1 Guidance Under Section 7874 Regarding Expatriated Entities and Their Foreign Parents, which promulgated Treas. Reg. § 1.7874–2T. Treasury Reg. § 1.7874–2T addresses the concerns raised in the preamble to Treas. Reg. § 1.7874–1T involving acquisitions by foreign partnerships and exchangeable shares. Accordingly, Treas. Reg. § 1.7874–2T(e) generally provides that any foreign partnership that would be treated as a corporation under section 7704 of the Code (but for the application of section 7704(c)) will be treated as a foreign corporation for purposes of determining whether the partnership is a surrogate foreign corporation, as the term is defined in section 7874. In addition, Treas. Reg. § 1.7874–2T(f) generally provides that options and similar interests held by a former shareholder or former partner of the expatriated entity by reason of holding stock or a partnership interest in the expatriated entity will be treated, for purposes of the owner continuity test in section 7874, as exercised, to the extent that the effect is to treat the foreign corporation as a surrogate foreign corporation.

The effective date provision in Treas. Reg. § 1.7874–2T(j) provides that Treas. Reg. § 1.7874–2T applies to acquisitions completed on or after June 6, 2006. The effective date provision does not, however, address situations in which a binding commitment to make an acquisition described in section 7874(a)(2)(B)(i) had been entered into prior to June 6, 2006, but such acquisition had not been completed prior to June 6, 2006.

DISCUSSION

The Treasury Department and the IRS will, when finalizing Treas. Reg. § 1.7874–2T, amend the effective date provision in Treas. Reg. § 1.7874–2T(j) such that Treas. Reg. § 1.7874–2 will not apply to an acquisition otherwise described in section 7874(a)(2)(B)(i) that was completed on or after June 6, 2006, provided such acquisition was entered into pursuant to a written agreement which was (subject to customary conditions) binding on December 28, 2005, and at all times thereafter (binding commitment). For purposes of the preceding sentence, a binding commitment shall include entering into options and similar interests in connection with one or more written agreements described in the preceding sentence. Accordingly, the provisions of Treas. Reg. § 1.7874–2T, when finalized, will not apply to acquisitions that occur, in whole or in part, as a result of the exercise of such options or similar interests.

EFFECTIVE DATE

Taxpayers may rely on this notice until the issuance of regulations described herein.

COMMENTS

Written comments on the issues addressed in this notice may be submitted to the Office of Associate Chief Counsel International, Attention: Milton M. Cahn (*Notice* 2006–70), room 4555, CC:INTL:BR4, 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. Treasury and the IRS request comments by November 30, 2006.

DRAFTING INFORMATION

The principal author of this notice is Milton M. Cahn of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Milton M. Cahn at (202) 622–3870 (not a toll-free call).

Part IV. Items of General Interest

Revision of Instructions for Form 3115 for Use with the December 2003 Version of Form 3115, Application for Change in Accounting Method

Announcement 2006–52

The Instructions for Form 3115 have been revised. The May 2006 revision is the current version of the Instructions for Form 3115 and is to be used with the December 2003 version of Form 3115, *Application for Change in Accounting Method.*

In general, a taxpayer requesting a change in accounting method must complete and file a current Form 3115. See section 8.06 of Rev. Proc. 97–27, 1997–21 I.R.B. 10 (as modified and amplified by Rev. Proc. 2002–19, 2002–13 I.R.B. 696, as amplified and clarified by Rev. Proc. 2002–54, 2002–35 I.R.B. 432). See also Rev. Proc. 2002–9, 2002–3 I.R.B. 327 (as modified and clarified by Announcement 2002–17, 2002–8 I.R.B. 561, modified and amplified by Rev. Proc. 2002–19, and amplified, clarified, and modified by Rev. Proc. 2002–54).

The May 2006 Instructions for Form 3115 incorporate changes made in published guidance, such as Rev. Proc. 2004–34, 2004–22 I.R.B. 991 (regarding reporting advance payments) and Rev. Proc. 2006–1, 2006–1 I.R.B. 1 (regarding letter rulings). It also lists and describes automatic accounting method change numbers 77 through 103, and revises the descriptions of automatic accounting method change numbers 7, 8, and 9, to incorporate guidance published since the December 2003 version.

The May 2006 Instructions for Form 3115, as well as the December 2003 Form 3115, may be downloaded from the IRS website, *www.irs.gov*, or may be ordered by calling 1–800–TAX FORM (1–800–829–3676).

DRAFTING INFORMATION

The principal author of this announcement is Brenda D. Wilson of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this announcement, contact Ms. Wilson at (202) 622–4800 (not a toll-free call).

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

Announcement 2006–53

AGENCY: Internal Revenue Service, Treasury.

ACTION: Change of location for public hearing.

SUMMARY: This document provides a change of location for a public hearing on proposed regulations (REG–111578–06, 2006–24 I.R.B. 1060) under section 199 of the Internal Revenue Code. The regulations provide a deduction for income attributable to domestic production activities to certain transactions involving computer software.

DATES: The public hearing is being held on Tuesday, August 29, 2006, at 10 a.m.

ADDRESSES: The public hearing was originally being held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. The hearing location has changed. The public hearing will be held in the IRS Auditorium (New Carrollton location), 5000 Ellin Road, Lanham, MD 20706.

FOR FURTHER INFORMATION CONTACT: Guy R. Traynor, (202) 622–7180 or Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov*.

SUPPLEMENTARY INFORMATION:

The subject of the public hearing is a notice of proposed rulemaking (REG–111578–06) that was published in the **Federal Register** on Thursday, June 1, 2006 (71 FR 31128).

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who submitted written comments by August 30, 2006, and outlines by August 8, 2006, may present oral comments at the hearing.

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

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 July 28, 2006, 8:45 a.m., and published in the issue of the Federal Register for July 31, 2006, 71 F.R. 43085)

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

Announcement 2006–54

The Internal Revenue Service has revoked its determination that the organization listed below qualifies as an organization described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

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

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on August 14, 2006, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Nationwide Consumer Credit Services
Ft. Lauderdale, FL

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

Numerical Finding List[1]

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

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

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