Internal Revenue
bulletin

Bulletin No. 2007-43
October 22, 2007

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 9360, page 860.

Final regulations under section 1291 of the Code provide certain elections for taxpayers that continue to be subject to the passive foreign investment company (PFIC) excess distribution regime even though the foreign corporation in which they own stock is no longer treated as a PFIC under section 1297(a) or (e).

REG–143326–05, page 873.

Proposed regulations under sections 1361, 1362, and 1366 of the Code provide guidance regarding changes to the rules governing S corporations under the American Jobs Creation Act of 2004 (AJCA) and the Gulf Opportunity Zone Act of 2005 (GOZA). The regulations provide guidance on the family shareholder rules, the treatment of electing small business trusts, the allowance of suspended losses to spouses and former spouses of S corporation shareholders, and relief for inadvertently terminated or invalid qualified subchapter S subsidiary elections. The regulations also remove or update various obsolete references in the current regulations. A public hearing is scheduled for January 16, 2008.

REG–106143–07, page 881.

Proposed regulations under section 148 of the Code provide arbitrage guidance for tax-exempt bonds. A public hearing is scheduled for January 30, 2008.

REG–129916–07, page 891.

Proposed regulations under section 6011 of the Code add the patented transactions category of reportable transaction to regulations section 1.6011–4. A patented transaction is a transaction for which a taxpayer pays (directly or indirectly) a fee in any amount to a patent holder or the patent holder's agent for the legal right to use a tax planning method that is the subject of the patent. A patented transaction is also a transaction for which a taxpayer (the patent holder or the patent holder's agent) has the right to payment for another person's use of a tax planning method that is the subject of the patent.

Notice 2007–80, page 867.

Extension of replacement period for livestock sold on account of drought. This notice explains the circumstances under which the 4–year replacement period under section 1033(e)(2) of the Code is extended for livestock sold on account of drought. The Appendix to this notice contains a list of the counties that experienced exceptional, extreme, or severe drought during the preceding 12–month period ending August 31, 2007. Taxpayers may use this list to determine if an extension is available.

EXEMPT ORGANIZATIONS

Announcement 2007–99, page 896.

A list is provided of organizations now classified as private foundations.

ADMINISTRATIVE

Announcement 2007–95, page 894.

This document contains corrections to proposed regulations (REG–128224–06, 2007–36 I.R.B. 551) providing guidance on which costs incurred by estates or non-grantor trusts are subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a) of the Code.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Announcement 2007–97, page 895.
This document contains corrections to proposed regulations (REG–116215–07, 2007–38 I.R.B. 659) that amend existing regulations issued under sections 6104 and 6110 of the Code and clarify rules relating to information that is made available by the IRS for public inspection under section 6104(a) and materials that are made publicly available under section 6110.

Announcement 2007–98, page 896.
This document contains corrections to proposed regulations (REG–148393–06, 2007–39 I.R.B. 714) regarding the tax treatment of payments by qualified plans for medical or accident insurance.

Announcement 2007–101, page 898.
This document cancels a public hearing on proposed regulations (REG–138707–06, 2007–32 I.R.B. 342) relating to income derived by foreign corporations from the international operation of ships or aircraft.

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 1291.—Interest on Tax Deferral

26 CFR 1.1291–9: Deemed dividend election.

T.D. 9360

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

Guidance on Passive Foreign Investment Company (PFIC) Purging Elections

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of the temporary regulations.

SUMMARY: This document contains final regulations that provide certain elections for taxpayers that continue to be subject to the PFIC excess distribution regime of section 1291 of the Internal Revenue Code even though the foreign corporation in which they own stock is no longer treated as a PFIC under section 1297(a) or (e) of the Code. The regulations are necessary to provide guidance about purging the PFIC taint for such foreign corporations. The regulations will affect U.S. persons that hold stock in a PFIC.

DATES: *Effective Date:* These regulations are effective on September 27, 2007.

Applicability Date: For dates of applicability, see §§1.1291–9(k), 1.1297–3(f), 1.1298–3(f).

FOR FURTHER INFORMATION CONTACT: Paul J. Carlino at (202) 622–3840 (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 1545–1965.

The collection of information in these final regulations is in §1.1297–3(c)(5)(ii). This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of income or gain or is claiming the correct amount of losses, deductions or credits from that taxpayer's interest in the foreign corporation.

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

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

Background

On December 8, 2005, the IRS and the Treasury Department published final regulations under section 1298(b)(1) and removal of temporary regulations (T.D. 9231, 2006–1 C.B. 272) in the **Federal Register** (70 FR 72914). The final regulations provided rules for a shareholder of a former PFIC (as defined in §1.1291–9(j)(2)(iv)) to make a deemed dividend or deemed sale election to purge the PFIC taint of the stock of the foreign corporation (that is, to end treatment of the stock of the foreign corporation as PFIC stock with respect to the shareholder). On December 8, 2005, the Internal Revenue Service and the Treasury Department also published temporary regulations (T.D. 9232, 2006–1 C.B. 266) under sections 1291(d)(2), 1297(e) and 1298(b)(1) in the **Federal Register** (70 FR 72908). A notice of proposed rulemaking (REG–133446–03, 2006–1 C.B. 299) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (70 FR 72952). The temporary and proposed regulations provided guidance to shareholders of section 1297(e) PFICs (as defined in §1.1291–9(j)(2)(v)) on making a deemed sale or deemed dividend election to purge the PFIC taint of the stock of the foreign corporation. The temporary and proposed regulations also provided guidance to shareholders of section 1297(e) PFICs and shareholders of former PFICs on making late purging elections (provided certain requirements are met).

No public hearing was requested or held. A comment responding to the notice of proposed rulemaking was received. After consideration of the comment, the proposed regulations are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed. The comment and revision is discussed in this preamble.

Summary of Comments and Explanation of Revisions

1. *Multiple Purging Elections*

Sections 1.1297–3 and 1.1298–3 provide guidance for a shareholder of a section 1297(e) PFIC and a shareholder of a former PFIC, respectively, to make a deemed sale or a deemed dividend election to purge the PFIC taint of the stock of the foreign corporation. A *section 1297(e) PFIC* is a foreign corporation that qualifies as a PFIC under section 1297(a) on the first day of the qualified portion of the shareholder's holding period under section 1297(e), and is treated as a PFIC with respect to the shareholder under section 1298(b)(1) because at any time during the shareholder's holding period of the stock, other than the qualified portion, the foreign corporation was a PFIC that was not a qualified electing fund (QEF) under section 1295. (The "qualified portion" is the portion of the shareholder's holding period which is after December 31, 1997, and during which the shareholder is a U.S. shareholder (as defined in section 951(b)) and the foreign corporation is a controlled foreign corporation.) A *former PFIC* is a foreign corporation that satisfies neither the income nor the asset test of section 1297(a), but whose stock held by a shareholder is treated as stock of a PFIC, pursuant to section 1298(b)(1), because the corporation was a PFIC that was not a

QEF at some time during the shareholder's holding period of the stock.

Sections 1.1297–3(e) and 1.1298–3(e) provide rules for making late purging elections when the time prescribed for making timely purging elections under §§1.1297–3(b)(3) or (c)(4) and 1.1298–3(b)(3) or (c)(4) has elapsed.

One commentator requested that the final regulations clarify whether multiple late purging elections can be made under §§1.1297–3(e) and 1.1298–3(e). The IRS and the Treasury Department believe that multiple late purging elections should be allowed to the same extent such multiple purging elections could have been made if filed timely. The final regulations are amended to clarify this rule.

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 will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that these regulations affect only U.S. persons with stock ownership in a PFIC. There are not a substantial number of U.S. persons that are small entities that own stock in a PFIC. Further, the economic costs necessary to comply with the rule for the small entities that may be impacted are not significant. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this final 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 Paul J. Carlino of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1291–9 is amended by revising paragraphs (i), (j)(2)(v) and (k) to read as follows:

§1.1291–9 Deemed dividend election.

* * * * *

(i) *Election inapplicable to shareholder of a former PFIC or of a section 1297(e) PFIC*. A shareholder may not make the section 1295 and deemed dividend elections if the foreign corporation is a former PFIC (as defined in paragraph (j)(2)(iv) of this section) or a section 1297(e) PFIC (as defined in paragraph (j)(2)(v) of this section) with respect to the shareholder. For the rules regarding the election by a shareholder of a former PFIC, see §1.1298–3. For the rules regarding the election by a shareholder of a section 1297(e) PFIC, see §1.1297–3.

(j) * * *

(2) * * *

(v) *Section 1297(e) PFIC*. A foreign corporation is a section 1297(e) PFIC with respect to a shareholder (as defined in paragraph (j)(3) of this section) if—

(A) The foreign corporation qualifies as a PFIC under section 1297(a) on the first day on which the qualified portion of the shareholder's holding period in the foreign corporation begins, as determined under section 1297(e)(2); and

(B) The stock of the foreign corporation held by the shareholder is treated as stock of a PFIC, pursuant to section 1298(b)(1), because, at any time during the shareholder's holding period of the stock, other than the qualified portion, the corporation was a PFIC that was not a QEF.

(k) *Effective/applicability date*. (1) The rules of this section, except for paragraph (j)(2)(v) of this section, are applicable as of April 1, 1995.

(2) The rules of paragraph (j)(2)(v) of this section are applicable as of December 8, 2005.

§1.1291–9T [Removed]

Par. 3. Section 1.1291–9T is removed.

Par. 4. Section 1.1297–0 is revised to read as follows:

§1.1297–0 Table of contents.

This section contains a listing of the headings for §1.1297–3.

§1.1297–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC.

(a) In general.

(b) Application of deemed sale election rules.

(1) Eligibility to make the deemed sale election.

(2) Effect of the deemed sale election.

(3) Time for making the deemed sale election.

(4) Manner of making the deemed sale election.

(5) Adjustments to basis.

(6) Treatment of holding period.

(c) Application of deemed dividend election rules.

(1) Eligibility to make the deemed dividend election.

(2) Effect of the deemed dividend election.

(3) Post-1986 earnings and profits defined.

(4) Time for making the deemed dividend election.

(5) Manner of making the deemed dividend election.

(6) Adjustments to basis.

(7) Treatment of holding period.

(8) Coordination with section 959(e).

(d) CFC qualification date.

(e) Late purging elections requiring special consent.

(1) In general.

(2) Prejudice to the interests of the U.S. government.

(3) Procedural requirements.

(4) Time and manner of making late election.

(5) Multiple late elections.

(f) Effective/applicability date.

§1.1297–0T [Removed]

Par. 5. Section 1.1297–0T is removed.

Par. 6. Section 1.1297–3 is added to read as follows:

§1.1297–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC.

(a) *In general*. A shareholder (as defined in §1.1291–9(j)(3)) of a foreign corporation that is a section 1297(e) passive foreign investment company (PFIC) (as defined in §1.1291–9(j)(2)(v)) with respect to such shareholder, shall be treated for tax purposes as holding stock in a PFIC and therefore continues to be subject to taxation under section 1291 unless the shareholder makes a purging election under section 1298(b)(1). A purging election under section 1298(b)(1) is made under rules similar to the rules of section 1291(d)(2). Section 1291(d)(2) allows a shareholder to purge the continuing PFIC taint by either making a deemed sale election or a deemed dividend election.

(b) *Application of deemed sale election rules*—(1) *Eligibility to make the deemed sale election*. A shareholder of a foreign corporation that is a section 1297(e) PFIC with respect to such shareholder may make a deemed sale election under section 1298(b)(1) by applying the rules of this paragraph (b).

(2) *Effect of the deemed sale election*. A shareholder making the deemed sale election with respect to a section 1297(e) PFIC shall be treated as having sold all of its stock in the section 1297(e) PFIC for its fair market value on the controlled foreign corporation (CFC) qualification date, as defined in paragraph (d) of this section. A deemed sale under this section is treated as a disposition subject to taxation under section 1291. Thus, the gain from the deemed sale is taxed as an excess distribution received on the CFC qualification date. In the case of an election made by an indirect shareholder, the amount of gain to be recognized and taxed as an excess distribution is the amount of gain that the direct owner of the stock of the PFIC would have realized on an actual sale or disposition of the stock of the PFIC indirectly owned by the shareholder. Any loss realized on the deemed sale is not recognized. After the deemed sale election, the shareholder's stock with respect to which the election was made under this paragraph (b) shall not be treated as stock in a PFIC and the shareholder shall not be subject to taxation under section 1291 with respect to such stock unless the qualified portion of the shareholder's holding period ends, as determined under section 1297(e)(2), and the foreign corporation thereafter qualifies as a PFIC under section 1297(a).

(3) *Time for making the deemed sale election*. Except as provided in paragraph (e) of this section, a shareholder shall make the deemed sale election under this paragraph (b) and section 1298(b)(1) in the shareholder's original or amended return for the taxable year that includes the CFC qualification date (election year). If the deemed sale election is made in an amended return, the return must be filed by a date that is within three years of the due date, as extended under section 6081, of the original return for the election year.

(4) *Manner of making the deemed sale election*. A shareholder makes the deemed sale election under this paragraph (b) by filing Form 8621, *"Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund"*, with the return of the shareholder for the election year, reporting the gain as an excess distribution pursuant to section 1291(a) as if such sale occurred under section 1291(d)(2), and paying the tax and interest due on the excess distribution. A shareholder that makes the deemed sale election after the due date of the return (determined without regard to extensions) for the election year must pay additional interest, pursuant to section 6601, on the amount of underpayment of tax for that year. An electing shareholder that realizes a loss shall report the loss on Form 8621, but shall not recognize the loss.

(5) *Adjustments to basis*. A shareholder that makes the deemed sale election increases its adjusted basis of the PFIC stock owned directly by the amount of gain recognized on the deemed sale. If the shareholder makes the deemed sale election with respect to a PFIC of which it is an indirect shareholder, the shareholder's adjusted basis of the stock or other property owned directly by the shareholder, through which ownership of the PFIC is attributed to the shareholder, is increased by the amount of gain recognized by the shareholder. In addition, solely for purposes of determining the subsequent treatment under the Internal Revenue Code (Code) and regulations of a shareholder of the stock of the PFIC, the adjusted basis of the direct owner of the stock of the PFIC is increased by the amount of gain recognized on the deemed sale. A shareholder shall not adjust the basis of any stock with respect to which the shareholder realized a loss on the deemed sale, which loss is not recognized under paragraph (b)(2) of this section.

(6) *Treatment of holding period*. If a shareholder of a foreign corporation has made a deemed sale election, then, for purposes of applying sections 1291 through 1298 to such shareholder after the deemed sale, the shareholder's holding period in the stock of the foreign corporation begins on the CFC qualification date, without regard to whether the shareholder recognized gain on the deemed sale. For other purposes of the Code and regulations, this holding period rule does not apply.

(c) *Application of deemed dividend election rules*—(1) *Eligibility to make the deemed dividend election*. A shareholder of a foreign corporation that is a section 1297(e) PFIC with respect to such shareholder may make the deemed dividend election under the rules of this paragraph (c). A deemed dividend election may be made by a shareholder whose *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to the PFIC stock held on the CFC qualification date is zero.

(2) *Effect of the deemed dividend election*. A shareholder making the deemed dividend election with respect to a section 1297(e) PFIC shall include in income as a dividend its *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to all of the stock it held, directly or indirectly on the CFC qualification date, as defined in paragraph (d) of this section. The deemed dividend is taxed under section 1291 as an excess distribution received on the CFC qualification date. The excess distribution determined under this paragraph (c) is allocated under section 1291(a)(1)(A) only to each day of the shareholder's holding period of the stock during which the foreign corporation qualified as a PFIC. For purposes of the preceding sentence, the shareholder's holding period of the PFIC stock ends on the day before the CFC qualification date. After the deemed dividend election, the shareholder's stock with respect to which the election was made under this paragraph (c) shall not be treated as stock in a PFIC and the shareholder shall not be subject to taxation under section 1291 with respect to such stock unless the qualified portion of

the shareholder's holding period ends, as determined under section 1297(e)(2), and the foreign corporation thereafter qualifies as a PFIC under section 1297(a).

(3) *Post-1986 earnings and profits defined*—(i) *In general*—(A) *General rule*. For purposes of this section, the term post-1986 earnings and profits means the post-1986 undistributed earnings, within the meaning of section 902(c)(1) (determined without regard to section 902(c)(3)), as of the day before the CFC qualification date, that were accumulated and not distributed in taxable years of the PFIC beginning after 1986 and during which it was a PFIC, without regard to whether the earnings related to a period during which the PFIC was a CFC.

(B) *Special rule*. If the CFC qualification date is a day that is after the first day of the taxable year, the term post-1986 earnings and profits means the post-1986 undistributed earnings, within the meaning of section 902(c)(1) (determined without regard to section 902(c)(3)), as of the close of the taxable year that includes the CFC qualification date. For purposes of this computation, only earnings and profits accumulated in taxable years during which the foreign corporation was a PFIC shall be taken into account, but without regard to whether the earnings related to a period during which the PFIC was a CFC.

(ii) *Pro rata share of post-1986 earnings and profits attributable to shareholder's stock*—(A) *In general*. A shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to the stock held by the shareholder on the CFC qualification date is the amount of post-1986 earnings and profits of the PFIC accumulated during any portion of the shareholder's holding period ending at the close of the day before the CFC qualification date and attributable, under the principles of section 1248 and the regulations under that section, to the PFIC stock held on the CFC qualification date.

(B) *Reduction for previously taxed amounts*. A shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC does not include any amount that the shareholder demonstrates to the satisfaction of the Commissioner (in the manner provided in paragraph (c)(5)(ii) of this section) was, pursuant to another provision of the law, previously included in the income of the shareholder, or of another U.S. person if the shareholder's holding period of the PFIC stock includes the period during which the stock was held by that other U.S. person.

(4) *Time for making the deemed dividend election*. Except as provided in paragraph (e) of this section, the shareholder shall make the deemed dividend election under this paragraph (c) and section 1298(b)(1) in the shareholder's original or amended return for the taxable year that includes the CFC qualification date (election year). If the deemed dividend election is made in an amended return, the return must be filed by a date that is within three years of the due date, as extended under section 6081, of the original return for the election year.

(5) *Manner of making the deemed dividend election*—(i) *In general*. A shareholder makes the deemed dividend election by filing Form 8621 and the attachment to Form 8621 described in paragraph (c)(5)(ii) of this section with the return of the shareholder for the election year, reporting the deemed dividend as an excess distribution pursuant to section 1291(a)(1), and paying the tax and interest due on the excess distribution. A shareholder that makes the deemed dividend election after the due date of the return (determined without regard to extensions) for the election year must pay additional interest, pursuant to section 6601, on the amount of underpayment of tax for that year.

(ii) *Attachment to Form 8621*. The shareholder must attach a schedule to Form 8621 that demonstrates the calculation of the shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC that is treated as distributed to the shareholder on the CFC qualification date, pursuant to this paragraph (c). If the shareholder is claiming an exclusion from its *pro rata* share of the post-1986 earnings and profits for an amount previously included in its income or the income of another U.S. person, the shareholder must include the following information:

(A) The name, address and taxpayer identification number of each U.S. person that previously included an amount in income, the amount previously included in income by each such U.S. person, the provision of law, pursuant to which the amount was previously included in income, and the taxable year or years of inclusion of each amount.

(B) A description of the transaction pursuant to which the shareholder acquired, directly or indirectly, the stock of the PFIC from another U.S. person, and the provision of law pursuant to which the shareholder's holding period includes the period the other U.S. person held the CFC stock.

(6) *Adjustments to basis*. A shareholder that makes the deemed dividend election increases its adjusted basis of the stock of the PFIC owned directly by the shareholder by the amount of the deemed dividend. If the shareholder makes the deemed dividend election with respect to a PFIC of which it is an indirect shareholder, the shareholder's adjusted basis of the stock or other property owned directly by the shareholder, through which ownership of the PFIC is attributed to the shareholder, is increased by the amount of the deemed dividend. In addition, solely for purposes of determining the subsequent treatment under the Code and regulations of a shareholder of the stock of the PFIC, the adjusted basis of the direct owner of the stock of the PFIC is increased by the amount of the deemed dividend.

(7) *Treatment of holding period*. If the shareholder of a foreign corporation has made a deemed dividend election, then, for purposes of applying sections 1291 through 1298 to such shareholder after the deemed dividend, the shareholder's holding period of the stock of the foreign corporation begins on the CFC qualification date. For other purposes of the Code and regulations, this holding period rule does not apply.

(8) *Coordination with section 959(e)*. For purposes of section 959(e), the entire deemed dividend is treated as having been included in gross income under section 1248(a).

(d) *CFC qualification date*. For purposes of this section, the CFC qualification date is the first day on which the qualified portion of the shareholder's holding period in the section 1297(e) PFIC begins, as determined under section 1297(e).

(e) *Late purging elections requiring special consent*—(1) *In general*. This section prescribes the exclusive rules under which a shareholder of a section 1297(e) PFIC may make a section 1298(b)(1) election after the time prescribed in paragraph (b)(3) or (c)(4) of this section for making a deemed sale or a deemed dividend election has elapsed (late purging election).

Therefore, a shareholder may not seek such relief under any other provisions of the law, including §301.9100–3 of this chapter. A shareholder may request the consent of the Commissioner to make a late deemed sale or deemed dividend election for the taxable year of the shareholder that includes the CFC qualification date provided the shareholder satisfies the requirements set forth in this paragraph (e). The Commissioner may, in his discretion, grant relief under this paragraph (e) only if—

(i) In a case where the shareholder is requesting consent under this paragraph (e) after December 31, 2005, the shareholder requests such consent before a representative of the Internal Revenue Service (IRS) raises upon audit the PFIC status of the foreign corporation for any taxable year of the shareholder;

(ii) The shareholder has agreed in a closing agreement with the Commissioner, described in paragraph (e)(3) of this section, to eliminate any prejudice to the interests of the U.S. government, as determined under paragraph (e)(2) of this section, as a consequence of the shareholder's inability to file amended returns for its taxable year in which the CFC qualification date falls or an earlier closed taxable year in which the shareholder has taken a position that is inconsistent with the treatment of the foreign corporation as a PFIC; and

(iii) The shareholder satisfies the procedural requirements set forth in paragraph (e)(3) of this section.

(2) *Prejudice to the interests of the U.S. government*. The interests of the U.S. government are prejudiced if granting relief would result in the shareholder having a lower tax liability (other than by a *de minimis* amount), taking into account applicable interest charges, for the taxable year that includes the CFC qualification date (or a prior taxable year in which the taxpayer took a position on a return that was inconsistent with the treatment of the foreign corporation as a PFIC) than the shareholder would have had if the shareholder had properly made the section 1298(b)(1) election in the time prescribed in paragraph (b)(2) or (c)(3) of this section (or had not taken a position in a return for an earlier year that was inconsistent with the status of the foreign corporation as a PFIC). The time value of money is taken into account for purposes of this computation.

(3) *Procedural requirements*—(i) *In general*. The amount due with respect to a late purging election is determined in the same manner as if the purging election had been timely filed. However, the shareholder is also liable for interest on the amount due, pursuant to section 6601, determined for the period beginning on the due date (without extensions) for the taxpayer's income tax return for the year in which the CFC qualification date falls and ending on the date the late purging election is filed with the IRS.

(ii) *Filing instructions*. A late purging election is made by filing a completed Form 8621–A, *"Return by a Shareholder Making Certain Late Elections To End Treatment as a Passive Foreign Investment Company."*

(4) *Time and manner of making late election*—(i) *Time for making a late purging election*. A shareholder may make a late purging election in the manner provided in paragraph (e)(4)(ii) of this section at any time. The date the election is filed with the IRS will determine the amount of interest due under paragraph (e)(3) of this section.

(ii) *Manner of making a late purging election*. A shareholder makes a late purging election by completing Form 8621–A in the manner required by that form and this section and filing that form with the Internal Revenue Service, DP 8621–A, Ogden, UT 84201.

(5) *Multiple late elections*—(i) *General rule*. A shareholder of a foreign corporation may make multiple late purging elections under the rules of this paragraph (e) or §1.1298–3(e) to the same extent such multiple purging elections could have been made if those purging elections had been filed within the time prescribed under paragraph (b)(3) or (c)(4) of this section or §1.1298–3(b)(3) or (c)(4).

(ii) *Example*. The rule of this paragraph (e)(5) is illustrated by the following example:

Example. (i) In 1991, X, a U.S person, acquired a five percent interest in the stock of FC, a controlled foreign corporation, as defined in section 957(a). In years 1991, 1992, 1995, 1996 and 1997, FC satisfied either the income test or the asset test of section 1297(a). X did not make a QEF election with regard to FC. In years 1993 and 1994, FC did not satisfy either the income or the asset test of section 1297(a). In 1998, X acquired additional stock in FC such that X was a U.S. shareholder (as defined in section 951(b)) of FC.

(ii) Because FC qualified as a PFIC in 1991, FC will be treated as a PFIC with respect to all of the stock held by X, under the "once a PFIC always a PFIC" rule of section 1298(b)(1), unless X makes an election to purge the PFIC taint. Because X ceased to satisfy either the income or asset test in 1993, X could have made an election under §1.1298–3 to purge the PFIC taint of FC for that year if X had filed such an election within the time prescribed under §1.1298–3(b)(3) or (c)(4). If X had done so, the stock X held in FC would not be treated as stock in a PFIC for the years 1993 and 1994. Because X became a U.S. shareholder of FC in 1998, X then could have made a deemed sale or deemed dividend election under this section to purge the PFIC taint of FC for the years 1995 through 1997 if X had filed within the time prescribed under paragraph (b)(3) or (c)(4) of this section. Accordingly, X may make a late purging election to purge the PFIC taint of FC for the years 1991 and 1992 under the rules of §1.1298–3(e) and may also make a late purging election to purge the PFIC taint of FC for the years 1995 through 1997 under the rules of this paragraph (e).

(f) *Effective/applicability date*. The rules of this section are applicable as of December 8, 2005.

§1.1297–3T [Removed]

Par. 7. Section 1.1297–3T is removed.

Par. 8. Section 1.1298–0 is revised to read as follows:

§1.1298–0 Table of contents.

This section contains a listing of the paragraph headings for §1.1298–3.

§1.1298–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC.

(a) In general.

(b) Application of deemed sale election rules.

(1) Eligibility to make the deemed sale election.

(2) Effect of the deemed sale election.

(3) Time for making the deemed sale election.

(4) Manner of making the deemed sale election.

(5) Adjustments to basis.

(6) Treatment of holding period.

(c) Application of deemed dividend election rules.

(1) Eligibility to make the deemed dividend election.

(2) Effect of the deemed dividend election.

(3) Post-1986 earnings and profits defined.

(4) Time for making the deemed dividend election.

(5) Manner of making the deemed dividend election.

(6) Adjustments to basis.

(7) Treatment of holding period.

(8) Coordination with section 959(e).

(d) Termination date.

(e) Late purging elections requiring special consent.

(1) In general.

(2) Prejudice to the interests of the U.S. government.

(3) Procedural requirements.

(4) Time and manner of making late election.

(5) Multiple late elections.

(f) Effective/applicability date.

§1.1298–0T [Removed]

Par. 9. Section 1.1298–0T is removed.

Par. 10. Section 1.1298–3 is amended by revising paragraphs (e) and (f) to read as follows:

§1.1298–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC.

* * * * *

(e) *Late purging elections requiring special consent*—(1) *In general*. This section prescribes the exclusive rules under which a shareholder of a former PFIC may make a section 1298(b)(1) election after the time prescribed in paragraph (b)(3) or (c)(4) of this section for making a deemed sale or a deemed dividend election has elapsed (late purging election). Therefore, a shareholder may not seek such relief under any other provisions of the law, including §301.9100–3 of this chapter. A shareholder may request the consent of the Commissioner to make a late purging election for the taxable year of the shareholder that includes the termination date provided the shareholder satisfies the requirements set forth in this paragraph (e). The Commissioner may, in his discretion, grant relief under this paragraph (e) only if—

(i) In a case where the shareholder is requesting consent under this paragraph (e) after December 31, 2005, the shareholder requests such consent before a representative of the Internal Revenue Service raises upon audit the PFIC status of the foreign corporation for any taxable year of the shareholder;

(ii) The shareholder has agreed in a closing agreement with the Commissioner, described in paragraph (e)(3) of this section, to eliminate any prejudice to the interests of the U.S. government, as determined under paragraph (e)(2) of this section, as a consequence of the shareholder's inability to file amended returns for its taxable year in which the termination date falls or an earlier closed taxable year in which the shareholder has taken a position that is inconsistent with the treatment of the foreign corporation as a PFIC; and

(iii) The shareholder satisfies the procedural requirements set forth in paragraph (e)(3) of this section.

(2) *Prejudice to the interests of the U.S. government*. The interests of the U.S. government are prejudiced if granting relief would result in the shareholder having a lower tax liability (other than by a *de minimis* amount), taking into account applicable interest charges, for the taxable year that includes the termination date (or a prior taxable year in which the taxpayer took a position on a return that was inconsistent with the treatment of the foreign corporation as a PFIC) than the shareholder would have had if the shareholder had properly made the section 1298(b)(1) election in the time prescribed in paragraph (b)(2) or (c)(3) of this section (or had not taken a position in a return for an earlier year that was inconsistent with the status of the foreign corporation as a PFIC). The time value of money is taken into account for purposes of this computation.

(3) *Procedural requirements*—(i) *In general*. The amount due with respect to a late purging election is determined in the same manner as if the purging election had been timely filed. However, the shareholder is also liable for interest on the amount due, pursuant to section 6601, determined for the period beginning on the due date (without extensions) for the taxpayer's income tax return for the year in which the termination date falls and ending on the date the late purging election is filed with the IRS.

(ii) *Filing instructions*. A late purging election is made by filing a completed Form 8621–A, *"Return by a Shareholder Making Certain Late Elections To End Treatment as a Passive Foreign Investment Company."*

(4) *Time and manner of making late election*—(i) *Time for making a late purging election*. A shareholder may make a late purging election in the manner provided in paragraph (e)(4)(ii) of this section at any time. The date the election is filed with the IRS will determine the amount of interest due under paragraph (e)(3) of this section.

(ii) *Manner of making a late purging election*. A shareholder makes a late purging election by completing Form 8621–A in the manner required by that form and this section and filing that form with the Internal Revenue Service, DP 8621–A, Ogden, UT 84201.

(5) *Multiple late elections*. For rules regarding the circumstances under which a shareholder of a foreign corporation may make multiple late purging elections under this paragraph (e) or §1.1297–3(e), see §1.1297–3(e)(5).

(f) *Effective/applicability date*. The rules of this section are applicable as of December 8, 2005.

§1.1298–3T [Removed]

Par. 11. Section 1.1298–3T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 12. The authority citation of part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 13. In §602.101, paragraph (b) is amended by removing the entry for "1.1297–3T" from the table.

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

Approved September 17, 2007.

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

(Filed by the Office of the Federal Register on September 26, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 27, 2007, 72 F.R. 54820)

Section 1297.—Passive Foreign Investment Company

A final regulation provides guidance regarding a deemed sale or deemed dividend election for certain U.S. shareholders of a former passive foreign investment company (PFIC) or a section 1297(e) PFIC. See T.D. 9360, page 860.

Section 1298.—Special Rules

A final regulation provides guidance regarding a deemed sale or deemed dividend election for certain U.S. shareholders of a former passive foreign investment company (PFIC) or a section 1297(e) PFIC. See T.D. 9360, page 860.

Section 1361.—S Corporation Defined

Proposed regulations provide rules relating to inadvertent terminations of S corporation and qualified subchapter S subsidiary elections and inadvertently ineffective elections. See REG-143326-05, page 873.

Section 1362.—Election; Revocation; Termination

Proposed regulations provide rules relating to inadvertent terminations of S corporation and qualified subchapter S subsidiary elections and inadvertently ineffective elections. See REG-143326-05, page 873.

Section 1366.—Pass-Thru of Items to Shareholders

Proposed regulations provide rules on the transfer of suspended losses associated with S corporation stock to spouses and former spouses of S corporation shareholders. See REG-143326-05, page 873.

Part III. Administrative, Procedural, and Miscellaneous

Extension of Replacement Period for Livestock Sold on Account of Drought in Specified Counties

Notice 2007–80

SECTION 1. PURPOSE

This notice provides guidance regarding an extension of the replacement period under § 1033(e) of the Internal Revenue Code for livestock sold on account of drought in specified counties.

SECTION 2. BACKGROUND

.01 *Nonrecognition of Gain on Involuntary Conversion of Livestock*. Section 1033(a) generally provides for nonrecognition of gain when property is involuntarily converted and replaced with property that is similar or related in service or use. Section 1033(e)(1) provides that a sale or exchange of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes in excess of the number that would be sold following the taxpayer's usual business practices is treated as an involuntary conversion if the livestock is sold or exchanged solely on account of drought, flood, or other weather-related conditions.

.02 *Replacement Period*. Section 1033(a)(2)(A) generally provides that gain from an involuntary conversion is recognized only to the extent the amount realized on the conversion exceeds the cost of replacement property purchased during the replacement period. If a sale or exchange of livestock is treated as an involuntary conversion under § 1033(e)(1) and is solely on account of drought, flood, or other weather-related conditions that result in the area being designated as eligible for assistance by the federal government, § 1033(e)(2)(A) provides that the replacement period ends four years after the close of the first taxable year in which any part of the gain from the conversion is realized. Section 1033(e)(2)(B) provides that the Secretary may extend this replacement period on a regional basis for such additional time as the Secretary determines appropriate if the weather-related conditions that resulted in the area being designated as eligible for assistance by the federal government continue for more than three years. Section 1033(e)(2) is effective for any taxable year with respect to which the due date (without regard to extensions) for a taxpayer's return is after December 31, 2002.

SECTION 3. EXTENSION OF REPLACEMENT PERIOD UNDER SECTION 1033(e)(2)(B)

Notice 2006–82, 2006–39 I.R.B. 529, provides for extensions of the replacement period under § 1033(e)(2)(B). If a sale or exchange of livestock is treated as an involuntary conversion on account of drought and the taxpayer's replacement period is determined under § 1033(e)(2)(A), the replacement period will be extended under § 1033(e)(2)(B) and Notice 2006–82 until the end of the taxpayer's first taxable year ending after the first drought-free year for the applicable region. For this purpose, the first drought-free year for the applicable region is the first 12-month period that (1) ends August 31; (2) ends in or after the last year of the taxpayer's 4-year replacement period determined under § 1033(e)(2)(A); and (3) does not include any weekly period for which exceptional, extreme, or severe drought is reported for any location in the applicable region. The applicable region is the county that experienced the drought conditions on account of which the livestock was sold or exchanged and all counties that are contiguous to that county.

A taxpayer may determine whether exceptional, extreme, or severe drought is reported for any location in the applicable region by reference to U.S. Drought Monitor maps that are produced on a weekly basis by the National Drought Mitigation Center. U.S. Drought Monitor maps are archived at *www.drought.unl.edu/dm/archive.html.*

In addition, Notice 2006–82 provides that the Internal Revenue Service will publish in September of each year a list of counties, districts, cities, or parishes (hereinafter "counties") for which exceptional, extreme, or severe drought was reported during the preceding 12 months. Taxpayers may use this list instead of U.S. Drought Monitor maps to determine whether exceptional, extreme, or severe drought has been reported for any location in the applicable region.

The Appendix to this notice contains the list of counties for which exceptional, extreme, or severe drought was reported during the 12-month period ending August 31, 2007. Under Notice 2006–82, the 12-month period ending on August 31, 2007, is not a drought-free year for an applicable region that includes any county on this list. Accordingly, for a taxpayer who qualified for a four-year replacement period for livestock sold or exchanged on account of drought and whose replacement period is scheduled to expire at the end of 2007 (or, in the case of a fiscal year taxpayer, at the end of the taxable year that includes August 31, 2007), the replacement period will be extended under § 1033(e)(2) and Notice 2006–82 if the applicable region includes any county on this list. This extension will continue until the end of the taxpayer's first taxable year ending after a drought-free year for the applicable region.

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is Jeffrey Marshall of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. Marshall at (202) 622–7287 (not a toll-free call).

APPENDIX

Alabama

Counties of Autauga, Baldwin, Barbour, Bibb, Blount, Bullock, Butler, Calhoun, Chambers, Cherokee, Chilton, Choctaw, Clarke, Clay, Cleburne, Coffee, Colbert, Conecuh, Coosa, Covington, Crenshaw, Cullman, Dale, Dallas, DeKalb, Elmore, Escambia, Etowah, Fayette, Franklin, Geneva, Greene, Hale, Henry, Houston, Jackson, Jefferson, Lamar, Lauderdale, Lawrence, Lee, Limestone, Lowndes, Macon, Madison, Marengo, Marion, Marshall, Mobile, Monroe, Montgomery, Morgan, Perry, Pickens, Pike, Randolph, Russell, St. Clair, Shelby, Sumter, Talladega, Tallapoosa, Tuscaloosa, Walker, Washington, Wilcox, Winston.

Arizona

Counties of Apache, Cochise, Coconino, Gila, La Paz, Maricopa, Mohave, Navajo, Pima, Pinal, Santa Cruz, Yavapai, Yuma.

Arkansas

Counties of Arkansas, Ashley, Bradley, Calhoun, Chicot, Clark, Clay, Cleburne, Cleveland, Columbia, Conway, Craighead, Crittenden, Cross, Dallas, Desha, Drew, Faulkner, Grant, Greene, Hempstead, Howard, Independence, Jackson, Jefferson, Lafayette, Lawrence, Lee, Lincoln, Little River, Lonoke, Miller, Mississippi, Monroe, Nevada, Ouachita, Perry, Phillips, Pike, Poinsett, Polk, Prairie, Pulaski, Randolph, St. Francis, Saline, Scott, Sevier, Sharp, Stone, Union, Van Buren, White, Woodruff.

California

Counties of Alameda, Alpine, Amador, Calaveras, El Dorado, Fresno, Imperial, Inyo, Kern, Kings, Lassen, Los Angeles, Madera, Mariposa, Merced, Modoc, Mono, Monterey, Nevada, Orange, Placer, Plumas, Riverside, San Benito, San Bernardino, San Diego, San Joaquin, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, Sierra, Stanislaus, Tulare, Tuolumne, Ventura.

Colorado

Counties of Adams, Arapahoe, Bent, Boulder, Broomfield, Cheyenne, Crowley, Denver, Dolores, Douglas, El Paso, Elbert, Jefferson, Kiowa, Kit Carson, La Plata, Larimer, Lincoln, Logan, Moffat, Montezuma, Morgan, Otero, Phillips, Prowers, Pueblo, San Miguel, Sedgwick, Washington, Weld, Yuma.

Delaware

Counties of Kent, Sussex.

The District of Columbia

Florida

Counties of Alachua, Baker, Bay, Bradford, Brevard, Broward, Calhoun, Charlotte, Citrus, Clay, Collier, Columbia, DeSoto, Dixie, Duval, Escambia, Flagler, Franklin, Gadsden, Gilchrist, Glades, Gulf, Hamilton, Hardee, Hendry, Highlands, Holmes, Indian River, Jackson, Jefferson, Lafayette, Lake, Lee, Leon, Levy, Liberty, Madison, Marion, Martin, Miami-Dade, Monroe, Nassau, Okaloosa, Okeechobee, Orange, Osceola, Palm Beach, Polk, Putnam, St. Johns, St. Lucie, Santa Rosa, Sumter, Suwannee, Taylor, Union, Volusia, Wakulla, Walton, Washington.

Georgia

Counties of Appling, Atkinson, Bacon, Baker, Baldwin, Banks, Barrow, Bartow, Ben Hill, Berrien, Bibb, Bleckley, Brantley, Brooks, Bryan, Bulloch, Burke, Butts, Calhoun, Camden, Candler, Carroll, Catoosa, Charlton, Chatham, Chattahoochee, Chattooga, Cherokee, Clarke, Clay, Clayton, Clinch, Cobb, Coffee, Colquitt, Columbia, Cook, Coweta, Crawford, Crisp, Dade, Dawson, Decatur, DeKalb, Dodge, Dooly, Dougherty, Douglas, Early, Echols, Effingham, Elbert, Emanuel, Evans, Fannin, Fayette, Floyd, Forsyth, Franklin, Fulton, Gilmer, Glascock, Glynn, Gordon, Grady, Greene, Gwinnett, Habersham, Hall, Hancock, Haralson, Harris, Hart, Heard, Henry, Houston, Irwin, Jackson, Jasper, Jeff Davis, Jefferson, Jenkins, Johnson, Jones, Lamar, Lanier, Laurens, Lee, Liberty, Lincoln, Long, Lowndes, Lumpkin, Macon, Madison, Marion, McDuffie, McIntosh, Meriwether, Miller, Mitchell, Monroe, Montgomery, Morgan, Murray, Muscogee, Newton, Oconee, Oglethorpe, Paulding, Peach, Pickens, Pierce, Pike, Polk, Pulaski, Putnam, Quitman, Rabun, Randolph, Richmond, Rockdale, Schley, Screven, Seminole, Spalding, Stephens, Stewart, Sumter, Talbot, Taliaferro, Tattnall, Taylor, Telfair, Terrell, Thomas, Tift, Toombs, Towns, Treutlen, Troup, Turner, Twiggs, Union, Upson, Walker, Walton, Ware, Warren, Washington, Wayne, Webster, Wheeler, White, Whitfield, Wilcox, Wilkes, Wilkinson, Worth.

Hawaii

Counties of Hawaii, Maui.

Idaho

Counties of Ada, Adams, Bannock, Bear Lake, Benewah, Bingham, Blaine, Boise, Bonner, Bonneville, Boundary, Butte, Camas, Canyon, Caribou, Cassia, Clark, Clearwater, Custer, Elmore, Franklin, Fremont, Gem, Gooding, Idaho, Jefferson, Jerome, Kootenai, Latah, Lemhi, Lewis, Lincoln, Madison, Minidoka, Nez Perce, Oneida, Owyhee, Payette, Power, Shoshone, Teton, Twin Falls, Valley, Washington.

Illinois

Counties of Alexander, Crawford, Edwards, Franklin, Gallatin, Hamilton, Hardin, Jackson, Jefferson, Johnson, Lawrence, Massac, Monroe, Perry, Pope, Pulaski, Randolph, Richland, Saline, Union, Wabash, Wayne, White, Williamson.

Indiana

Counties of Adams, Allen, Bartholomew, Blackford, Brown, Clark, Clay, Crawford, Daviess, Dearborn, Decatur, DeKalb, Delaware, Dubois, Elkhart, Fayette, Floyd, Franklin, Gibson, Grant, Greene, Hamilton, Hancock, Harrison, Hendricks, Henry, Howard, Huntington, Jackson, Jay, Jefferson, Jennings, Johnson, Knox, LaGrange, Lawrence, Madison, Marion, Martin, Monroe, Morgan, Noble, Ohio, Orange, Owen, Perry, Pike, Posey, Randolph, Ripley, Rush, Scott, Shelby, Spencer, Steuben, Sullivan, Switzerland, Tipton, Union, Vanderburgh, Wabash, Warrick, Washington, Wayne, Wells, Whitley.

Iowa

Counties of Clay, Dickinson, Emmet, Kossuth, Lyon, O'Brien, Osceola, Palo Alto, Plymouth, Sioux.

Kansas

Counties of Allen, Anderson, Barber, Bourbon, Butler, Chautauqua, Cherokee, Cheyenne, Clark, Comanche, Cowley, Crawford, Decatur, Elk, Greeley, Greenwood, Hamilton, Harper, Kingman, Kiowa, Labette, Linn, Logan, Miami, Montgomery, Neosho, Rawlins, Sedgwick, Sherman, Sumner, Thomas, Wallace, Wichita, Wilson, Woodson.

Kentucky

Counties of Adair, Allen, Anderson, Ballard, Barren, Bath, Bell, Boone, Bourbon, Boyd, Boyle, Bracken, Breathitt, Breckinridge, Bullitt, Butler, Caldwell, Calloway, Campbell, Carlisle, Carroll, Carter, Casey, Christian, Clark, Clay, Clinton, Crittenden, Cumberland, Daviess, Edmonson, Elliott, Estill, Fayette, Fleming, Floyd, Franklin, Fulton, Gallatin, Garrard, Grant, Graves, Grayson, Green, Greenup, Hancock, Hardin, Harlan, Harrison, Hart, Henderson, Henry, Hickman, Hopkins, Jackson, Jefferson, Jessamine, Johnson, Kenton, Knott, Knox, Larue, Laurel, Lawrence, Lee, Leslie, Letcher, Lewis, Lincoln, Livingston, Logan, Lyon, Madison, Magoffin, Marion, Marshall, Martin, Mason, McCracken, McCreary, McLean, Meade, Menifee, Mercer, Metcalfe, Monroe, Montgomery, Morgan, Muhlenberg, Nelson, Nicholas, Ohio, Oldham, Owen, Owsley, Pendleton, Perry, Pike, Powell, Pulaski, Robertson, Rockcastle, Rowan, Russell, Scott, Shelby, Simpson, Spencer, Taylor, Todd, Trigg, Trimble, Union, Warren, Washington, Wayne, Webster, Whitley, Wolfe, Woodford.

Louisiana

Parishes of Bossier, Caddo, De Soto, East Carroll, Madison, Morehouse, Sabine, Tensas, Webster, West Carroll.

Maryland

Counties of Anne Arundel, Baltimore, Calvert, Caroline, Carroll, Charles, Dorchester, Frederick, Howard, Kent, Montgomery, Prince George's, Queen Anne's, St. Mary's, Somerset, Talbot, Washington, Wicomico, Worcester.

Michigan

Counties of Alger, Allegan, Antrim, Baraga, Barry, Berrien, Branch, Cass, Charlevoix, Cheboygan, Chippewa, Delta, Dickinson, Emmet, Gogebic, Houghton, Iron, Kalamazoo, Keweenaw, Leelanau, Luce, Mackinac, Marquette, Menominee, Ontonagon, Ottawa, Presque Isle, St. Joseph, Schoolcraft, Van Buren.

Minnesota

Counties of Aitkin, Anoka, Becker, Beltrami, Benton, Big Stone, Blue Earth, Brown, Carlton, Carver, Cass, Chippewa, Chisago, Clearwater, Cook, Cottonwood, Crow Wing, Dakota, Dodge, Douglas, Faribault, Fillmore, Goodhue, Grant, Hennepin, Hubbard, Isanti, Itasca, Jackson, Kanabec, Kandiyohi, Kittson, Koochiching, Lac qui Parle, Lake, Lake of the Woods, Le Sueur, Lincoln, Lyon, Mahnomen, Marshall, Martin, McLeod, Meeker, Mille Lacs, Morrison, Murray, Nicollet, Nobles, Norman, Olmsted, Otter Tail, Pennington, Pine, Pipestone, Polk, Pope, Ramsey, Red Lake, Redwood, Renville, Rice, Rock, Roseau, St. Louis, Scott, Sherburne, Sibley, Stearns, Stevens, Swift, Todd, Wabasha, Wadena, Waseca, Washington, Watonwan, Winona, Wright, Yellow Medicine.

Mississippi

Counties of Alcorn, Amite, Attala, Benton, Bolivar, Calhoun, Carroll, Chickasaw, Choctaw, Claiborne, Clarke, Clay, Coahoma, Copiah, Covington, DeSoto, Forrest, Franklin, George, Greene, Grenada, Hinds, Holmes, Humphreys, Issaquena, Itawamba, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lafayette, Lamar, Lauderdale, Lawrence, Leake, Lee, Leflore, Lincoln, Lowndes, Madison, Marion, Marshall, Monroe, Montgomery, Neshoba, Newton, Noxubee, Oktibbeha, Panola, Perry, Pike, Pontotoc, Prentiss, Quitman, Rankin, Scott, Sharkey, Simpson, Smith, Sunflower, Tallahatchie, Tate, Tippah, Tishomingo, Tunica, Union, Walthall, Warren, Washington, Wayne, Webster, Winston, Yalobusha, Yazoo.

Missouri

Counties of Barton, Bates, Benton, Bollinger, Butler, Camden, Cape Girardeau, Carter, Cass, Cedar, Cooper, Crawford, Dade, Dallas, Dent, Dunklin, Franklin, Greene, Henry, Hickory, Iron, Jackson, Jasper, Jefferson, Johnson, Laclede, Lafayette, Lawrence, Madison, Miller, Mississippi, Moniteau, Morgan, New Madrid, Newton, Pemiscot, Perry, Pettis, Polk, Reynolds, Ripley, St. Clair, St. Francois, Ste. Genevieve, Saline, Scott, Shannon, Stoddard, Vernon, Washington, Wayne.

Montana

Counties of Beaverhead, Big Horn, Blaine, Broadwater, Carbon, Carter, Cascade, Chouteau, Custer, Daniels, Dawson, Deer Lodge, Fallon, Fergus, Flathead, Gallatin, Garfield, Glacier, Golden Valley, Granite, Hill, Jefferson, Judith Basin, Lake, Lewis and Clark, Liberty, Lincoln, Madison, McCone, Meagher, Mineral, Missoula, Musselshell, Park, Petroleum, Phillips, Pondera, Powder River, Powell, Prairie, Ravalli, Richland, Roosevelt, Rosebud, Sanders, Sheridan, Silver Bow, Stillwater, Sweet Grass, Teton, Toole, Treasure, Valley, Wheatland, Wibaux, Yellowstone.

Nebraska

Counties of Antelope, Arthur, Banner, Blaine, Box Butte, Boyd, Brown, Buffalo, Cedar, Chase, Cherry, Cheyenne, Custer, Dawes, Dawson, Deuel, Dixon, Dundy, Frontier, Furnas, Garden, Garfield, Gosper, Grant, Greeley, Hayes, Hitchcock, Holt, Hooker, Howard, Keith, Keya Paha, Kimball, Knox, Lincoln, Logan, Loup, McPherson, Morrill, Perkins, Pierce, Red Willow, Rock, Scotts Bluff, Sheridan, Sherman, Sioux, Thomas, Valley, Wheeler.

Nevada

Carson City. Counties of Churchill, Clark, Douglas, Elko, Esmeralda, Eureka, Humboldt, Lander, Lincoln, Lyon, Mineral, Nye, Pershing, Storey, Washoe, White Pine.

New Mexico

Counties of Catron, Cibola, McKinley, San Juan.

North Carolina

Counties of Alamance, Alexander, Alleghany, Anson, Ashe, Avery, Beaufort, Bertie, Bladen, Brunswick, Buncombe, Burke, Cabarrus, Caldwell, Caswell, Catawba, Chatham, Cherokee, Clay, Cleveland, Columbus, Cumberland, Davidson, Davie, Duplin, Durham, Edgecombe, Forsyth, Franklin, Gaston, Graham, Granville, Greene, Guilford, Halifax, Harnett, Haywood, Henderson, Hoke, Iredell, Jackson, Johnston, Jones, Lee, Lenoir, Lincoln, Macon, Madison, Martin, McDowell, Mecklenburg, Mitchell, Montgomery, Moore, Nash, New Hanover, Onslow, Orange, Pender, Person, Pitt, Polk, Randolph, Richmond, Robeson, Rockingham, Rowan, Rutherford, Sampson, Scotland, Stanly, Surry, Swain, Transylvania, Union, Vance, Wake, Warren, Watauga, Wayne, Wilkes, Wilson, Yadkin, Yancey.

North Dakota

Counties of Adams, Billings, Bottineau, Bowman, Burke, Cavalier, Divide, Emmons, Golden Valley, Grant, Hettinger, McHenry, McIntosh, McKenzie, Morton, Mountrail, Pembina, Renville, Rolette, Sioux, Slope, Stark, Towner, Walsh, Ward, Williams.

Ohio

Counties of Adams, Auglaize, Brown, Butler, Clermont, Clinton, Darke, Fayette, Gallia, Greene, Hamilton, Highland, Jackson, Lawrence, Meigs, Mercer, Miami, Montgomery, Paulding, Pike, Preble, Ross, Scioto, Shelby, Van Wert, Vinton, Warren.

Oklahoma

Counties of Alfalfa, Atoka, Beaver, Beckham, Blaine, Bryan, Caddo, Canadian, Carter, Choctaw, Cleveland, Coal, Comanche, Cotton, Craig, Creek, Custer, Delaware, Dewey, Ellis, Garfield, Garvin, Grady, Grant, Greer, Harmon, Harper, Haskell, Hughes, Jackson, Jefferson, Johnston, Kay, Kingfisher, Kiowa, Latimer, Le Flore, Lincoln, Logan, Love, Major, Marshall, Mayes, McClain, McCurtain, McIntosh, Murray, Muskogee, Noble, Nowata, Okfuskee, Oklahoma, Okmulgee, Osage, Ottawa, Pawnee, Payne, Pittsburg, Pontotoc, Pottawatomie, Pushmataha, Roger Mills, Rogers, Seminole, Sequoyah, Stephens, Tillman, Tulsa, Wagoner, Washington, Washita, Woods, Woodward.

Oregon

Counties of Baker, Grant, Harney, Lake, Malheur, Umatilla, Union, Wallowa.

South Carolina

Counties of Abbeville, Aiken, Allendale, Anderson, Bamberg, Barnwell, Beaufort, Berkeley, Calhoun, Charleston, Cherokee, Chester, Chesterfield, Clarendon, Colleton, Darlington, Dillon, Dorchester, Edgefield, Fairfield, Florence, Greenville, Greenwood, Hampton, Horry, Jasper, Kershaw, Lancaster, Laurens, Lee, Lexington, Marion, Marlboro, McCormick, Newberry, Oconee, Orangeburg, Pickens, Richland, Saluda, Spartanburg, Sumter, Union, Williamsburg, York.

South Dakota

Counties of Beadle, Bennett, Bon Homme, Brookings, Brule, Buffalo, Butte, Campbell, Charles Mix, Clark, Clay, Codington, Corson, Custer, Davison, Deuel, Dewey, Douglas, Edmunds, Fall River, Faulk, Grant, Gregory, Haakon, Hamlin, Hand, Hanson, Harding, Hughes, Hutchinson, Hyde, Jackson, Jones, Kingsbury, Lake, Lawrence, Lincoln, Lyman, McCook, McPherson, Meade, Mellette, Miner, Minnehaha, Moody, Pennington, Perkins, Potter, Roberts, Sanborn, Shannon, Stanley, Sully, Todd, Tripp, Turner, Union, Walworth, Yankton, Ziebach.

Tennessee

Counties of Anderson, Bedford, Benton, Bledsoe, Blount, Bradley, Campbell, Cannon, Carroll, Carter, Cheatham, Chester, Claiborne, Clay, Cocke, Coffee, Crockett, Cumberland, Davidson, Decatur, DeKalb, Dickson, Dyer, Fayette, Fentress, Franklin, Gibson, Giles, Grainger, Greene, Grundy, Hamblen, Hamilton, Hancock, Hardeman, Hardin, Hawkins, Haywood, Henderson, Henry, Hickman, Houston, Humphreys, Jackson, Jefferson, Johnson, Knox, Lake, Lauderdale, Lawrence, Lewis, Lincoln, Loudon, Macon, Madison, Marion, Marshall, Maury, McMinn, McNairy, Meigs, Monroe, Montgomery, Moore, Morgan, Obion, Overton, Perry, Pickett, Polk, Putnam, Rhea, Roane, Robertson, Rutherford, Scott, Sequatchie, Sevier, Shelby, Smith, Stewart, Sullivan, Sumner, Tipton, Trousdale, Unicoi, Union, Van Buren, Warren, Washington, Wayne, Weakley, White, Williamson, Wilson.

Texas

Counties of Anderson, Angelina, Archer, Atascosa, Austin, Bandera, Bastrop, Baylor, Bee, Bell, Bexar, Blanco, Bosque, Bowie, Brazos, Brewster, Brooks, Brown, Burleson, Burnet, Caldwell, Callahan, Cameron, Camp, Cass, Cherokee, Clay, Coke, Coleman, Collin, Collingsworth, Comal, Comanche, Concho, Cooke, Coryell, Crane, Crockett, Dallas, Delta, Denton, DeWitt, Dimmit, Duval, Eastland, Edwards, Ellis, Erath, Falls, Fannin, Fayette, Fisher, Foard, Franklin, Freestone, Frio, Gillespie, Glasscock, Goliad, Gonzales, Grayson, Gregg, Grimes, Guadalupe, Hamilton, Hardeman, Harrison, Haskell, Hays, Hemphill, Henderson, Hidalgo, Hill, Hood, Hopkins, Houston, Hunt, Irion, Jack, Jim Hogg, Jim Wells, Johnson, Jones, Karnes, Kaufman, Kendall, Kerr, Kimble, Kinney, Kleberg, Knox, La Salle, Lamar, Lampasas, Lavaca, Lee, Leon, Limestone, Lipscomb, Live Oak, Llano, Madison, Marion, Mason, Maverick, McCulloch, McLennan, McMullen, Medina, Menard, Milam, Mills, Montague, Montgomery, Morris, Nacogdoches, Navarro, Nolan, Nueces, Palo Pinto, Panola, Parker, Pecos, Polk, Presidio, Rains, Reagan, Real, Red River, Robertson, Rockwall, Runnels, Rusk, Sabine, San Augustine, San Jacinto, San Patricio, San Saba, Schleicher, Shackelford, Shelby, Smith, Somervell, Starr, Stephens, Sterling, Stonewall, Sutton, Tarrant, Taylor, Terrell, Throckmorton, Titus, Tom Green, Travis, Trinity, Upshur, Upton, Uvalde, Val Verde, Van Zandt, Walker, Washington, Webb, Wheeler, Wichita, Wilbarger, Willacy, Williamson, Wilson, Wise, Wood, Young, Zapata, Zavala.

Utah

Counties of Beaver, Box Elder, Cache, Carbon, Daggett, Davis, Duchesne, Emery, Garfield, Grand, Iron, Juab, Kane, Millard, Morgan, Piute, Rich, Salt Lake, San Juan, Sanpete, Sevier, Summit, Tooele, Uintah, Utah, Wasatch, Washington, Wayne, Weber.

Virginia

Cities of Alexandria, Bristol, Fairfax, Falls Church, Fredericksburg, Galax, Hampton, Manassas, Manassas Park, Newport News, Norfolk, Norton, Poquoson, Virginia Beach, Williamsburg, Winchester. Counties of Accomack, Arlington, Bland, Buchanan, Caroline, Carroll, Clarke, Culpeper, Dickenson, Essex, Fairfax, Fauquier, Frederick, Gloucester, Grayson, James City, King and Queen, King George, King William, Lancaster, Lee, Loudoun, Madison, Mathews, Middlesex, New Kent, Northampton, Northumberland, Orange, Prince William, Rappahannock, Richmond, Russell, Scott, Smyth, Spotsylvania, Stafford, Tazewell, Warren, Washington, Westmoreland, Wise, Wythe, York.

Washington

Counties of Asotin, Columbia, Garfield, Pend Oreille, Spokane, Stevens, Whitman.

West Virginia

Counties of Berkeley, Boone, Cabell, Jackson, Jefferson, Kanawha, Lincoln, Logan, Mason, McDowell, Mercer, Mingo, Putnam, Roane, Wayne.

Wisconsin

Counties of Ashland, Bayfield, Burnett, Door, Douglas, Florence, Forest, Iron, Langlade, Lincoln, Marinette, Menominee, Oconto, Oneida, Pierce, Polk, Price, St. Croix, Sawyer, Vilas, Washburn.

Wyoming

Counties of Albany, Big Horn, Campbell, Carbon, Converse, Crook, Fremont, Goshen, Hot Springs, Johnson, Laramie, Lincoln, Natrona, Niobrara, Park, Platte, Sheridan, Sublette, Sweetwater, Teton, Uinta, Washakie, Weston.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

S Corporation Guidance Under AJCA of 2004 and GOZA of 2005

REG–143326–05

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that provide guidance regarding certain changes made to the rules governing S corporations under the American Jobs Creation Act of 2004 and the Gulf Opportunity Zone Act of 2005. The proposed regulations are necessary to replace obsolete references in the current regulations and to allow taxpayers to make proper use of the provisions that made changes to prior law. In particular, the proposed regulations provide guidance on the S corporation family shareholder rules, the definitions of "powers of appointment" and "potential current beneficiaries" (PCBs) with regard to electing small business trusts (ESBTs), the allowance of suspended losses to the spouse or former spouse of an S corporation shareholder, and relief for inadvertently terminated or invalid qualified subchapter S subsidiary (QSub) elections. The proposed regulations will affect S corporations and their shareholders. This document also provides a notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by December 27, 2007. Outlines of topics to be discussed at the public hearing scheduled for January 16, 2008, at 10 a.m., must be received by December 27, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–143326–05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–143326–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov/* (indicate IRS REG–143326–05). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W. Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Bradford R. Poston, (202) 622–3060; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Kelly Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by November 27, 2007.

Comments are specifically requested concerning:

Whether the proposed 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 proposed collection of information;

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

How the burden of complying with the proposed 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 service to provide information.

The reporting requirement in these proposed regulations is in §1.1361–1(m)(2)(ii)(A). This information must be reported by the trustees of trusts electing to be ESBTs. This information will be used by the IRS to determine the number of shareholders of the corporation in which the trust holds stock and thus whether the corporation is an eligible S corporation. The respondents will be trusts making an ESBT election.

The following estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on the information that is available to the Internal Revenue Service. Individual respondents may require greater or less time, depending on their particular circumstances.

Estimated total annual reporting burden: 26,000 hours.

Estimated average annual burden: 1 hour.

Estimated number of respondents: 26,000.

Estimated annual frequency of response: On occasion.

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

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

Background

This document contains proposed amendments to the Income Tax Regu-

lations (26 CFR part 1) concerning S corporations under sections 1361, 1362, and 1366 of the Internal Revenue Code (Code). These Code sections were amended by sections 231, 232, 233, 234, 235, 236, 237, 238, and 239 of the American Jobs Creation Act of 2004 (Public Law 108–357, 118 Stat. 1418) (the 2004 Act) and sections 403 and 413 of the Gulf Opportunity Zone Act of 2005 (Public Law 109–135) (the 2005 Act). This document does not address other amendments made by the 2004 Act or the 2005 Act. In addition, this document contains additional proposed amendments to the regulations under Code section 1362 necessary to conform the regulations to the changes made by section 1305(a) of the Small Business Job Protection Act of 1996 (Public Law 104–188, 110 Stat. 1755) (the 1996 Act).

Explanation of Provisions

Increase in Maximum Number of Shareholders

Section 232 of the 2004 Act amends Code section 1361(b)(1)(A) by increasing the permitted number of shareholders from 75 to 100 for a small business corporation eligible to make an S election. This provision is effective for taxable years beginning after December 31, 2004. The proposed regulations remove or amend several references in the regulations under Code section 1361 that cite a specific number of permissible S corporation shareholders, except insofar as such references are necessary in an example. This change will accommodate any future statutory changes in the maximum number of permitted shareholders.

Family Shareholders

Section 1361(c)(1), as amended by section 231(a) of the 2004 Act and section 403(b) of the 2005 Act, treats a husband and wife (and their estates), and all members of a family (and their estates) as one shareholder for purposes of the 100 shareholder limitation. Section 403(b) of the 2005 Act eliminated the requirement of an election in order for a family to be treated as one shareholder, providing instead that members of a family would automatically be treated as one shareholder for purposes of Code section 1361(b)(1)(A). This amendment is effective as if included in section 231 of the 2004 Act for tax years beginning after December 31, 2004. Notice 2005–91, 2005–2 C.B. 1164, *see* § 601.601(d)(2)(ii)(*b*), issued prior to the enactment of section 403(b) of the 2005 Act, informed taxpayers that the Treasury Department and the IRS intended to issue guidance regarding the family shareholder election under section 1361(c) and provided that taxpayers could rely on the provisions of Notice 2005–91 until the issuance of that guidance. Although the portions of Notice 2005–91 addressing the manner of making the family shareholder election are no longer relevant, the proposed regulations retain the provisions of Notice 2005–91 describing certain entities other than individuals that will be treated as members of the family.

The family members are determined by reference to a common ancestor. Section 1361(c)(1)(B) defines "members of a family" as a common ancestor, any lineal descendant of the common ancestor, and any spouse or former spouse of the common ancestor or any such lineal descendant. Adopted and foster children are included among the lineal descendants as described in section 1361(c)(1)(C). An individual is not eligible to be the common ancestor for purposes of this provision if, on the applicable date, the individual is more than 6 generations removed from the youngest generation of shareholders who would otherwise be members of the family (without regard to the "six generation" test of Code section 1361(c)(1)(B)(ii)). Section 403(b) of the 2005 Act also changed the applicable date in section 1361(c)(1)(B)(iii) on which a person will be tested for qualification as a "common ancestor" to the latest of (1) the date the S election is made, (2) the earliest date an individual who is a "member of the family" holds stock in the S corporation, or (3) October 22, 2004. The regulation clarifies that the "six generation" test is applied only at the date specified in Code section 1361(c)(1)(B)(iii) for determining whether an individual meets the definition of "common ancestor," and has no continuing significance in limiting the number of generations of a family that may hold stock and be treated as a single shareholder. The regulation provides that there is no adverse consequence to a person being a member of two families.

Disregard of Unexercised Powers of Appointment in ESBTs

Potential current beneficiaries (PCBs) are treated as shareholders of the corporation for purposes of Code section 1361(b)(1) (which addresses both shareholder eligibility and the permitted number of shareholders). Section 234 of the 2004 Act amended Code section 1361(e)(2) by providing that in determining an ESBT's PCBs for any period, powers of appointment will be disregarded to the extent not exercised by the end of that period. The amended section also increases the period from 60 days to one year during which an ESBT may safely dispose of S corporation stock after an ineligible shareholder becomes a PCB. These amendments apply to taxable years beginning after December 31, 2004.

The amendment overrides current §1.1361–1(m)(4)(vi) and the illustrative example which provide that any person who may receive a distribution under a currently exercisable power of appointment is a PCB. Under §1.1361–1(m)(4)(vi), the broad powers of appointment commonly included in many trusts used for estate planning purposes would preclude those trusts from qualifying as ESBTs, because that power would cause the S corporation to have an excessive number of deemed shareholders or to have as deemed shareholders persons ineligible to hold S corporation stock. The proposed regulations remove and replace the sections of the regulation inconsistent with current law.

The Treasury Department and the IRS have received inquiries concerning whether certain powers held by a trustee or any other person who is not a beneficiary will be considered to be powers of appointment for purposes of Code section 1361(e)(2), and thus be disregarded (to the extent not exercised) in determining the PCBs of the ESBT. In particular, there is concern about the powers to add persons to the class of current beneficiaries or to select from an unlimited class of charitable beneficiaries. Under the current regulations, such powers, regardless of the identity of the holder, could result in the termination of the S corporation election if the class of charities that could currently receive distributions or the class of persons who could be added as bene-

ficiaries is sufficiently large to cause the corporation to have more than the number of shareholders allowed by Code section 1361(b)(1)(A).

"Power of appointment" is not defined or described in either Code section 1361(e)(2) as amended or in current §1.1361–1(m). However, "power of appointment" is described for estate tax purposes in §20.2041–1(b) of the Estate Tax Regulations and for gift tax purposes in §25.2514–1(b) of the Gift Tax Regulations. For transfer tax purposes, a power of appointment generally includes the power to appropriate or consume the principal of the trust or the power to affect the beneficial enjoyment of trust property or its income by altering, amending, or revoking the trust instrument or terminating the trust.

If the transfer tax descriptions are narrowly interpreted, powers held by fiduciaries (who are not also beneficiaries of the trust) to spray or sprinkle trust distributions would generally not be "powers of appointment." Therefore, the relief provided by the amended provision of Code section 1361(e)(2) would not apply to prevent the possible creation of an excessive number of PCBs. These powers would continue to be treated under the general rule of current §1.1361–1(m)(4)(i), which provides that a PCB "is, with respect to any period, any person who at any time during such period is entitled to, or in the discretion of any person may receive, a distribution from the principal or income of the trust." Any sufficiently broad power to spray or sprinkle trust distributions would result in an excessive number of PCBs and thus cause the termination of the S corporation election.

Alternatively, if all fiduciary powers to spray or sprinkle trust distributions to a class of current beneficiaries or possible current beneficiaries were deemed to be "powers of appointment" for purposes of Code section 1361(e)(2), this would effectively result in the replacement of "potential current beneficiaries" as a measuring tool under Code section 1361(b)(1) with "current beneficiaries," as only those actually receiving distributions would ever meet the PCB definition. The 2004 Act, however, did not replace "potential current beneficiary" with "current beneficiary".

The Treasury Department and the IRS believe that the proper interpretation of the change made by the 2004 Act is that the provision avoids counting as PCBs an unlimited number of potential appointees who may never become permissible beneficiaries. In this manner, the legislative change prevents the mere presence of common estate planning powers in a trust instrument from resulting in a termination of the S corporation election because of an excessive number of PCBs. The power to select from among an unlimited class of charities within the class of beneficiaries who may receive current distributions from a trust in the discretion of a fiduciary is a common estate planning power.

The proposed regulations amend the definition of "potential current beneficiary" to provide that all members of a class of unnamed charities permitted to receive distributions under a discretionary distribution power held by a fiduciary that is not a power of appointment, will be considered, collectively, to be a single PCB for purposes of determining the number of permissible shareholders under section 1361(b)(1)(A) unless the power is actually exercised, in which case each charity that actually receives distributions will also be a PCB. The ESBT election requirements under §1.1361–1(m)(2)(ii)(A) are amended to require a trust containing such a power to indicate the presence of the power in the election statement. This amended PCB definition applies only to powers to distribute to one or more members of a class of unnamed charities which is unlimited in number. The amended PCB definition does not apply to a power to make distributions to or among particular named charities.

The proposed regulations further provide that a power to add beneficiaries, whether or not charitable, to a class of current permissible beneficiaries is generally a power of appointment and thus will be disregarded to the extent it is not exercised. However, if the power is exercised and an unlimited class of charitable beneficiaries is added to the class of current permissible beneficiaries, that class will count as a single PCB under the amended definition of PCB, and, to the extent distributions are actually made to one or more charities, those charities will each count as PCBs.

Transfer of Stock Between Spouses or Incident to Divorce

Section 235 of the 2004 Act amended Code section 1366(d)(2) to provide that if the stock of an S corporation is transferred between spouses or incident to divorce under Code section 1041(a), any loss or deduction with respect to the transferred stock which cannot be taken into account by the transferring shareholder in the year of the transfer because of the basis limitation in section 1366(d)(1) shall be treated as incurred by the corporation in the succeeding taxable year with regard to the transferee. Prior to this amendment, any losses or deductions disallowed under section 1366(d) were personal to the shareholder and did not transfer upon the transfer of the S corporation stock to another person. Section 1366(d)(2) is effective for transfers after December 31, 2004.

The proposed regulations amend the provisions of §1.1366–2(a)(5) to include this exception to the general rule of nontransferability of losses and deductions. Losses and deductions allocable to the transferor spouse for the taxable year immediately preceding the year of transfer that are subject to the basis limitation rule of section 1366(d) will be treated as incurred by the corporation with respect to the transferor spouse in the taxable year of the transfer. The transferor spouse may use all losses and deductions carried over to the year of transfer if the transferor spouse has sufficient basis in the transferor's adjusted basis in stock or adjusted basis in the indebtedness of the corporation to the transferor. Under §1.1366–2(a)(4), if the transferor's *pro rata* share of the losses and deductions in the year of transfer exceeds the transferor's basis in stock or the indebtedness of the corporation to the transferor, then the limitation must be allocated among the transferor spouse's *pro rata* share of each loss or deduction, including disallowed losses and deductions carried over from the prior year. Under the proposed regulations, losses and deductions carried over to the year of transfer that are not used by the transferor spouse in such year will be prorated between the transferor spouse and the transferee spouse based on their stock ownership at the beginning of the succeeding taxable year. The proposed regulations include examples illustrating these rules. The Treasury

Department and IRS request comments on the best methods to ensure that losses are properly allocated between the transferor and transferee spouses, including whether a notification requirement should be imposed on the transferor spouse.

Passive Activity Losses and At-risk Amounts of Qualified Subchapter S Trusts

Section 236 of the 2004 Act amends Code section 1361(d)(1) to provide that, for purposes of applying Code sections 465 and 469 to the beneficiary of a qualified subchapter S trust (QSST) with respect to which the beneficiary has made an election under Code section 1361(d)(2), the disposition of S corporation stock by the QSST shall be treated as a disposition by the beneficiary. This creates an exception to the general rule of §1.1361–1(j)(8), which provides that the trust, rather than the beneficiary, is treated as the owner of the S corporation stock in determining the income tax consequences of a disposition of the stock. The proposed regulations add conforming language to §1.1361–1(j)(8).

Qualified Subchapter S Subsidiary Relief and Inadvertent Invalid Elections or Terminations

Section 238 of the 2004 Act amends Code section 1362(f) to provide that QSubs are eligible for relief for an inadvertent invalid QSub election or termination under the same standards applied to an inadvertent invalid S corporation election or termination. This provision is effective for elections made and terminations occurring after December 31, 2004. The proposed regulations make conforming changes to §1.1362–4. The proposed regulations make additional changes to §1.1362–4 addressing the change to Code section 1362(f) made by section 1305(a) of the 1996 Act, which provided relief for corporations with inadvertently invalid S corporation elections, in addition to the relief already available for inadvertent terminations of valid S corporation elections.

Effect on Other Documents

The following publication is proposed to be obsoleted as of the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**:

Notice 2005–91, 2005–2 C.B. 1164.

Proposed Effective Date

These regulations are proposed to be effective on the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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. Further, it has been determined that these regulations are not subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6) because the collection of information required by these regulations is imposed on electing small business trusts and such entities are not "small entities" for purposes of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Additionally, the information collection burden imposed on the electing small business trusts is minimal. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

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

A public hearing has been scheduled for January 16, 2008, beginning at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by December 27, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the schedule of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Bradford R. Poston of the Office of Associate Chief Counsel (Passthroughs and Special Industries).

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Proposed Amendment to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1361–0 is amended by adding a new entry in the table of contents for §1.1361–1(e)(3) to read as follows:

§1.1361–0 Table of contents.

* * * * *

§1.1361–1 S Corporation defined.

* * * * *

(e) * * *

(3) Special rules relating to stock owned by members of a family.

Par. 3. Section 1.1361–1 is amended by:

1. Revising paragraphs (b)(1)(i) and (e)(1).

2. Adding paragraphs (e)(3), (h)(1)(vii), and (h)(3)(i)(G).

3. Adding a new sentence to the end of paragraph (j)(8).

4. Adding a new sentence to the end of paragraph (k)(2)(i).

5. Revising paragraphs (m)(2)(ii)(A), (m)(4)(iii), and (m)(4)(vi).

6. Revising paragraph (m)(8), *Example 2*.

7. Revising the seventh sentence of paragraph (m)(8), *Example 5*.

8. Revising paragraph (m)(8), *Example 7*.

9. Adding paragraph (m)(8), *Example 8*.

10. Adding paragraph (m)(8), *Example 9*.

11. Adding a sentence to the end of paragraph (m)(9).

The revisions and additions read as follows:

§1.1361–1 S Corporation defined.

* * * * *

(b) * * * (1) * * *

(i) More than the number of shareholders provided in section 1361(b)(1)(A);

* * * * *

(e) Number of shareholders—(1) *General rule*. A corporation does not qualify as a small business corporation if it has more than the number of shareholders provided in section 1361(b)(1)(A). Ordinarily, the person who would have to include in gross income dividends distributed with respect to the stock of the corporation (if the corporation were a C corporation) is considered to be the shareholder of the corporation. For example, if stock (owned other than by a husband and wife or members of a family described in section 1361(c)(1)) is owned by tenants in common or joint tenants, each tenant in common or joint tenant is generally considered to be a shareholder of the corporation. (For special rules relating to stock owned by husband and wife or members of a family, see paragraphs (e)(2) and (3) of this section, respectively; for special rules relating to restricted stock, see paragraphs (b)(3) and (6) of this section.) The person for whom stock of a corporation is held by a nominee, guardian, custodian, or an agent is considered to be the shareholder of the corporation for purposes of this paragraph (e) and paragraphs (f) and (g) of this section. For example, a partnership may be a nominee of S corporation stock for a person who qualifies as a shareholder of an S corporation. However, if the partnership is the beneficial owner of the stock, then the partnership is the shareholder, and the corporation does not qualify as a small business corporation. In addition, in the case of stock held for a minor under a uniform transfers to minors or similar statute, the minor and not the custodian is the shareholder. Except as otherwise provided in paragraphs (h) and (j) of this section, and for purposes of this paragraph (e) and paragraphs (f) and (g) of this section, if stock is held by a decedent's estate or a trust described in section 1361(c)(2)(A)(ii) or (iii), the estate or trust (and not the beneficiaries of the estate or trust) is considered to be the shareholder; however, if stock is held by a subpart E trust (which includes a voting trust) or an electing QSST described in section 1361(d)(1), the deemed owner of the trust is considered to be the shareholder. If stock is held by an ESBT described in section 1361(c)(2)(A)(v), each potential current beneficiary of the trust shall be treated as a shareholder, except that the trust shall be treated as the shareholder during any period in which there is no potential current beneficiary of the trust. If stock is held by a trust described in section 1361(c)(2)(A)(vi), the individual for whose benefit the trust was created shall be treated as the shareholder. See paragraph (h) of this section for special rules relating to trusts.

* * * * *

(3) *Special rules relating to stock owned by members of a family*—(i) *In general*. For purposes of paragraph (e)(1) of this section, stock owned by members of a family is treated as owned by one shareholder. Members of a family include a common ancestor, any lineal descendant of the common ancestor, and any spouse (or former spouse) of the common ancestor or of any lineal descendants of the common ancestor. An individual shall not be considered to be a common ancestor if, on the applicable date, the individual is more than six generations removed from the youngest generation of shareholders who would (but for this six-generation test) be members of the family. For purposes of this test, a spouse (or former spouse) is treated as being of the same generation as the individual to whom the spouse is or was married. This test is applied on the latest of the date the election under section 1362(a) is made for the corporation, the earliest date that a member of the family holds stock in the corporation, or October 22, 2004. For this purpose, the date the election under section 1362(a) is made for the corporation is the effective date of the election, not the date it is signed or received by any person. The test is only applied as of the applicable date, and lineal descendants (and spouses) more than six generations removed from the common ancestor will be treated as members of the family even if they acquire stock in the corporation after that date. The members of a family are treated as one shareholder under this paragraph (e)(3) solely for purposes of section 1361(b)(1)(A), and not for any other purpose, whether under section 1361 or any other provision. Specifically, each member of the family who owns or is deemed to own stock must meet the requirements of sections 1361(b)(1)(B) and (C) (regarding permissible shareholders) and section 1362(a)(2) (regarding shareholder consents to an S corporation election). Although a person may be a member of more than one family under this paragraph (e)(3), each family (not all of whose members are also members of the other family) will be treated as one shareholder. For purposes of this paragraph (e)(3), any legally adopted child of an individual, any child who is lawfully placed with an individual for legal adoption by that individual, and any eligible foster child of an individual (within the meaning of section 152(f)(1)(C)), shall be treated as a child of such individual by blood.

(ii) *Certain entities treated as members of a family*. For purposes of this paragraph (e)(3), the estate or trust (described in section 1361(c)(2)(A)(ii) or (iii)) of a deceased member of the family will be considered to be a member of the family during the period in which the estate or such trust (if the trust is described in section 1361(c)(2)(A)(ii) or (iii)), holds stock in the S corporation. The members of the family also will include—

(A) In the case of an ESBT, each potential current beneficiary who is a member of the family;

(B) In the case of a QSST, the income beneficiary who makes the QSST election, if that income beneficiary is a member of the family;

(C) In the case of a trust created primarily to exercise the voting power of stock transferred to it, each beneficiary who is a member of the family;

(D) The individual for whose benefit a trust described in section 1361(c)(2)(A)(vi) was created, if that individual is a member of the family;

(E) The deemed owner of a trust described in section 1361(c)(2)(A)(i) if that deemed owner is a member of the family; and

(F) The owner of an entity disregarded as an entity separate from its owner under §301.7701–3 of the Procedure and Administration Regulations, if that owner is a member of the family.

* * * * *

(h)* * * (1)* * *

(vii) *Individual retirement accounts*. In the case of a corporation which is a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1)), a trust which constitutes an individual retirement account under section 408(a), including one designated as a Roth IRA under section 408A, but only to the extent of the stock held by such trust in such bank or company as of October 22, 2004. Individual retirement accounts (including Roth IRAs) are not otherwise eligible S corporation shareholders.

* * * * *

(3)* * * (i) * * *

(G) If stock in an S corporation bank or depository institution holding company is held by an individual retirement account (including a Roth IRA) described in paragraph (h)(1)(vii) of this section, the individual for whose benefit the trust was created shall be treated as the shareholder.

* * * * *

(j)* * *

(8)* * * However, solely for purposes of applying sections 465 and 469 to the income beneficiary, a disposition of S corporation stock by a QSST shall be treated as a disposition by the income beneficiary.

* * * * *

(k)* * *(2) * * *

(i) * * * Paragraphs (b)(1)(i), (e)(1), (e)(3), (h)(1)(vii), (h)(3)(i)(G), and the fifth sentence of paragraph (j)(8) are effective on and after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

* * * * *

(m)* * *(2)* * *

(ii)* * *

(A) The name, address, and taxpayer identification number of the trust, the potential current beneficiaries, and the S corporations in which the trust currently holds stock. If the trust includes a power described in paragraph (m)(4)(vi)(B) of this section, then the election statement must include a statement that such a power is included in the instrument, but does not need to include the name, address, or taxpayer identification number of any particular charity or any other information regarding the power.

* * * * *

(4)* * *

(iii) *Special rule for dispositions of stock*. Notwithstanding the provisions of paragraph (m)(4)(i) of this section, if a trust disposes of all of the stock which it holds in an S corporation, then, with respect to that corporation, any person who first met the definition of a potential current beneficiary during the 1-year period ending on the date of such disposition is not a potential current beneficiary and thus is not a shareholder of that corporation.

* * * * *

(vi) *Currently exercisable powers of appointment and other powers*—(A) *Powers of appointment*. A person to whom a distribution may be made during any period pursuant to a power of appointment (as described for transfer tax purposes in section 2041 and §20.2041–1(b) of this chapter and section 2514 and §25.2514–1(b) of this chapter) is not a potential current beneficiary unless the power is exercised in favor of that person during the period. It is immaterial for purposes of this paragraph (m)(4)(vi)(A) whether such power of appointment is a "general power of appointment" for transfer tax purposes as described in §20.2041–1(c) and §25.2514–1(c) of this chapter. The mere existence of one or more powers of appointment during the lifetime of a power holder that would permit current distributions from the trust to be made to more than the number of persons described in section 1361(b)(1)(A) or to a person described in section 1361(b)(1)(B) or (C), will not cause the S corporation election to terminate unless one or more of such powers are exercised, collectively, in favor of an excessive number of persons or in favor of a person who is ineligible to be an S corporation shareholder. For purposes of this paragraph (m)(4)(vi)(A), a "power of appointment" includes a power, regardless of by whom held, to add a beneficiary or class of beneficiaries to the class of potential current beneficiaries, but generally does not include a power held by a fiduciary who is not also a beneficiary of the trust to spray or sprinkle trust distributions among beneficiaries. Nothing in this paragraph (m)(4)(vi)(A) alters the definition of "power of appointment" for purposes of any provision of the Internal Revenue Code or the regulations.

(B) *Powers to distribute to certain organizations not pursuant to powers of appointment*. If a trustee or other fiduciary has a power (that does not constitute a power of appointment for transfer tax purposes as described in §§20.2041–1(b) and 25.2514–1(b) of this chapter) to make distributions from the trust to one or more members of a class of organizations described in section 1361(c)(6), such organizations will be counted collectively as only one potential current beneficiary for purposes of this paragraph (m), except that each organization receiving a distribution also will be counted as a potential current beneficiary. This paragraph (m)(4)(vi)(B) shall not apply to a power to currently distribute to one or more particular charitable organizations named in the instrument. Each of such organizations is a potential current beneficiary of the trust.

* * * * *

(8)* * *

Example 2. (i) *Invalid potential current beneficiary*. Effective January 1, 2005, Trust makes a valid ESBT election. On January 1, 2006, *A*, a nonresident alien, becomes a potential current beneficiary of Trust. Trust does not dispose of all of its S corporation stock within one year after January 1, 2006. As of January 1, 2006, *A* is the potential current beneficiary of Trust and therefore is treated as a shareholder of the S corporation. Because *A* is not an eligible shareholder of an S corporation under section 1361(b)(1), the S corporation election of any corporation in which Trust holds stock terminates effective January 1, 2006. Relief may be available under section 1362(f).

(ii) *Invalid potential current beneficiary and disposition of S stock*. Assume the same facts as in *Ex-*

ample 2 (i) except that within one year after January 1, 2006, trustee of Trust disposes of all Trust's S corporation stock. *A* is not considered a potential current beneficiary of Trust and therefore is not treated as a shareholder of any S corporation in which Trust previously held stock.

* * * * *

*Example 5.** * *Trust–2 itself will not be counted toward the shareholder limit of section 1361(b)(1)(A).* * *

* * * * *

Example 7. Potential current beneficiaries and powers of appointment. M creates Trust from which *A* has a right to all net income and funds it with S corporation stock. *A* also has a currently exercisable power to appoint income or principal to anyone except *A*, *A*'s creditors, *A*'s estate, and the creditors of *A*'s estate. The potential current beneficiaries of Trust for any period will be *A* and each person who receives a distribution from Trust pursuant to *A*'s exercise of *A*'s power of appointment during that period.

Example 8. Power to distribute to an unlimited class of charitable organizations not pursuant to a power of appointment. M creates Trust from which *A* has a right to all net income and funds it with S corporation stock. In addition, the trustee of Trust, who is not *A* or a descendant of *M*, has the power to make discretionary distributions of principal to the living descendants of *M* and to any organizations described in section 1361(c)(6). The potential current beneficiaries of Trust for any period will be *A*, each then-living descendant of *M*, and each exempt organization described in section 1361(c)(6) that receives a distribution during that period. In addition, the class of exempt organizations will be counted as one potential current beneficiary.

Example 9. Power to distribute to a class of named charitable organizations not pursuant to a power of appointment. M creates Trust from which *A* has a right to all net income and funds it with S corporation stock. In addition, the trustee of Trust, who is not *A* or a descendant of *M*, has the power to make discretionary distributions of principal to the living descendants of *M* and to *X*, *Y*, and *Z*, each of which is an organization described in section 1361(c)(6). The potential current beneficiaries of Trust for any period will be *A*, *X*, *Y*, *Z*, and each living descendant of *M*.

(9) *Effective/applicability date.* * * *

Paragraphs (m)(2)(ii)(A), (m)(4)(iii) and (vi), and (m)(8), *Example 2*, *Example 5*, *Example 7*, *Example 8*, and *Example 9* are effective on and after the date of publication of the Treasury decision adopting these rules as final regulations is published in the **Federal Register**.

Par. 4. Section 1.1361–4 is amended by revising paragraph (a)(1) and adding new paragraph (a)(9) to read as follows:

§1.1361–4 Effect of QSub Election.

(a) *Separate existence ignored*—(1) *In general.* Except as otherwise provided in paragraphs (a)(3), (a)(6), (a)(7), (a)(8), and (a)(9) of this section, for Federal tax purposes—

(i) A corporation which is a QSub shall not be treated as a separate corporation; and

(ii) All assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and items of income, deduction, and credit of the S corporation.

* * * * *

(9) *Information returns*—(i) *In general.* Except to the extent provided by the Secretary, paragraph (a)(1) of this section shall not apply to part III of subchapter A of chapter 61, relating to information returns.

(ii) *Effective/applicability date.* This paragraph (a)(9) is effective on and after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

* * * * *

Par. 5. Section 1.1361–6 is amended by revising the first sentence as follows:

§1.1361–6 Effective date.

Except as provided in §§1.1361–4(a)(3)(iii), 1.1361–4(a)(5)(i), 1.1361–4(a)(6)(iii), 1.1361–4(a)(7)(ii), 1.1361–4(a)(8)(ii), 1.1361–4(a)(9), and 1.1361–5(c)(2), the provisions of §§1.1361–2 through 1.1361–5 apply to taxable years beginning on or after January 20, 2000; however, taxpayers may elect to apply the regulations in whole, but not in part (aside from those sections with special dates of applicability), for taxable years beginning on or after January 1, 2000, provided all affected taxpayers apply the regulations in a consistent manner. * * *

Par. 6. Section 1.1362–0 is amended by revising the heading of the table of contents for §1.1362–4 to read as follows:

§1.1362–0 Table of contents.

* * * * *

§1.1362–4 Inadvertent terminations and inadvertently invalid elections.

* * * * *

Par. 7. Section 1.1362–4 is amended by:

1. Revising the section heading and paragraphs (a), (b), (c), (d), and (f).

2. Adding paragraph (g).

The addition and revisions read as follows:

§1.1362–4 Inadvertent terminations and inadvertently invalid elections

(a) *In general.* A corporation is treated as continuing to be an S corporation or a QSub (or, an invalid election to be either an S corporation or a QSub is treated as valid) during the period specified by the Commissioner if—

(1) The corporation made a valid election under section 1362(a) or section 1361(b)(3) and the election terminated or the corporation made an election under section 1362(a) or section 1361(b)(3) that was invalid;

(2) The Commissioner determines that the termination or invalidity was inadvertent;

(3) Steps were taken by the corporation to return to or qualify for small business corporation or QSub status within a reasonable period after discovery of the terminating event or invalid election, or the required shareholder consents are acquired; and

(4) The corporation and shareholders agree to adjustments that the Commissioner may require for the period.

(b) *Inadvertent termination or inadvertently invalid election.* For purposes of paragraph (a) of this section, the determination of whether a termination or invalid election was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination or invalid election was inadvertent. The fact that the terminating event or invalidity of the election was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination or invalidity of the election was inadvertent.

(c) *Corporation's request for determination of an inadvertent termination or invalid election.* A corporation that believes that the termination or invalidity of

its election was inadvertent may request a determination from the Commissioner that the termination or invalidity of its election was inadvertent. The request is made in the form of a ruling request and should set forth all relevant facts pertaining to the event or circumstance including, but not limited to, the facts described in paragraph (b) of this section, the date of the corporation's election (or intended election) under section 1362(a) or 1361(b)(3), a detailed explanation of the event or circumstance causing the termination or invalidity, when and how the event or circumstance was discovered, and the steps taken under paragraph (a)(3) of this section.

(d) *Adjustments*. The Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation or QSub during the period specified by the Commissioner. In the case of stock held by an ineligible shareholder that causes an inadvertent termination or invalid election for an S corporation under section 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of the S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent the loss of any revenue due to the holding of stock by an ineligible shareholder (for example, a nonresident alien).

* * * * *

(f) *Status of corporation*. The status of the corporation after the terminating event or invalid election and before the determination of inadvertence is determined by the Commissioner. Inadvertent termination or inadvertent invalid election relief may be granted retroactively for all years for which the terminating event or circumstance giving rise to invalidity is effective, in which case the corporation is treated as if its election was valid or had not terminated. Alternatively, relief may be granted only for the period in which the corporation became eligible for subchapter S or QSub treatment, in which case the corporation is treated as a C corporation or, in the case of a QSub with an inadvertently terminated or invalid election, as a separate C corporation, during the period for which the corporation was not eligible for its intended status.

(g) *Effective/applicability date*. Paragraphs (a), (b), (c), (d), and (f) of this section are effective on and after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 8. Section 1.1366–0 is amended by adding new entries in the table of contents for §1.1366–2(a)(5)(i) through (iii) to read as follows:

§1.1366–0 Table of contents.

* * * * *

§1.1366–2 Limitations on deduction of passthrough items of an S corporation to its shareholders.

(a) * * *

(5) * * * (i) *In general.*

(ii) *Exceptions for transfers of stock under section 1041(a).*

(iii) *Examples.*

Par. 9. Section 1.1366–2(a)(5) is amended by:

1. Adding a heading and revising the first sentence of paragraph (a)(5)(i).

2. Adding paragraphs (a)(5)(ii) and (a)(5)(iii).

The revisions and additions read as follows:

§1.1366–2 Limitations on deduction of passthrough items of an S corporation to its shareholders.

(a) *In general.** * *

(5) *Nontransferability of losses and deductions*—(i) *In general.* Except as provided in paragraph (a)(5)(ii) of this section, any loss or deduction disallowed under paragraph (a)(1) of this section is personal to the shareholder and cannot in any manner be transferred to another person. * * *

(ii) *Exceptions for transfers of stock under section 1041(a).* If a shareholder transfers stock of an S corporation after December 31, 2004, in a transfer described in section 1041(a), any loss or deduction with respect to the transferred stock that is disallowed to the transferring shareholder under paragraph (a)(1) of this section shall be treated as incurred by the corporation in the following taxable year with respect to the transferee spouse or former spouse. The amount of any loss or deduction with respect to the stock transferred shall be determined by prorating any losses or deductions disallowed under paragraph (a)(1) for the year of the transfer between the transferor and the spouse or former spouse based on the stock ownership at the beginning of the following taxable year. If a transferor claims a deduction for losses in the taxable year of transfer, then under paragraph (a)(4) of this section, if the transferor's *pro rata* share of the losses and deductions in the year of transfer exceeds the transferor's basis in stock or the indebtedness of the corporation to the transferor, then the limitation must be allocated among the transferor spouse's *pro rata* share of each loss or deduction, including disallowed losses and deductions carried over from the prior year.

(iii) *Examples.* The following examples illustrates the provisions of paragraph (a)(5)(ii) of this section:

Example 1. *A* owns all 100 shares in *X*, a calendar year S corporation. For *X*'s taxable year ending December 31, 2006, *A* has zero basis in the shares and *X* does not have any indebtedness to *A*. For the 2006 taxable year, *X* had $100 in losses which *A* cannot use because of the basis limitation in section 1366(d)(1) and which are treated as incurred by the corporation with respect to *A* in the following taxable year. Halfway through the 2007 taxable year, *A* transfers 50 shares to *B*, *A*'s former spouse in a transfer to which section 1041(a) applies. In the 2007 taxable year, *X* has $80 in losses. On *A*'s 2007 individual income tax return, *A* may use the entire $100 carryover loss from 2006, as well as *A*'s share of the $80 2007 loss determined under section 1377(a) ($60), assuming *A* acquires sufficient basis in the *X* stock. On *B*'s 2007 individual income tax return, *B* may use *B*'s share of the $80 2007 loss determined under section 1377(a) ($20), assuming *B* has sufficient basis in the *X* stock. If any disallowed 2006 loss is disallowed to *A* under section 1366(d)(1) in 2007, that loss is prorated between *A* and *B* based on their stock ownership at the beginning of 2008. On *B*'s 2008 individual income tax return, *B* may use that loss, assuming *B* acquires sufficient basis in the *X* stock. If neither *A* nor *B* acquires any basis during the 2007 taxable year, then as of the beginning of 2008, the corporation will be treated as incurring $50 of loss with respect to *A* and $50 of loss with respect to *B* for the $100 of disallowed 2006 loss, and the corporation will be treated as incurring $60 of loss with respect to *A* and $20 with respect to *B* for the $80 of disallowed 2007 loss.

Example 2. Assume the same facts as *Example 1*, except that during the 2007 taxable year, *A* acquires $10 of basis in *A*'s shares in *X*. For the 2007 taxable year, *A* may claim a $10 loss deduction, which represents $6.25 of the disallowed 2006 loss of $100 and $3.75 of *A*'s 2007 loss of $60. The disallowed 2006 loss is reduced to $93.75. As of the beginning of 2008, the corporation will be treated as incurring

half of the remaining $93.75 of loss with respect to *A* and half of that loss with respect to *B* for the remaining $93.75 of disallowed 2006 loss, and if *B* does not acquire any basis during 2007, the corporation will be treated as incurring $56.25 of loss with respect to *A* and $20 with respect to *B* for the remaining disallowed 2007 loss.

* * * * *

Par. 10. Section 1.1366–5 is amended by adding a new sentence at the end.

The addition reads as follows:

§1.1366–5 Effective/applicability date.

* * * Paragraphs 1.1366–2(a)(5)(i), (ii) and (iii) are effective on and after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

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

(Filed by the Office of the Federal Register on September 27, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 28, 2007, 72 F.R. 55132)

Notice of Proposed Rulemaking and Notice of Public Hearing

Arbitrage Guidance for Tax-Exempt Bonds

REG–106143–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of Proposed Rulemaking and Notice of Public Hearing.

SUMMARY: This document contains proposed regulations on the arbitrage restrictions under section 148 of the Internal Revenue Code applicable to tax-exempt bonds issued by State and local governments. These proposed regulations are being issued in order to update existing regulations to address certain current market developments, to simplify and correct certain provisions, and to make existing regulations more administrable. These proposed regulations affect State and local governmental issuers of tax-exempt bonds. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by December 26, 2007. Outlines of topics to be discussed at the public hearing scheduled for January 30, 2008, at 10 a.m., must be received by January 2, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–106143–07), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–106143–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–106143–07). The public hearing will be held in the Main IRS Auditorium at the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Carla Young, (202) 622–3980; concerning submissions of comments and the hearing, *Richard.A.Hurst@irscounsel.treas.gov*, or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) on the arbitrage investment restrictions under section 148 of the Internal Revenue Code (Code). On June 18, 1993, the Treasury Department and the Internal Revenue Service (IRS) published comprehensive final regulations in the **Federal Register** (T.D. 8476, 1993–2 C.B. 13 [58 FR 33510]) on the arbitrage investment restrictions and related provisions on tax-exempt bonds under sections 103, 148, 149, and section 150 of the Code, and, since that time, those final regulations have been amended in certain limited respects (the regulations issued in 1993 and the amendments thereto are collectively referred to as the Existing Regulations). The Treasury Department and the IRS have since determined that certain provisions in the Existing Regulations need to be modified. This document contains proposed discrete amendments to the Existing Regulations (the Proposed Regulations) to update the Existing Regulations to address certain current market developments, to simplify certain provisions in the Existing Regulations, to correct certain technical issues in the Existing Regulations, and to make the Existing Regulations more administrable.

In addition, the Treasury Department and the IRS are in the process of reviewing the Existing Regulations for future regulatory guidance on additional discrete issues for the same purposes.

Explanation of Provisions

I. ***Existing Regulations***

Section 103(a) of the Code generally excludes from gross income interest on a State or local bond. Under section 103(b), however, the interest exclusion does not apply to an arbitrage bond, as defined in section 148. Section 148 provides two related, but independent types of restrictions to determine whether a bond is an arbitrage bond: a yield restriction requirement and an arbitrage rebate requirement. Generally, these restrictions limit the ability of an issuer to invest bond proceeds in investments at a yield that materially exceeds the yield on the bond issue and require that certain excess earnings above the yield on the bond issue be rebated to the Federal government. Investment earnings that exceed the yield on the bond issue are commonly referred to as arbitrage.

Under section 148(a) of the Code, the yield restriction requirement generally provides that a bond is an arbitrage bond if an issuer reasonably expects to earn arbitrage or if the issuer, subsequent to the issuance of the bonds, engages in a deliberate action to earn arbitrage on bond proceeds. Exceptions to the yield restriction requirement permit an issuer to earn arbitrage in limited circumstances, such as during limited temporary periods for prompt spending of bond proceeds and other similar temporary periods.

Under section 148(f) of the Code, the arbitrage rebate requirement provides that a bond is an arbitrage bond if the issuer fails to timely rebate to the United States arbitrage otherwise permitted to be earned

on certain investments acquired with bond proceeds. Generally, arbitrage rebate is paid every 5 years and upon the redemption of the bond issue.

The Existing Regulations provide detailed rules for applying the two types of arbitrage restrictions, including rules for determining yield on the bond issue and yield on the investments, and rules for computing and paying arbitrage rebate. The Treasury Department and the IRS believe that discrete changes need to be made to the Existing Regulations to simplify and clarify certain provisions, to make certain provisions more administrable, and to update the regulations to reflect current market practices.

II. *Proposed Regulations*

The Proposed Regulations make a number of discrete changes to the Existing Regulations. Highlighted in this preamble are certain more substantive changes which are discussed in further detail. In addition, certain more minor changes are addressed in summary form.

(1) *Hedges based on taxable interest rates*. The Proposed Regulations make revisions to accommodate certain hedges in which floating payments under the hedge are based on a taxable interest rate and to clarify that bonds covered by such a hedge are ineligible for treatment as fixed yield bonds under the special hedging rule in §1.148–4(h)(4).

(2) *Joint Bond Yield Authority*. The Proposed Regulations remove the provision in the Existing Regulations that permits the IRS Commissioner to authorize a single yield computation on multiple bond issues.

(3) *Electronic GIC Bidding*. The Proposed Regulations revise the bidding safe harbor for establishing the fair market value of guaranteed investment contracts (GICs) to accommodate electronic bidding.

(4) *Refunds of Overpayments of Rebate*. The Proposed Regulations clarify that the amount that an issuer is entitled to receive under a rebate refund claim is the excess of the total amount actually paid over the rebate amount.

A. *Changes to Accommodate Certain Hedges*

Section 1.148–4 of the Existing Regulations sets forth rules for determining the yield on an issue of bonds for purposes of applying the arbitrage rules. In general, §1.148–4(h) of the Existing Regulations permits issuers to compute the yield on an issue by taking into account payments under "qualified hedges." The Existing Regulations provide two ways in which a qualified hedge can be taken into account in computing yield on the issue, known commonly as "simple integration" and "super integration."

For both simple integration and super integration, a hedge must be a "qualified hedge," which is a hedge that meets a series of eligibility requirements. Generally, in order to be a qualified hedge, a hedge must be interest based, the terms of the hedge must correspond closely with the terms of the hedged bonds, the issuer must duly identify the hedge, and the hedge must contain no significant investment element. For super integration, the hedge must meet additional eligibility requirements which focus on assuring that the terms of the hedge and the hedge bonds sufficiently correspond so as to warrant treating the hedged bonds as fixed-yield bonds for arbitrage purposes.

In the case of simple integration, generally all net payments on the hedge and the hedged bonds are taken into account in determining the yield on the bond issue. For example, if an issuer issues bonds paying interest at a variable rate and enters into a hedge under which the issuer receives floating interest rate payments from the hedge provider and pays fixed interest payments to the hedge provider (a variable-to-fixed hedge), the variable rate that the issuer pays to the bondholders, the floating rate that the issuer receives on the hedge, and the fixed payments that the issuer pays on the hedge are all taken into account on a net basis in determining the yield on the bond issue. In the case of simple integration, the hedged bonds are treated as variable yield bonds, which means that the yield on the bond issue is periodically recomputed and the rebate the issuer must pay to the United States is based on the issuer's actual net payments and receipts on the bond and the hedge. Thus, for example, any "basis risk" difference between the actual interest rate that the issuer pays on its variable-yield hedged bond and the actual interest rate it receives on the floating interest rate on the hedge (along with the fixed payments on the hedge) is taken into account in determining the yield on the hedged bonds.

In the case of super integration where the payments on the hedge and the hedged bonds sufficiently correspond so that the yield on the hedged bonds is fixed and determinable with certain assumptions, the hedged bonds are treated as fixed-yield bonds for arbitrage purposes. In the case of super integration, any basis risk difference between the floating-rate interest payments on the hedge and the variable-rate interest payments on the hedged bonds is ignored in determining the yield on the hedged bonds for arbitrage purposes through an assumption that treats those floating and variable rates as the same.

One of the eligibility requirements for a qualified hedge under the Existing Regulations is that it be interest based. For simple integration, one of the subsidiary aspects used in determining whether a variable-to-fixed interest rate hedge is interest based focuses on whether the variable interest rate on the hedged bonds and the floating interest rate on the hedge are "substantially the same." For super integration purposes, such rates must be "reasonably expected to be substantially the same throughout the term of the hedge." This aspect of the interest-based contract standard has raised technical issues in recent years in connection with its application to certain kinds of hedges, as discussed further in this preamble.

In general, hedging plays an increasingly important role in the tax-exempt bond market. An issuer of bonds may use hedges to protect itself against interest rate risks. For example, an issuer that issues variable-rate bonds may hedge or protect itself against unfavorable interest rate changes in the market by entering into a variable-to-fixed interest rate swap. Historically, issuers of tax-exempt bonds generally used a type of swap under which the hedge provider paid a floating interest rate that was determined based on a market index of tax-exempt interest rates, such as the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index.

A significant development in the tax-exempt bond market since the promulgation of the Existing Regulations has been the trend toward the use by issuers of variable-to-fixed interest rate swaps as hedges

in which the floating interest rate that the swap provider pays to the issuer is determined based on a percentage of a market index of taxable interest rates, such as the London Interbank Offered Rate (LIBOR) (a taxable-index hedge). Issuers have indicated that these taxable-index hedges offer more liquidity, more transparency in pricing, and lower costs than hedges based on a tax-exempt interest index.

Issuers have raised interpretative questions about how to apply the qualified hedge provisions of the Existing Regulations to taxable-index hedges because interest rates on taxable indices generally do not correspond as closely as interest rates on tax-exempt market indices to actual market interest rates on tax-exempt, variable-rate bonds. These interpretative questions are particularly important for taxable-index hedges used with advance refunding bond issues because issuers generally need to use the qualified hedge rules or some other regime to determine with certainty the yield on the tax-exempt advance refunding bonds in order to comply with the applicable arbitrage yield restrictions on investments in defeasance escrows.

The IRS and the Treasury Department have determined that taxable-index hedges based on widely-used taxable indices, such as LIBOR based hedges, sufficiently improve the efficiency of the tax-exempt bond market to warrant accommodation. The Proposed Regulations accommodate these hedges by modifying (1) the provisions for "yield reduction payments," which permit an issuer to reduce yield on an investment by making payments to the Federal government in certain permitted circumstances to comply with yield restriction rules and (2) the qualified hedge provisions. The Proposed Regulations make clear, however, that while taxable-index hedges can be qualified hedges, and therefore eligible for simple integration, they are not eligible for super integration because there is an insufficient correlation between tax-exempt bond interest rates and taxable market interest rate indices. However, the IRS and the Treasury Department understand that issuers have recently issued variable-rate bonds that bear interest equal to a percentage of LIBOR, and seek public comments on whether special accommodation under the super integration rule is required for those bond issues.

Yield reduction payments effectively integrate the yield restriction requirements with the arbitrage rebate requirements. For certain limited situations, §1.148–5(c) of the Existing Regulations permits yield reduction payments to be paid to the United States to satisfy yield restriction requirements on certain investments. Yield reduction payments are similar to, but not identical to, rebate payments. In general, the purpose of the yield reduction payment rules is to simplify compliance with the sometimes overlapping yield restriction and arbitrage rebate requirements by allowing issuers to make payments similar to rebate payments to the United States to satisfy yield restriction and rebate in appropriate circumstances. For example, an issuer may effectively reduce the yield on an investment to a yield that will not violate the yield restriction rules and also satisfy the arbitrage rebate requirement through a yield reduction payment.

The Proposed Regulations modify the yield reduction payment rules to permit issuers to make yield reduction payments on certain variable-yield advance refunding issues in which the issuer has entered into a qualified hedge in the form of a variable-to-fixed interest rate swap to hedge its interest rate risk. This modification to the yield reduction rule applies for nonpurpose investments allocable to gross proceeds of an advance refunding issue deposited into an advance refunding escrow when: (1) the issuer has entered into a qualified hedge in the form of a variable-to-fixed interest rate swap on all of its variable-rate bonds that are allocable to the yield restricted defeasance escrow, (2) the hedge covers a period from the issue date of the bonds until the final payment is made from the defeasance escrow, and (3) the yield on the advance refunding escrow is not reasonably expected to exceed the yield on the issue, determined by taking into account the fixed payments that the issuer is expected to make under the hedge and by assuming that the corresponding variable interest payments to be made by the issuer on the hedged bonds and to be received by the issuer on the hedge are equal and paid on the same date. In effect, the Proposed Regulations allow yield reduction payments in this context only to be made to cover the basis risk differences between the hedge and the hedged bonds.

The Proposed Regulations also modify the qualified hedge provisions to provide that the floating rate on the taxable-index hedge and the variable rate on the hedged bonds will be treated as substantially the same for purposes of §1.148–4(h)(2)(v)(B) if: (1) the difference between the two rates is not greater than one-quarter of one percent (.25 percent, or 25 basis points) on the date the issuer enters into the hedge, and (2) for a three-year period that ends on the date the issuer enters into the hedge, the average difference between the issuer's actual tax-exempt interest rate on comparable variable-rate bonds (or, if no such comparable bonds exist, a reasonable tax-exempt interest rate index, such as the SIFMA Municipal Swap Index, for that same period) and an interest rate determined in the same manner as the floating interest rate on the hedge does not exceed one-quarter of one percent (.25 percent, or 25 basis points). For example, if the floating rate on the hedge is 67 percent of LIBOR, then 67 percent of LIBOR, determined on the same days as the issuer's actual interest rates (or tax-exempt index, if applicable) are determined, is compared to the issuer's actual interest rates (or the tax-exempt index, if applicable) for the three-year period ending on the date the hedge is entered into and the differences are averaged to determine whether the average difference exceeds one-quarter of one percent. For this purpose, a reasonable sample may be used if the sample for the issuer's actual rates (or tax-exempt market index rates, if applicable) and the sample of floating rates used for the hedge are determined as of the same dates.

The Proposed Regulations also make certain other limited changes to the hedging and yield reduction rules which are discussed with other miscellaneous changes in this preamble.

B. *Joint Yield Authority*

In general, for arbitrage purposes, the yield on a bond issue is determined on an issue-by-issue basis. Section 1.148–4(a) of the Existing Regulations, however, authorizes the IRS Commissioner to permit issuers of certain types of tax-exempt bonds, specifically qualified mortgage bonds and qualified student loan bonds,

to compute a single joint bond yield for purposes of applying the arbitrage restrictions to two or more issues of these types of tax-exempt bonds.

Since the promulgation of the Existing Regulations, the IRS has received numerous private letter ruling requests for joint bond yield computations and has ruled on one of these requests. The Treasury Department and the IRS, based on what the IRS has learned from these ruling requests, are concerned about the highly factual nature of the requests, and the potential for arbitrage manipulations with joint yield computations that would not be apparent from a private letter ruling request and that could not reasonably be discovered in the context of such a request. For these reasons, the Proposed Regulations eliminate the regulatory provision that permits joint yield computations. However, the Treasury Department and the IRS are considering whether generally applicable, objective standards can be created under which joint yield computations should be allowed. Accordingly, the Proposed Regulations solicit public comments on when joint yield computations are needed for sound business reasons and whether objective standards can be created that would allow these computations in a manner that is consistent with the purposes of section 148. In addition, comments are sought on the following: the treatment of open-ended joint yield calculations that allow future issues to be included in the joint yield computation, the treatment of qualified hedges or guarantees that cover some but not all of the bonds, the treatment of reserves, the application of prepayment assumptions, the effect of partial refundings, and other issues that impact the administrability of joint yield calculations. Pending final resolution of this issue, the IRS will not entertain any private letter ruling requests for permission to use a joint yield computation.

C. *Modified Fair Market Value Safe Harbor for Guaranteed Investment Contracts*

Under §1.148–5(d)(3) of the Existing Regulations, investments purchased with bond proceeds must be valued at fair market value. Section 1.148–5(d)(6)(iii) of the Existing Regulations provides a safe harbor for establishing the fair market value of a guaranteed investment contract (GIC) for arbitrage purposes. That safe harbor generally relies on a prescribed bidding procedure and the receipt of at least three bids from independent parties. The bidding process requirements under the safe harbor include a requirement that all bidders be given an equal opportunity to bid with no opportunity to review other bids (that is, the "no last look" rule) and a requirement that the bid specifications be provided to prospective bidders "in writing."

In the past several years, the tax-exempt bond market has seen the advent of various electronic bidding procedures and internet platforms for bidding GICs. While the particular features of specific GIC bidding procedures may vary, characteristics of these electronic GIC bidding procedures generally include using the internet to receive bid specifications and to make bids. The electronic bidding process permits providers, under prescribed times and procedures, to continuously bid and to continuously view the current highest bids (without identification of the bidders). The electronic platforms also provide the capability to print out the results of the GIC bidding process. The electronic GIC bidding procedures have raised certain technical issues regarding whether they can comply with the fair market value safe harbor for GICs under the Existing Regulations.

The Treasury Department and the IRS believe that electronic GIC bidding procedures generally offer the constructive potential for increasing the transparency of pricing of investments purchased with proceeds of tax-exempt bonds. Accordingly, the Proposed Regulations amend the fair market value safe harbor for GICs to accommodate electronic bidding procedures by 1) permitting bid specifications to be sent electronically over the internet or by fax and 2) amending the no last look rule to provide that there is not a prohibited last look if all bidders have an equal opportunity for a last look.

D. *Recovery of Overpayment of Rebate*

Generally, an issuer computes the amount of arbitrage rebate that it owes under a method that future values payments and receipts on investments using the yield on the bond issue. Under this method, an arbitrage payment made on one computation date is future valued to the next computation date to determine the amount of arbitrage rebate owed on that subsequent computation date. Section 1.148–3(i)(1) of the Existing Regulations provides that an issuer may recover an overpayment of arbitrage rebate with respect to an issue of tax-exempt bonds if the issuer establishes to the satisfaction of the IRS Commissioner that an overpayment occurred. Section 1.148–3(i)(1) further defines an overpayment as the excess of "*the amount paid*" (emphasis added) to the United States for an issue under section 148 over the sum of the rebate amount for that issue as of the most recent computation date and all amounts that are otherwise required to be paid under section 148 as of the date the recovery is requested. Thus, even if the future value of the issuer's arbitrage rebate payment on a computation date, computed under the method for determining arbitrage rebate, is greater than the issuer's rebate amount on that date, an issuer is only entitled to a refund to the extent that the amount actually paid exceeds that rebate amount. The Existing Regulations limit the amount of the refund in this manner because the Treasury Department and the IRS were concerned about whether the IRS had statutory authority to pay interest on arbitrage rebate payments. To permit a refund in an amount calculated in whole or in part based upon a future value of the amount actually paid would effectively result in an interest payment on that payment.

Example 2(iii)(D) in §1.148–3(j) of the Existing Regulations has caused confusion because it could be interpreted to mean that an issuer can receive a refund of a rebate payment when the future value of such rebate payment exceeds the rebate amount on the next computation date, even though the actual amount of the previous rebate payment does not exceed the rebate amount on that next computation date. The Proposed Regulations make a technical amendment to this example to conform this example to the intended purpose of §1.148–3(i)(1). Because the proposed change does not change the regulatory rule, but merely makes an existing example conform to that rule, the Proposed Regulations provide that the effective date for this provision is the same as the effective date for the regulatory rule. However, the IRS will not reopen rebate re-

fund claims that have been processed before the date the Proposed Regulations are published in the **Federal Register**.

E. *Other Miscellaneous Changes*

1. *Qualified Hedge Provisions.*

The Proposed Regulations make the following additional changes to the hedging rules in §1.148–4(h) and specifically seek the following comments on the hedging rules.

a. *Cost of Funds Hedges*. The Proposed Regulations clarify that for purposes of applying the definition of periodic payment under §1.446–3(e)(1) to determine whether a hedge has a significant investment element under §1.148–4(h)(2)(ii)(A), a "specified index" under §1.446–3(c)(2) (upon which periodic payments are based) is deemed to include payments under a cost-of-funds swap, thereby eliminating any doubt that these hedges can be qualified hedges.

b. *Size and Scope of a Qualified Hedge*. The Proposed Regulations add an express requirement under §1.148–4(h)(2)(v) that limits the size and scope of a qualified hedge to a level that is reasonably necessary to hedge the issuer's risk with respect to interest rate changes on the hedged bonds. This proposed limitation is comparable to a former provision that was in the arbitrage regulations from 1993 to 1997, but was removed in connection with 1997 amendments to the Existing Regulations. The Treasury Department and the IRS believe that this principle was implicitly carried forward in the subsidiary standards under the interest-based contract requirement in the Existing Regulations in 1997. The Proposed Regulations, however, provide an explicit separate requirement to clarify the continued application of this principle.

c. *Correspondence of Payments for Simple Integration*. Commentators have requested guidance on what time period satisfies the rule under §1.148–4(h)(2)(vi) that requires payments on a hedge to correspond closely in time to the payments on the hedged bonds. The Proposed Regulations add a rule for simple integration that treats payments as corresponding closely in time for this purpose if the payments are made within 60 calendar days of each other. This proposed rule contrasts with the rules for super integration, which require that payments be made within 15 days of each other. The Proposed Regulations provide a more flexible time period for correspondence of payments for simple integration purposes consistent with the fact that simple integration results in more accurate accounting for all net payments.

d. *Time for Identification of Qualified Hedges*. Commentators have indicated that the three-day period for identifying a hedge under §1.148–4(h)(2)(viii) of the Existing Regulations raises practical difficulties, particularly with respect to hedges that are not entered into contemporaneously with the issuance of the hedged bonds. The Proposed Regulations extend the time in §1.148–4(h)(2)(viii) for when an issuer must identify a qualified hedge from three days to fifteen days and clarify that these are calendar days. The Proposed Regulations, however, retain the requirement that the actual State or local governmental issuer, rather than the conduit borrower, identify the hedge because the Treasury Department and the IRS believe that it is important for State and local governments to be responsible for qualified hedges on their bonds.

e. *Termination of Hedges at Fair Market Value*. The Proposed Regulations clarify that under §1.148–4(h)(3)(iv)(B), the termination payment for a termination or a deemed termination is equal to the fair market value of the hedge on the termination date.

f. *Solicitation of Comment on Offsetting Hedges*. The Treasury Department and the IRS have received requests for clarification of the scope of the rule that treats offsetting hedges as deemed terminations of qualified hedges under §1.148–4(h)(3)(iv)(A). The Treasury Department and the IRS seek express public comment regarding the types of offsetting hedges that are necessary for valid business purposes and recommendations on how to clarify the scope of this rule on offsetting hedges.

2. *Yield Reduction Payment Rules.*

The Proposed Regulations permit issuers to make yield reduction payments for nonpurpose investments allocable to proceeds of an issue, including an advance refunding issue, that an issuer purchases on a date when the issuer is unable to purchase State and Local Government Series Securities (SLGS) because the Department of Treasury, Bureau of Public Debt, has suspended sales of SLGS. This provision incorporates and expands Revenue Procedure 95–47, 1995–2 C.B. 417, which permits yield reduction payments in more limited situations than the Proposed Regulations when SLGS are unavailable.

The Proposed Regulations also reorganize the yield reduction rules to make them easier to read.

3. *Modification of Yield Computation for Yield-to-Call Premium Bonds.*

The Proposed Regulations simplify the rules for computing yield on an issue that has certain callable premium bonds. Existing Regulations generally provide that the yield on an issue is based on the yield to maturity, taking into account certain assumptions. The Existing Regulations have a special rule for certain callable bonds issued with significant amounts of bond premium (sometimes called yield-to-call bonds), which requires a determination of yield to a call date, based on certain assumed optional redemptions. The general purpose of this rule is to recognize that a yield-to-maturity computation may not be economically accurate in this circumstance because these yield-to-call bonds are more likely than other bonds to be called before maturity and before amortization of the premium.

Section 1.148–4(b)(3)(i) of the Existing Regulations treats a yield-to-call bond as redeemed at the stated redemption price on the optional redemption date that would produce the lowest yield on the *issue* (as contrasted with the lowest yield on the particular premium bond). This methodology, which considers the lowest yield on the issue for these yield-to-call bonds, requires computations of possible combinations of redemption dates in circumstances in which the variations of redemption dates may have very limited impact on yield.

The Proposed Regulations simplify the yield calculations for these yield-to-call bonds to focus on the redemption date that results in the lowest yield on the particular premium bond (rather than the more complex existing focus on the lowest yield on the issue). This change corresponds to a former version of this regulatory rule which was in effect under applicable arbitrage regulations from 1989 through 1992.

4. *Arbitrage Rebate Computation Credit.*

Section 1.148–3(d)(1)(iv) of the Existing Regulations provides that an issuer

may take certain credits against payment of arbitrage rebate in the amount of $1,000 for each rebate computation date, subject to certain limitations, to help offset the cost of computing rebate. The Proposed Regulations increase this rebate credit to $1,400 for any bond year ending in the year 2007 to reflect the change in the Consumer Price Index since the $1,000 rebate credit was published. The Proposed Regulations further adjust the computation date credit for inflation for bond years ending in each year thereafter.

5. *External Commingled Investment Funds*.

The Existing Regulations provide certain preferential rules for the treatment of administrative costs to certain widely-held "external commingled funds," as defined in §1.148–5(e)(2)(ii)(B). Under the Existing Regulations, a fund is treated as widely held if the fund, on average, has more than 15 unrelated investors each of which maintains prescribed minimum average investments in the fund. The Proposed Regulations make a technical change to allow additional smaller investors to invest in an external commingled fund without disqualifying the fund so long as at least 16 unrelated investors each maintain the required minimum average investments in the fund.

6. *Pooled Bonds*.

The Proposed Regulations make conforming changes to §1.148–8(d) to reflect legislative changes made to section 148(f)(4)(D) by section 508 of the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109–222, 120 Stat. 345 (TIPRA). Under TIPRA, Congress eliminated the rule in §148(f)(4)(D)(ii)(II) that permitted a pool bond issuer to ignore its pool bond issue in computing whether it had exceeded its $5 million limit for purposes of the small issuer rebate exception of section 148(f)(4)(D). Correspondingly, the Proposed Regulations eliminate the provisions in the Existing Regulations that permit a pool bond issuer to ignore the amount of its pool bond issue in determining whether the issuer meets the small issuer exception of section 148(f)(4)(D). The Proposed Regulations retain the provision that permits a State or local governmental conduit borrower to ignore the amount of certain pool bond issues in excess of the amount it borrows from that pool. Consistent with the statutory change, the Proposed Regulations provide that the change for pool bond issuers is effective for bonds issued after May 17, 2006, the effective date of the relevant provision of TIPRA.

III. *Effective Dates*

The Proposed Regulations are proposed to apply to bonds sold on or after a date that is 90 days after publication of final regulations in the **Federal Register**, but an issuer may apply certain specified provisions of the Proposed Regulations to bonds sold before the date that is 90 days after publication of the final regulations in the Federal Register as provided in proposed §1.148–11(k). Except for the changes to the qualified hedging rules which must be applied in their entirety, issuers that are permitted, but not required, to apply the proposed changes may apply some or all of the changes to a bond issue.

The Proposed Regulations contain a technical amendment to the example in the general arbitrage rebate rules. This change applies to bonds subject to §1.148–3(i), the dates of applicability for which are set forth in the Existing Regulations.

The Proposed Regulations contain a special effective date provision for the regulatory change that conforms the arbitrage regulations to the legislative change made to the small issuer rebate exception for pooled bond issuers. This change applies to bonds issued after May 17, 2006, the effective date of the relevant provision of TIPRA.

Effect On Other Documents

On the date of applicability of the final regulations, Revenue Procedure 95–47, 1995–2 C.B. 417, will be obsoleted.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Some of the proposed changes clarify existing regulatory provisions, conform the regulations to a recent statutory change, or otherwise involve simplifying or clarifying changes that will not have a significant economic impact on governmental jurisdictions or other entities of any size. Other proposed changes involve the treatment of certain hedging transactions, such as interest rate swaps, for purposes of the arbitrage investment restrictions on tax-exempt bonds issued by State and local governments. Although there is a lack of available data regarding the extent of usage of these hedging transactions by small entities, the IRS and the Treasury Department understand that these hedging transactions are used primarily by larger State and local governments and other eligible larger entities. The IRS and the Treasury Department specifically solicit comment from any party, particularly affected small entities, on the accuracy of this certification. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Small Business Administration for comment on its impact on small governmental jurisdictions.

Comments and Public Hearing

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

A public hearing has been scheduled for January 30, 2008 at 10 a.m. in the Main IRS Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by January 2, 2008. A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Rebecca L. Harrigal and Carla A. Young, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Sections 1.148–0, 1.148–3, 1.148–4, 1.148–5, 1.148–8 and 1.148–11 also issued under 26 U.S.C. 148(i).

Par. 2. Section 1.148–0(c) is amended as follows:

1. Add entry for new paragraph (d)(4) in the table of contents for §1.148–3.

2. Revise entry for paragraph (d) in the table of contents for §1.148–8.

3. Remove entries for paragraph (d)(1) and paragraph (d)(2) in the table of contents for §1.148–8.

4. Add entries for new paragraphs (k), (k)(1), (k)(2), (k)(3) and (k)(4) in the table of contents for §1.148–11.

The revised and added provisions read as follows:

§1.148–0 Scope and Table of Contents.

* * * * *

§1.148–3 General arbitrage rebate rules.

* * * * *

(d) * * *

(4) Cost-of living adjustment.

* * * * *

§1.148–8 Small issuer exception to rebate requirement.

* * * * *

(d) Pooled financings — treatment of conduit borrowers.

* * * * *

§1.148–11 Effective dates.

* * * * *

(k) Certain arbitrage guidance updates.

(1) In general.

(2) Permissive earlier application.

(3) Rebate overpayment recovery.

(4) Small issuer exception to rebate requirement for conduit borrowers of pooled financings.

* * * * *

Par. 3. Section 1.148–3 is amended by revising paragraph (d)(1)(iv) and adding a new paragraph (d)(4) as follows:

§1.148–3 General arbitrage rebate rules.

* * * * *

(d) * * *

(1) * * *

(iv) On the last day of each bond year during which there are amounts allocated to gross proceeds of an issue that are subject to the rebate requirement, and on the final maturity date, a computation credit of $1,400 for any bond year ending in 2007 and, for bond years ending after 2007, a computation credit in the amount determined under paragraph (d)(4) of this section; and

* * * * *

(4) *Cost-of-living adjustment.* For any calendar year after 2007, the $1,400 computation credit set forth in paragraph (d)(1)(iv) shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such year as modified by this paragraph (d)(4). In applying section 1(f)(3) to determine this cost-of-living adjustment, the reference to "calendar year 1992" in section 1(f)(3)(B) shall be changed to "calendar year 2006." If any such increase determined under this paragraph (d)(4) is not a multiple of $10, such increase shall be rounded to the nearest multiple thereof.

* * * * *

Par. 4. Section 1.148–3(j) is amended by revising *Example 2*(iii)(D) to read as follows:

§1.148–3 General arbitrage rebate rules.

* * * * *

(j) * * *

Example 2. * * *

(iii) * * *

(D) If the yield during the second computation period were, instead, 7.0000 percent, the rebate amount computed as of July 1, 2004, would be $1,320,891. The future value of the payment made on July 1, 1999, would be $1,471,007. Although the future value of the payment made on July 1, 1999 ($1,471,007), exceeds the rebate amount computed as of July 1, 2004 ($1,320,891), §1.148–3(i) limits the amount recoverable as a defined overpayment of rebate under section 148 to the excess of the total "amount paid" over the sum of the amount determined under the future value method to be the "rebate amount" as of the most recent computation date and all other amounts that are otherwise required to be paid under section 148 as of the date the recovery is requested. Because the total amount that the issuer paid on July 1, 1999 ($1,042,824.60), does not exceed the rebate amount as of July 1, 2004 ($1,320,891), the issuer would not be entitled to recover any overpayment of rebate in this case.

* * * * *

Par. 5. Section 1.148–4(a) is revised to read as follows:

§1.148–4 Yield on an issue of bonds.

(a) *In general.* The yield on an issue of bonds is used to apply investment yield restrictions under section 148(a) and to compute rebate liability under section 148(f). Yield is computed under the economic accrual method using any consistently applied compounding interval of not more than one year. A short first compounding interval and a short last compounding interval may be used. Yield is expressed

as an annual percentage rate that is calculated to at least four decimal places (for example, 5.2525 percent). Other reasonable, standard financial conventions, such as the 30 days per month/360 days per year convention, may be used in computing yield but must be consistently applied. The yield on an issue that would be a purpose investment (absent section 148(b)(3)(A)) is equal to the yield on the conduit financing issue that financed that purpose investment.

* * * * *

Par. 6. Section 1.148–4 is amended by:

1. Revising paragraph (b)(3)(i), and adding a new sentence at the end of paragraph (h)(2)(ii)(A).

2. Revising the heading and introductory text of paragraph (h)(2)(v).

3. Amending paragraph (h)(2)(v)(B) by revising the last sentence.

4. Adding paragraphs (h)(2)(v)(B)(*1*), (*2*) and (*3*).

5. Adding a new sentence at the end of paragraph (h)(2)(vi).

6. Revising the heading and first sentence of paragraph (h)(2)(viii).

7. Amending paragraph (h)(3)(iv)(B) by adding a new sentence immediately after the first sentence.

8. Adding a new sentence at the end of paragraph (h)(4)(i)(C).

The revised and added provisions read as follows:

§1.148–4 Yield on an issue of bonds.

* * * * *

(b) * * *

(3) *Yield on certain fixed yield bonds subject to optional early redemption*—(i) *In general.* If a fixed yield bond is subject to optional early redemption and is described in paragraph (b)(3)(ii) of this section, the yield on the issue containing the bond is computed by treating the bond as redeemed at its stated redemption price on the optional redemption date that would produce the lowest yield on that bond.

* * * * *

(h) * * *

(2) * * *

(ii) * * * (A) * * * For purposes of applying the definition of periodic payment under §1.446–3 to determine whether a hedge has a significant investment element under this paragraph (h)(2)(ii)(A), the definition of "specified index" under §1.446–3 (upon which periodic payments are required to be based) is deemed also to include payments an issuer receives under a hedge that are computed to be equal to the issuer's cost of funds, such as the issuer's actual market-based tax-exempt variable interest rate on its bonds.

* * * * *

(v) *Interest-based contract and size and scope of hedge.* The contract is primarily interest-based (for example, a hedge based on a debt index rather than an equity index). In addition, the size and scope of the hedge under the contract is limited to that which is reasonably necessary to hedge the issuer's risk with respect to interest rate changes on the hedged bonds. For example, a contract is limited to hedging an issuer's risk with respect to interest rate changes on the hedged bonds if the hedge is based on the issuer's principal amount of bonds and reasonably expected interest requirements rather than based on a greater notional amount or an interest rate level greater than the expected interest requirements. A contract is not primarily interest based unless —

* * * * *

(B) * * * For this purpose, differences that would not prevent the resulting bond from being substantially similar to another type of bond or to result in overhedging include:

(*1*) A difference between the interest rate used to compute payments on the hedged bond and the interest rate used to compute payments on the hedge where one interest rate is substantially the same as, but not identical to, the other. For this purpose, if an interest rate swap under which the issuer pays the hedge provider a fixed interest payment and receives from the hedge provider a floating interest rate that is based on a taxable interest rate or a taxable market interest rate index, the floating rate on the hedge and the variable rate on the hedged bonds will be treated as being substantially the same only if:

(*i*) The difference between the interest rate on the issuer's hedged bonds and the floating interest rate on the hedge does not exceed one quarter of one percent (.25 percent, or 25 basis points) on the date that the issuer enters into the hedge; and

(*ii*) For a three-year period that ends on the date the issuer enters into the hedge, the average difference between the issuer's actual tax-exempt interest rate on comparable variable-rate bonds (or, if no such comparable bonds exist, rates from a reasonable tax-exempt interest rate index, such as the SIFMA Municipal Swap Index, for that same period) and interest rates determined in the same manner as the floating interest rate on the hedge and as of the same dates as the issuer's comparable variable-rate bonds (or the tax-exempt market index, if applicable) does not exceed one-quarter of one percent (.25 percent, or 25 basis points). For example, if the floating rate on the hedge is 67 percent of LIBOR, then 67 percent of LIBOR, determined as of the same dates as the issuer's actual interest rates (or tax-exempt market index, if applicable) is compared to those actual interest rates (or the tax-exempt market index, if applicable) for the three-year period ending on the date the hedge is entered into and the differences are averaged to determine whether the average difference exceeds one-quarter of one percent. For this purpose, a reasonable sample may be used if the sample for the issuer's actual rates (or tax-exempt market index rates, if applicable) and the sample of floating rates used for the hedge are determined as of the same dates.

(*2*) A difference resulting from the payment of a fixed premium for a cap (for example, payments for a cap that are made in other than level installments).

(*3*) A difference resulting from the allocation of a termination payment if the termination was unexpected as of the date that the parties entered into the hedge contract.

(vi) * * * For this purpose, such payments will be treated as corresponding closely in time under this paragraph (h)(2)(vi) if they are made within 60 calendar days of each other.

* * * * *

(viii) *Reasonably contemporaneous identification.* The contract must be identified by the actual issuer on its books and records maintained for the hedged bonds not later than 15 calendar days after the date on which the issuer and the hedge provider enter into the hedge contract.

* * *

(3) * * *

(iv) * * *

(B) * * * The amount of the termination payment in a termination or deemed termination is equal to the fair market value of the qualified hedge on the date of the termination.* * *

* * * * *

(4) * * *

(i) * * *

(C) * * * Except for an anticipatory hedge that is terminated or otherwise closed substantially contemporaneously with the hedged bond in accordance with paragraph (h)(5)(ii) or (h)(5)(iii) of this section, a hedge based on a taxable interest rate or taxable interest index (for example, the London Interbank Offered Rate or LIBOR) does not meet the requirements of this paragraph (C).

* * * * *

Par. 7. Section 1.148–5(c) is amended by:

1. Removing existing paragraph (c)(3)(ii).

2. Adding introductory language to paragraph (c)(3).

3. Removing the heading in paragraph (c)(3)(i) and redesignating the existing text in paragraph (c)(3)(i)(A) as the text in paragraph (c)(3)(i).

4. Redesignate existing paragraphs (c)(3)(i)(B), (c)(3)(i)(C), (c)(3)(i)(D), (c)(3)(i)(E), (c)(3)(i)(F), and (c)(3)(i)(G) as paragraphs (c)(3)(ii), (c)(3)(iii), (c)(3)(iv), (c)(3)(v), (c)(3)(vi), and (c)(3)(vii), respectively.

5. Redesignate existing paragraphs (c)(3)(i)(C)(*1*) and (c)(3)(i)(C)(*2*) as paragraphs (c)(3)(iii)(A) and (c)(3)(iii)(B), respectively, in newly redesignated paragraph (c)(3)(iii).

6. Redesignate existing paragraphs (c)(3)(i)(E)(*1*) and (c)(3)(i)(E)(*2*) as paragraphs (c)(3)(v)(A) and (c)(3)(v)(B), respectively, in newly redesignated paragraph (c)(3)(v).

7. Amend newly redesignated paragraph (c)(3)(i), (c)(3)(ii), (c)(3)(iii), (c)(3)(iv), (c)(3)(v), (c)(3)(vi) and (c)(3)(vii) by adding headings to each paragraph.

8. Revise newly redesignated paragraph (c)(3)(v).

9. Revise newly redesignated paragraph (c)(3)(vi).

10. Amend newly redesignated paragraph (c)(3)(vii) by removing the period at the end of the paragraph and replacing it with a semicolon.

11. Amending paragraph (c)(3) by adding new paragraphs (c)(3)(viii) and (c)(3)(ix).

The revised and added provisions read as follows:

§1.148–5 Yield and valuation of investments.

* * * * *

(c) * * *

(3) *Applicability of special yield reduction rule*. Except as otherwise expressly provided in paragraphs (c)(3)(i) through (ix) of this section, paragraph (c) applies only to investments listed in paragraphs (c)(3)(i) through (c)(3)(ix) of this section that are allocated to proceeds of an issue other than gross proceeds of an advance refunding issue.

(i) *Nonpurpose investments allocated to proceeds of an issue that qualified for certain temporary periods*. * * *

(ii) *Investments allocable to certain variable yield issues*. * * *

(iii) *Nonpurpose investments allocable to certain transferred proceeds*. * * *

(A) * * *

(B) * * *

(iv) *Purpose investments allocable to certain qualified student loans*. * * *

(v) *Nonpurpose investments allocable to gross proceeds in certain reserve funds*. Nonpurpose investments allocable to gross proceeds of an issue in a reasonably required reserve or replacement fund or a fund that, except for its failure to satisfy the size limitation in §1.148–2(f)(2)(ii), would qualify as a reasonably required reserve or replacement fund, but only to the extent the requirements in paragraphs (c)(3)(v)(A) or (B) of this section are met. This paragraph (c)(3)(v) includes nonpurpose investments described in this paragraph that are allocable to transferred proceeds of an advance refunding issue, but only to the extent necessary to satisfy yield restriction under section 148(a) on those proceeds treating all investments allocable to those proceeds as a separate class.

(A) * * *

(B) * * *

(vi) *Nonpurpose investments allocable to certain replacement proceeds of refunded issues*. Nonpurpose investments allocated to replacement proceeds of a refunded issue, including a refunded issue that is an advance refunding issue, as a result of the application of the universal cap to amounts in a refunding escrow;

(vii) *Investments allocable to replacement proceeds under a certain transition rule*. * * *

(viii) *Nonpurpose investments allocable to proceeds when SLGS are unavailable*. Nonpurpose investments allocable to proceeds of an issue, including an advance refunding issue, that an issuer purchases on a date when the issuer is unable to purchase State and Local Government Series Securities (SLGS) because the U.S. Department of Treasury, Bureau of Public Debt, has suspended sales of those securities; and

(ix) *Nonpurpose investments allocable to proceeds of certain variable-yield advance refunding issues*. Nonpurpose investments allocable to proceeds of a variable-yield advance refunding issue (the hedged bond issue) deposited in a yield restricted defeasance escrow if—

(A) The issuer has entered into a qualified hedge under §1.148–4(h)(2) with respect to all of the variable-yield bonds of the issue allocable to the yield restricted defeasance escrow and that hedge is in the form of a variable-to-fixed interest rate swap under which the issuer pays the hedge provider a fixed interest rate and receives from the hedge provider a floating interest rate;

(B) Such qualified hedge covers a period beginning on the issue date of the hedged bond issue and ending on or after the date on which the final payment is to be made from the yield restricted defeasance escrow; and

(C) The issuer restricts the yield on the yield restricted defeasance escrow to a yield that is not greater than the yield on the hedged bond issue, determined by taking into account the issuer's fixed payments to be made under the hedge and by assuming that the issuer's variable yield payments to be paid on the hedged bonds are equal to the floating payments to be received by the issuer under the qualified hedge and are paid on the same dates (that is, such yield reduction payments can only be made to address basis risk differences between the variable yield payments on the hedged bonds and the floating payments received on the hedge).

* * * * *

Par. 8. Section 1.148–5(d)(6) is amended by revising paragraphs (d)(6)(iii)(A)(*1*) and (d)(6)(iii)(A)(*6*) to read as follows:

§1.148–5 Yield and valuation of investments.

* * * * *

(d) * * *

(6) * * *

(iii) * * *

(A) * * *

(*1*) The bid specifications are in writing and are timely forwarded, or are made available on an internet website or other similar electronic media that is regularly used to post bid specifications, to potential bidders. For purposes of this paragraph (d)(6)(iii)(A), a writing includes a hard copy, a fax, or an electronic email copy.

* * * * *

(*6*) All potential providers have an equal opportunity to bid. If the bidding process affords any opportunity for a potential provider to review other bids before providing a bid, then providers have an equal opportunity to bid only if all potential providers have an equal opportunity to review other bids. Thus, no potential provider may be given an opportunity to review other bids that is not equally given to all potential providers (that is, no exclusive "last look").

* * * * *

Par. 9. Section 1.148–5(e)(2) is amended by revising the second sentence of paragraph (e)(2)(ii)(B) to read as follows:

§1.148–5 Yield and valuation of investments.

* * * * *

(e) * * *

(2) * * *

(ii) * * *

(B) *External commingled funds.* * * * For purposes of this paragraph (e)(2)(ii)(B), a fund is treated as widely held only if, during the immediately preceding fixed, semiannual period chosen by the fund (for example, semiannual periods ending June 30 and December 31), the fund had a daily average of more than 15 investors that were not related parties, and at least 16 of the unrelated investors each maintained a daily average amount invested in the fund that was not less than the lesser of $500,000 and one percent (1%) of the daily average of the total amount invested in the fund (with it being understood that additional smaller investors will not disqualify the fund). * * *

* * * * *

Par. 10. Section 1.148–8(d) is revised to read as follows:

§1.148–8 Small Issuer Exception to Rebate Requirement.

* * * * *

(d) *Pooled financings — treatment of conduit borrowers.* A loan to a conduit borrower in a pooled financing qualifies for the small issuer exception, regardless of the size of either the pooled financing or of any loan to other conduit borrowers, only if—

(1) The bonds of the pooled financing are not private activity bonds;

(2) None of the loans to conduit borrowers are private activity bonds; and

(3) The loan to the conduit borrower meets all the requirements of the small issue exception.

* * * * *

Par. 11. Section 1.148–11 is revised by adding new paragraph (k) as follows:

§1.148–11 Effective Dates.

* * * * *

(k) *Certain arbitrage guidance updates.*

(1) *In general.* Sections 1.148–3(d)(1)(iv); 1.148–3(d)(4); 1.148–4(a); 1.148–4(b)(3)(i); 1.148–4(h)(2)(ii)(A); 1.148–4(h)(2)(v); 1.148–4(h)(2)(vi); 1.148–4(h)(2)(viii); 1.148–4(h)(3)(iv)(B); 1.148–4(h)(4)(i)(C); 1.148–5(c)(3); 1.148–5(d)(6)(iii)(A) and 1.148–5(e)(2)(ii)(B), as in effect on the effective date of the final regulations (the revised provisions), apply to bonds sold on or after the date that is 90 days after publication of the final regulations in the **Federal Register**, for bonds subject to such applicable section of the regulations as in effect before the effective date of the final regulations.

(2) *Permissive earlier application.* To the extent provided in paragraphs (k)(2)(i) through (vi) of this section, issuers may apply the proposed regulations to bonds sold before the date that is 90 days after publication of the final regulations in the **Federal Register**.

(i) Section 1.148–3(d)(1)(iv) and §1.148–3(d)(4) may be applied for bond years ending on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which 1.148–3(d)(1)(iv) applies.

(ii) Section 1.148–4(b)(3)(i) may be applied for bonds sold on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which that section applies.

(iii) Sections 1.148–4(h)(2)(ii)(A), 1.148–4(h)(2)(v), 1.148–4(h)(2)(vi), 1.148–4(h)(2)(viii), 1.148–4(h)(3)(iv)(B), and 1.148–4(h)(4)(i)(C) may be applied, in whole but not in part, for qualified hedges entered into on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which §1.148–4(h) applies.

(iv) Section 1.148–5(c)(3) may be applied for investments purchased on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which that section applies.

(v) Section 1.148–5(d)(6)(iii)(A) may be applied to guaranteed investment contracts entered into on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which §1.148–5(d)(6)(iii) applies.

(vi) Section 1.148–5(e)(2)(ii)(B) may be applied with respect to investors investing in the fund on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which that section applies.

(3) *Rebate overpayment recovery.* Section 1.148–3(j) applies to bonds subject to §1.148–3(i).

(4) *Small issuer exception to rebate requirement for conduit borrowers of pooled financings.* Section 1.148–8(d) applies to bonds issued after May 17, 2006.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 24, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2007, 72 F.R. 54606)

Notice of Proposed Rulemaking

Patented Transactions

REG–129916–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide rules relating to the disclosure of reportable transactions under sections 6011 and 6111 of the Internal Revenue Code (Code). These regulations propose to add the patented transactions category of reportable transaction to the regulations under §1.6011–4 of the Income Tax Regulations. The regulations also include conforming changes to the rules relating to the disclosure of reportable transactions by material advisors under section 6111. The regulations affect taxpayers participating in reportable transactions under section 6011, material advisors responsible for disclosing reportable transactions under section 6111, and material advisors responsible for keeping lists under section 6112.

DATES: Written or electronic comments and requests for a public hearing must be received by December 26, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–129916–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–129916–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–129916–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Michael H. Beker or Charles D. Wien, (202) 622–3070; concerning the submissions of comments and requests for hearing, Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov* or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document proposes to amend 26 CFR parts 1 and 301 by adding the patented transactions category of reportable transaction to the rules under section 6011 and by making conforming changes to the rules relating to the disclosure of reportable transactions by material advisors under section 6111.

On November 1, 2006, the IRS and Treasury Department issued a notice of proposed rulemaking and temporary and final regulations under sections 6011, 6111, and 6112 (REG–103038–05, 2006–49 I.R.B. 1049, REG–103039–05, 2006–49 I.R.B. 1057, REG–103043–05, 2006–49 I.R.B. 1063, T.D. 9295, 2006–49 I.R.B. 1030) (the November 2006 regulations). The November 2006 regulations were published in the **Federal Register** (71 FR 64488, 71 FR 64496, 71 FR 64501, 71 FR 64458) on November 2, 2006. In the preamble to those proposed regulations, the IRS and Treasury Department expressed concern, shared by many commentators, regarding the patenting of tax advice or tax strategies that have the potential for tax avoidance. A patent for tax advice or a tax strategy might be interpreted by taxpayers as approval by the IRS and Treasury Department of the transaction, which might impede the efforts of the IRS and Treasury Department to obtain information regarding tax avoidance transactions and have an impact on effective tax administration. Consequently, the IRS and Treasury Department requested comments regarding the creation of a new category of reportable transaction to address these concerns.

The IRS and Treasury Department received written public comments responding to the proposed regulations and held a public hearing regarding the proposed rules on March 20, 2007. After consideration of the comments received, the IRS and Treasury Department are issuing these proposed regulations with respect to patented transactions. Upon publication of final regulations, these regulations will be effective for transactions entered into on or after the date of publication of this notice of proposed rulemaking.

Explanation of Provisions

In response to the request for comments, the IRS and Treasury Department received five comments regarding the creation of a new category of reportable transaction to address the patenting of tax advice or tax strategies. One commentator suggested that the patenting of tax advice or tax strategies should not be addressed through the addition of a new category of reportable transaction. The commentator suggested that the IRS should require a form of notification or have a disclosure requirement informing the IRS when the United States Patent and Trademark Office (USPTO) issues a tax strategy patent. The commentator suggested that this could be accomplished through cooperation between the IRS and the USPTO. To the extent cooperation does not result in the necessary disclosures, the commentator suggested that the current reportable transaction regime or another mechanism could provide the necessary notifications and disclosures.

One commentator suggested that the patenting of tax advice or tax strategies should be addressed through the transaction of interest category of reportable transaction under §1.6011–4(b)(6). The commentator suggested that each application for, or grant of a patent be automatically included within the scope of a transaction of interest, thereby requiring anyone who "participated" in the transaction to file a disclosure statement. In addition, the commentator suggested that the party who files an application for a patent, or for whom a patent is granted, be considered a material advisor, as defined in §301.6111–3(b) of the Procedure and Administration Regulations. The commentator noted that treating the patent applicant or holder as a material advisor would obligate that party to file a disclosure statement under §301.6111–3 and also to maintain an investor list under §301.6112–1. Further, the commentator proposed that each material advisor should be required to disclose to each taxpayer on that material advisor's list of investors that the transaction is a transaction of interest and that the taxpayer is required to disclose the transaction.

Two commentators suggested the creation of a new category of reportable transaction for taxpayers who participate

in a transaction that uses a patented tax strategy for each year in which the taxpayer's return reports items attributable to such transaction. The two commentators both suggested treating the patent holder as a material advisor within the meaning of section 6111. One of the two commentators suggested lowering the gross income threshold amounts for material advisors in §301.6111–3(b)(3). One of the commentators recommended that a material advisor should only include the owner of the patent and advisors who pay fees directly or indirectly for the patented tax strategy or advice. This commentator also recommended that the disclosure obligations be narrowly construed so as not to apply to those taxpayers and material advisors who implement patented tax strategies and provided advice without any knowledge that the tax strategy or advice has been patented.

Another commentator also recommended limiting the scope of a category of reportable transaction for patents so that the category applies only to those taxpayers and material advisors who have a legal right to use the patented tax strategy or tax advice. Finally, commentators recommended excluding from the category of reportable transaction the use of patented tax methods or processes for complying with return preparation and filing and other administrative requirements.

After careful consideration of the comments received, the IRS and Treasury Department continue to be concerned about the patenting of tax advice or tax strategies and believe that adding a new category of reportable transaction to the section 6011 regulations for patented transactions will assist the IRS and Treasury Department in obtaining disclosures of tax avoidance transactions and in providing effective tax administration. Under the new category of reportable transactions, the "patented transaction" is a transaction for which a taxpayer pays (directly or indirectly) a fee in any amount to a patent holder or the patent holder's agent for the legal right to use a tax planning method that the taxpayer knows or has reason to know is the subject of the patent. A patented transaction also is a transaction for which a taxpayer (the patent holder or the patent holder's agent) has the right to payment for another person's use of a tax planning method that is the subject of the patent.

The proposed regulations exclude mathematical calculations or mechanical assistance in the preparation of tax returns from the patented transaction category of reportable transactions. Thus, a patented transaction does not include patent-protected tax preparation software or other tools used to perform or model mathematical calculations or to provide mechanical assistance in the preparation of tax or information returns.

For purposes of the new patented transaction category, a taxpayer has participated in a patented transaction if the taxpayer's tax return reflects a tax benefit from the transaction (including a deduction for fees paid in any amount to the patent holder or patent holder's agent). A taxpayer also has participated in a patented transaction if the taxpayer is the patent holder or patent holder's agent and the taxpayer's tax return reflects a tax benefit in relation to obtaining a patent for a tax planning method (including any deduction for amounts paid to the United States Patent and Trademark Office as required by title 35 of the United States Code and attorney's fees) or reflects income from a payment received from another person for the use of the tax planning method that is the subject of the patent.

These regulations also describe when a person is a material advisor with respect to a patented transaction under section 6111. Because of the nature of patented transactions and how those transactions are marketed, the threshold amount as described in section 6111(b) is reduced from $50,000 to $250 and from $250,000 to $500. A person who is a material advisor with respect to a patented transaction will have a list maintenance obligation under section 6112.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that 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. This certification is based on the fact that most information is already required to be reported on the disclosure statement referenced in the regulation and approved under OMB control number 1545–0074; the new information required by these proposed regulations add little or no new burden to the existing requirements. Therefore, a Regulatory Flexibility Analysis under the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

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

Drafting Information

The principal authors of these regulations are Michael H. Beker and Charles D. Wien, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.6011–4 is amended by:

1. Revising paragraphs (b)(7) and (c)(3)(i)(F).

2. Adding to paragraph (c)(3)(ii) *Examples 4*, *5*, *6*, and *7*.

3. Revising paragraph (h)(2).

The revisions and additions read as follows:

§1.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

* * * * *

(b) * * *

(7) *Patented transactions*—(i) *In general*. A patented transaction is a transaction for which a taxpayer pays (directly or indirectly) a fee in any amount to a patent holder or the patent holder's agent for the legal right to use a tax planning method that the taxpayer knows or has reason to know is the subject of the patent. A patented transaction also is a transaction for which a taxpayer (the patent holder or the patent holder's agent) has the right to payment for another person's use of a tax planning method that is the subject of the patent.

(ii) *Definitions*. For purposes of this paragraph (b)(7), the following definitions apply:

(A) *Fee*. The term *fee* means consideration in whatever form paid, whether in cash or in kind, for the right to use a tax planning method that is the subject of a patent. The term *fee* includes any consideration the taxpayer knows or has reason to know will be paid indirectly to the patent holder or patent holder's agent, such as through a referral fee, fee-sharing arrangement, or license. The term *fee* does not include amounts paid in settlement of, or as the award of damages in, a suit for damages for infringement of the patent.

(B) *Patent*. The term *patent* means a patent granted under the provisions of title 35 of the United States Code, or any foreign patent granting rights generally similar to those under a United States patent. See §1.1235–2(a). The term *patent* includes patents that have been applied for but not yet granted.

(C) *Patent holder*. A person is a patent holder if—

(*1*) The person is a holder as defined in §1.1235–2(d) and (e);

(*2*) The person would be a holder as defined in §1.1235–2(d)(2) if the phrase *S corporation or trust* was substituted for the word *partnership* and the phrase *shareholder or beneficiary* was substituted for the words *member* and *partner*;

(*3*) The person is an employer of a holder as defined in §1.1235–2(d) and the holder transferred to the employer all substantial rights to the patent as defined in §1.1235–2(b); or

(*4*) The person receives all substantial rights to the patent as defined in §1.1235–2(b) in exchange (directly or indirectly) for consideration in any form.

(D) *Patent holder's agent*. The term *patent holder's agent* means any person who has the permission of the patent holder to offer for sale or exchange, to sell or exchange, or to market a tax planning method that is the subject of a patent. The term *patent holder's agent* also means any person who receives (directly or indirectly) for or on behalf of a patent holder a fee in any amount for a tax planning method that is the subject of a patent.

(E) *Payment*. The term *payment* includes consideration in whatever form paid, whether in cash or in kind, for the right to use a tax planning method that is the subject of a patent. For example, if a patent holder or patent holder's agent receives payment for a patented transaction and a separate payment for another transaction, part or all of the payment for the other transaction may be treated as payment for the patented transaction if the facts and circumstances indicate that the payment for the other transaction is in consideration for the patented transaction. The term *payment* also includes amounts paid in settlement of, or as the award of damages in, a suit for damages for infringement of the patent.

(F) *Tax planning method*. The term *tax planning method* means any plan, strategy, technique, or structure designed to affect Federal income, estate, gift, generation skipping transfer, employment, or excise taxes. A patent issued solely for tax preparation software or other tools used to perform or model mathematical calculations or to provide mechanical assistance in the preparation of tax or information returns is not a tax planning method.

(iii) *Related parties*. For purposes of this paragraph (b)(7), persons who bear a relationship to each other as described in section 267(b) or 707(b) will be treated as the same person.

* * * * *

(c) * * *

(3) * * *

(i) * * *

(F) *Patented transactions*. A taxpayer has participated in a patented transaction, as defined in paragraph (b)(7) of this section, if the taxpayer's tax return reflects a tax benefit from the transaction (including a deduction for fees paid in any amount to the patent holder or patent holder's agent). A taxpayer also has participated in a patented transaction, as defined in paragraph (b)(7) of this section, if the taxpayer is the patent holder or patent holder's agent and the taxpayer's tax return reflects a tax benefit in relation to obtaining a patent for a tax planning method (including any deduction for amounts paid to the United States Patent and Trademark Office as required by title 35 of the United States Code and attorney's fees) or reflects income from a payment received from another person for the use of the tax planning method that is the subject of the patent.

* * * * *

(ii) * * *

Example 4. (i) A, an individual, creates a tax planning method and applies for a U.S. patent. A pays attorney fees in relation to obtaining the patent and A pays the fee required under title 35 of the United States Code for the patent application. Subsequently, C pays a fee to A for the legal right to use the tax planning method that C knows or has reason to know is the subject of A's patent. A's tax return reflects both a deduction for an amount paid in relation to obtaining a patent and income from C's payment to A for the legal right to use the tax planning method that is the subject of the patent. C's tax return reflects a deduction for an amount paid to A for the right to use the tax planning method that is the subject of the patent.

(ii) A is a patent holder under paragraph (b)(7)(ii)(C)(*1*) of this section. The transaction is a reportable transaction for A under paragraph (b)(7) of this section because A has the right to payment for another person's use of the tax planning method that is the subject of the patent. The transaction is a reportable transaction for C under paragraph (b)(7) of this section, because C paid a fee to A for the legal right to use a tax planning method that C knew or had reason to know was the subject of a patent. A has participated in the transaction in the year in which A's tax return reflects a tax benefit in relation to obtaining the patent or reflects income from C's payment to A for the legal right to use the tax planning method that is the subject of the patent.

C has participated in the transaction in the year in which C's tax return reflects the deduction for any amount paid to A for the legal right to use the tax planning method that is the subject of the patent. C also participates in the transaction for any years for which any other tax benefit from the transaction is reflected on C's tax return.

Example 5. (i) A, an individual, is the employee of B, a corporation. A creates a tax planning method and applies for a U.S. patent but B pays the fee required under title 35 of the United States Code for A's patent application. Pursuant to A's employment contract with B, B holds all substantial rights to the patent. B's tax return reflects a deduction for the amount paid in relation to obtaining the patent.

(ii) A and B are patent holders under paragraph (b)(7)(ii)(C)(*1*) and (*3*) of this section, respectively. The transaction is not a reportable transaction for A under paragraph (b)(7) of this section because A does not have the right to payment for another person's use of the tax planning method that is the subject of the patent. The transaction is a reportable transaction for B under paragraph (b)(7) of this section because B holds all substantial rights to the patent and has the right to payment for another person's use of the tax planning method that is the subject of the patent. B has participated in the transaction in the year in which B's tax return reflects a tax benefit in relation to obtaining the patent. B also participates in the transaction for any years for which B's tax return reflects income from a payment received from another person for the use of the tax planning method that is the subject of the patent.

Example 6. (i) Assume the facts as in *Example 4*, except that A agrees to license the patent to F, a financial institution. The license agreement between A and F provides that F may offer the tax planning method to its clients and if a client decides to use the tax planning method, F must pay A for each client's use of the tax planning method. F offers the tax planning method to G who uses the tax planning method and knows or has reason to know it is the subject of a patent. F charges G for financial planning services and pays A for G's use of the tax planning method. A's tax return reflects income from the payment received from F. F's tax return reflects income from the payment received from G, and G's tax return reflects a deduction for the fees paid to F.

(ii) F is a patent holder's agent under paragraph (b)(7)(ii)(D) of this section because F has the permission of the patent holder to offer for sale or exchange, to sell or exchange, or to market a tax planning method that is the subject of a patent. F also is a patent holder's agent under paragraph (b)(7)(ii)(D) of this section because F receives (directly or indirectly) a fee in any amount for a tax planning method that is the subject of a patent for or on behalf of a patent holder. The transaction is a reportable transaction for both A and F under paragraph (b)(7) of this section because A and F each have the right to payment for another person's use of the tax planning method that is the subject of the patent. The transaction is a reportable transaction for G under paragraph (b)(7) of this section because G paid a fee (directly or indirectly) to a patent holder or a patent holder's agent for the legal right to use a tax planning method that G knew or had reason to know was the subject of the patent. A has participated in the transaction in the years in which A's tax return reflects income from the payment received from F for G's use of the tax planning method that is the subject of the patent. F has participated in the transaction in the years in which F's tax return reflects income from the payment received from G for use of the tax planning method that is the subject of the patent. G has participated in the transaction in the years in which G's tax return reflects a deduction for the fees paid to F. G also participates in the transaction for any years for which any other tax benefit from the transaction is reflected on G's tax return.

Example 7. Assume the same facts as in *Example 4*. J uses a tax planning method that is the same as the tax planning method that is the subject of A's patent. J does not pay any fees to any patent holder or patent holder's agent with respect to the tax planning method that is the subject of the patent. A sues J for infringement of the patent and J pays A an amount for damages. A's tax return reflects as income the amounts for damages received from J. The transaction is not a reportable transaction for J under paragraph (b)(7) of this section because J did not pay any fees (as defined in paragraph (b)(7)(ii)(A) of this section) (directly or indirectly) to a patent holder or patent holder's agent for the legal right to use a tax planning method that J knew or had reason to know was the subject of the patent. A has participated in a reportable transaction under paragraph (b)(7) of this section in the year in which A's tax return reflects income from a payment (the amount received as an award for damages in a suit for damages for infringement of the patent) received from another person for the use of the tax planning method that is the subject of a patent.

* * * * *

(h) * * *

(2) *Patented transactions*. Upon the publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**, paragraphs (b)(7), (c)(3)(i)(F), and (c)(3)(ii) *Examples 4* through *7* of this section will apply to transactions entered into on or after September 26, 2007.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read, in part, as follows:

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

Par. 4. Section 301.6111–3 is amended by revising paragraphs (b)(2)(ii)(E), (b)(3)(i)(C), and (i)(2) to read as follows:

§301.6111–3 Disclosures of reportable transactions.

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(E) *Patented transactions*. A statement relates to a tax aspect of a transaction that causes it to be a patented transaction if the statement is made or provided by the patent holder or by the patent holder's agent, as defined in §1.6011–4(b)(7)(ii)(C) or (D) of this chapter, and concerns the tax planning method that is the subject of the patent.

* * * * *

(3) * * *

(i) * * *

(C) *Patented transactions*. For patented transactions described in §1.6011–4(b)(7) of this chapter, the threshold amounts in §301.6111–3(b)(3)(i)(A) are reduced from $50,000 to $250 and from $250,000 to $500.

* * * * *

(i) * * *

(2) *Patented transactions*. Upon the publication of the Treasury decision adopting these rules as final regulations in the Federal Register, paragraphs (b)(2)(ii)(E) and (b)(3)(i)(C) of this section will apply to transactions with respect to which a material advisor makes a tax statement on or after September 26, 2007.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 25, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2007, 72 F.R. 54615)

Section 67 Limitations on Estates or Trusts; Correction

Announcement 2007–95

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to notice of proposed rulemaking (REG–128224–06, 2007–36 I.R.B. 551) that was published in the **Federal Register** on Friday, July 27, 2007 providing guidance on which costs incurred by estates or non-grantor trusts are subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a).

FOR FURTHER INFORMATION CONTACT: Jennifer N. Keeney at (202) 622–3060.

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–128224–06) that is the subject of these corrections is under section 67 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–128224–06) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking (REG–128224–06) that was the subject of FR. Doc. E7–14489 is corrected as follows:

On page 41245, column 1, in the preamble, under the paragraph heading "Drafting Information", line 3, the language "of the Office of Associate Chief Counsel" is corrected to read "of the Associate Chief Counsel".

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

(Filed by the Office of the Federal Register on August 22, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 23, 2007, 72 F.R. 48248)

Public Inspection of Material Relating to Tax-Exempt Organizations; Correction

Announcement 2007–97

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to proposed regulations (REG–116215–07, 2007–38 I.R.B. 659) that amend existing regulations issued under sections 6104 and 6110. These regulations clarify rules relating to information that is made available by the IRS for public inspection under section 6104(a) and materials that are made publicly available under section 6110.

FOR FURTHER INFORMATION CONTACT: Mary Ellen Keys, (202) 622–4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–116215–07) that is the subject of these corrections are under sections 6110 and 6104(a) of the Internal Revenue Code.

Need for Correction

As published, this notice of proposed rulemaking (REG–116215–07) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking (REG–116215–07) that was the subject of FR. Doc. E7–15952 is corrected as follows:

1. On page 45394, column 2, in the preamble, under the caption heading "SUMMARY:", line 11 from the bottom of the paragraph, the language "denied or revoked an organization's tax" is corrected to read "denied or revoked an organization's tax-".

2. On page 45394, column 2, in the preamble, under the caption heading "ADDRESSES:", line 2 from the bottom of the column, the language "NW., Washington, DC, or sent" is corrected to read "NW., Washington, DC 20224, or sent".

3. On page 45394, column 3, in the preamble, under the paragraph heading "Background", paragraph 2, line 7, the language "tax exempt status from the public" is corrected to read "tax-exempt status from the public".

4. On page 45395, column 1, in the preamble, line 7 from the bottom of the first paragraph of the column, the language "public. See AOD 2004–02, 2004–29 IRB is corrected to read "See AOD 2004–2, 2004–29 I.R.B.".

5. On page 45395, column 1, in the preamble, under the paragraph heading "*Explanation of Provisions*", line 4 from the bottom of paragraph 1, the language "sections 509(a), 4942(j)(3), or 4943(f), is corrected to read "section 509(a), 4942(j)(3), or 4943(f),".

6. On page 45395, column 2, in the preamble, under the paragraph heading "*Other Changes to the Existing Regulations*", paragraph 6, line 3, the language "disclose, in response to or anticipation" is corrected to read "in response to or in anticipation".

7. On page 45395, column 2, in the preamble, under the paragraph heading "*Other Changes to the Existing Regulations*", paragraph 7, line 5 from the bottom of the column, the language "organizations whose tax exempt status" is corrected to read "organizations whose tax-exempt status".

§ 301.6104(a)–1 [Corrected]

8. On page 45396, column 2, § 301.6104(a)–1(c)(4), line 4, the language "organization described in sections" is corrected to read "organization described in section".

9. On page 45396, column 3, § 301.6104(a)–1(c)(2), line 4 from the bottom of the paragraph, the language "Procedure 2007–52, 2007–30 IRB 222, is corrected to read "Procedure 2007–52, 2007–30 I.R.B. 222,".

10. On page 45396, column 3, § 301.6104(a)–1(e)(3), line 4 from the bottom of the paragraph, the language "Procedure 80–27, 1980–1CB 677, and" is corrected to read "Procedure 80–27, 1980–1 C.B. 677, and".

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

(Filed by the Office of the Federal Register on September 25, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2007, 72 F.R. 54618)

Medical and Accident Insurance Benefits Under Qualified Plans; Correction

Announcement 2007–98

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to notice of proposed rulemaking (REG–148393–06, 2007–39 I.R.B. 714) that was published in the **Federal Register** on Monday, August 20, 2007 (72 FR 46421), regarding the tax treatment of payments by qualified plans for medical or accident insurance.

FOR FURTHER INFORMATION CONTACT: Pamela Kinard at (202) 622–6060.

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–148393–06) that is the subject of these corrections is under section 402(a) of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–148393–06) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking (REG–148393–06) that was the subject of FR. Doc. E7–16084 is corrected as follows:

1. On page 46423, column 3, in the preamble, under the paragraph heading "*Explanation of Provisions*", paragraph 2, lines 11 and 12, the language "to provide medical benefits in section 401(h) under a qualified plan or annuity" is corrected to read "to provide medical benefits in a section 401(h) account under a qualified plan or annuity".

2. On page 46424, column 1, in the preamble, under the paragraph heading "*Explanation of Provisions*", paragraph 3, line 22, the language "Public Lic 108–311" is corrected to read "Public Law 108–311".

§ 1.402(a)–1 [Corrected]

3. On page 46425, column 2, § 1.402(a)–1, lines 1 and 2, the language "(a) * * * (1) * * * (i) * * * " is corrected to read "(a) * * * (1)(i) * * * "

4. On page 46425, column 2, § 1.402(a)–1(a)(1)(ii), lines 3 and 4, the language "qualified pension, annuity, profit sharing, or stock bonus plan to provide" is corrected to read "qualified pension, annuity, profit-sharing, or stock bonus plan to provide."

5. On page 46425, column 2, § 1.402(a)–1(e), line 3, the language "profit sharing, or stock bonus plan—(1)" is corrected to read "profit-sharing, or stock bonus plan—(1)".

6. On page 46426, column 1, § 1.402(a)–1(e)(6), paragraph (ii) of *Example*., line 3, the language "the $1,000 constitutes a distribution under" is corrected to read "$1,000 constitutes a distribution under".

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

(Filed by the Office of the Federal Register on September 25, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2007, 72 F.R. 54614)

Foundations Status of Certain Organizations

Announcement 2007–99

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Absolute Beginnings, Inc., Gibson, NC
African Trade Center, Plano, TX
All Things Through Christ Ministries, Fresno, TX
American Institute of Research, Inc., McLean, VA
Avoyelles Parish Medical Society Association, Marksville, LA
Belize Musical Action Commission, Inc., Richmond, VA
Bethany Lutheran Ministries, Inc., Indianapolis, IN
Bethlehem Community Development Corporation, Inc., Osceola, AR
Beyond the Church Ministries, Kansas City, MO
Bibleway Community Outreach Center, Detroit, MI
Brotherhood of the Balloon, Inc., Mattapoisett, MA
BSR Racing Scholarship Fund, Inc., Port Orange, FL
Buddhist Society of Contemplative Living, Inc., Stuart, FL
Canaan Community Development Center, Ahoskie, NC
Center for Alternative Dispute Resolution Education, Inc., Westlake Village, CA
Christian Management Resources and Development, Inc., St. Louis, MO
Community Outreach Corporation, West Berlin, NJ
Cornerstone Community Development Corporation, Anniston, AL
Covenant One Organization, Bloomingdale, IL
C.V. Russell Sr. Multipurpose Center, Inc., Portsmouth, VA
Dalit Solidarity Forum in the USA, Inc., Oakland, NJ
Edie Action Development Services, Inc., St. Paul, MN
Elite Element Academy, Inc., Honolulu, HI
Empire Community Development Corporation, Southfield, MI
Environmental Relief Center, Studio City, CA
Fayette County, Uniontown, PA

First Impression Second Chance, Chillicothe, OH
Four Gospel Ministry, Inc., Cincinnati, OH
Fulton Families First, Inc., Fulton, KY
G to G Mission Homes, Gastonia, NC
George Roskrudge & S. Barry Casey Masonic Memorial Library & Museum, Phoenix, AZ
Gods Lady Ministry, Youngstown, OH
Good Life Health and Service, Omaha, NE
Gray's Creek Outreach Community Service Ministry, Inc., Arlington, TN
Haas Academic Research Foundation, Menlo Park, CA
Hands of Joy Youth Services, Inc., Statesville, NC
Hartleys Community Training Academy, Lake Charles, LA
Healthcare Justice Education Fund, St. Louis, MO
Hebrew Language and Cultural Center of Manhattan, New York, NY
Help a Family Out Reach, Peoria, IL
Hemet Valley Medical Center, Hemet, CA
Henry K. Lindsey Foundation, Hilo, HI
HIV Anonymous, San Clemente, CA
Holiness Unto the Lord Ministry, Inc., Oakland, MI
Hollywood RHF Housing, Inc., Long Beach, CA
HRH Computer Learning Center, Youngstown, OH
Hunterbrook Ridge at Fieldhome, Inc., Yorktown Heights, NY
Hunter's Brotherhood Alumni Alumnae, Inc., New Orleans, LA
I Had a Dream Foundation, Ft. Lauderdale, FL
In Music We Trust (NFP), Chicago, IL
International Transplant-Skin Cancer Collaborative, Milwaukee, WI
Iola Old Car Show Foundation, Inc., Iola, WI
J & J Foundation, Malibu, CA
Jamaica Progressive League, Inc., Upper Darby, PA
Jes-Us, Inc., Los Angeles, CA
Johnny Rodgers Youth Foundation, Omaha, NE
Kansas City Business Center for Entrepreneurial Development, Kansas City, KS
Kems House, Bartlett, TN
Lees Gentle Touch Adult Day Care Health Rehab Services, Houston, TX
Linda's Life Skills and Mentorship Program, Cedar Hill, TX
Long Island Physicians Assistants, Inc., Commack, NY
Mason Temple Community Economic Development Corporation, Conway, SC
Medical Mission Exchange, Thetford Center, VT
MIA Health Center, Inc., Los Angeles, CA
Mighty Warrior, Inc., Yorba Linda, CA
Mississippi Workforce Education Social Development Centers, Inc., Meridian, MS
Mount Pleasant Community Development Corporation, Inc., Baltimore, MD
Multi-County Child and Family Services (MCCFS), Forrest City, AR
Muse Foundation of New York, Inc., New York, NY
National Center for Behavioral Health Solutions, San Antonio, TX
National Council of Minority Arts, Fresno, CA
National Health & Education Association, Inc., Kennesaw, GA
National Resource Center for Deafblindness, Pineville, NC
No Limit Press, Inc., San Mateo, CA
Officer Brian A. Aselton Memorial Scholarship Fund, Glastonbury, CT
On My Way, Atlanta, GA
Oneill Theater Project Plus N F P, Berwyn, IL
Paducah Homeownership Program, Inc., Paducah, KY
Paths to the Promise, Institute, WV
Paul T. OConnor Foundation, Inc., Houston, TX
Phoenix Agenda Foundation, Fairlawn, OH
Platte River Habitat Foundation, Inc., Kearney, NE
Poly Booster Club, Sun Valley, CA
Porter Broadcasting Network, Inc., Rocky Mount, NC
Power Circle Development Association, Chicago, IL
Rabboni Retirement Villa, Los Angeles, CA
Recovery Care Solutions, Cumberland, MD
Repairing the Breaches Family Services Ministry, Inc., Bloomfield, CT
Research and Service Foundation, Opa Locka, FL
RUB, Inc., Weehawken, NJ
Sanctuary of Christ, Inc., Brandon, FL
Scholastic Outreach Services, Inc., Houston, TX
Shas Chabura, Inc., Lakewood, NJ
Sidney Park Outreach Ministries, Inc., Columbia, SC
Silver Center, Inc., Guyten, GA
Soundview Senior Housing Development Fund Company, St. Albans, NY
Sports Foundation of America, Inc., Spring Lake, NJ
Student Program for Academic and Athletic Transitioning, Oakland, CA
Sunshine Children and Family Development, Inc., Victorville, CA
Team Morris, Orange Park, FL
Tehachapi Mountain Boys Home, Tehachapi, CA
Texas Music Library & Research Center, Houston, TX
Touched by Angel Youth Foundation, Los Angeles, CA
Universal Christian Revivalist, Harvey, LA
Valhalla Animal Sanctuary, Inc., Cable, OH
Virtuous Women of Valor Association, Birmingham, AL
Walking in Faith Ministries, Brooklyn Park, MN
Wind of the Spirit Community Services, Inc., Rancho Cucamonga, CA
Winners Choice Center, San Antonio, TX
World Café Community Foundation, Mill Valley, CA
Worldwide Christian University, Inc., Oklahoma City, OK
Youth Awareness Foundation, Detroit, MI

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Exclusions From Gross Income of Foreign Corporations; Hearing Cancellation

Announcement 2007–101

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document cancels a public hearing on proposed regulations (REG–138707–06, 2007–32 I.R.B. 342) relating to income derived by foreign corporations from the international operation of ships or aircraft.

DATES: The public hearing, originally scheduled for October 24, 2007 at 10 a.m. is cancelled.

FOR FURTHER INFORMATION CONTACT: Kelly Banks of the Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration) at (202) 622–0392 (not a toll-free number).

SUPPLEMENTARY INFORMATION: A notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing (REG–138707–06) that appeared in the **Federal Register** on Monday, June 25, 2007 (72 FR 34650), announced that a public hearing was scheduled for October 24, 2007, at 10 a.m. in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. The subject of the public hearing is under section 883 of the Internal Revenue Code.

The public comment period for these regulations expired on September 24, 2007. The notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing instructed those interested in testifying at the public hearing to submit a request to speak and an outline of the topics to be addressed by September 24, 2007. As of September 28, 2007, no one has requested to speak and therefore, the public hearing scheduled for October 24, 2007, is cancelled.

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

(Filed by the Office of the Federal Register on October 9, 2007, 8:45 a.m., and published in the issue of the Federal Register for October 10, 2007, 72 F.R. 57503)

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.
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